Gas and Electricity Pricing Policy.
Gas and Electricity Industries EFL's.
Industrial Energy Pricing.

PART 3

NATIONALISED INDUSTRIES

Part 1: Sept 1979
Part 3: Oct 1980

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~4.11.80~~							
~~5-11-80.~~							
~~17.11.80~~							
~~21.11.80~~							
~~29.11.80~~							
~~10.12.80~~							
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13.2.81							
~~28-2-81~~							
~~6-3-81~~							
12.3.81							
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PREM 19/542

PART 3 ends:-

12.3.81

PART 4 begins:-

13.3.87

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
E (80) 120	17.10.80
E (80) 128	3.11.80
E (80) 39th Meeting Minute 3	5.11.80
L (81) 7	16.1.81
E (EA) (81) 11	20.2.81
E (EA) (81) 4th Mtg (extract: NI Electricity Review)	26.2.81
E (EA) (81) 12	4.3.81
E (EA) (81) 13	4.3.81

The documents listed above, which were enclosed on this file, have been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate **CAB** (CABINET OFFICE) CLASSES

Signed OWayland Date 27 June 2011

PREM Records Team

NATIONAL ECONOMIC DEVELOPMENT COUNCIL
(NEDC)

The following NEDC papers/minutes of meetings were enclosed on this file. They have been removed and destroyed. Records from NEDC and the National Economic Development Office are held elsewhere in The National Archives - see series FG1, FG2, etc.

Reference	Date
NEDC (80) 84	
NEDC (81) 15	27.2.81

Signed OMWayland Date 27 June 2011

PREM Records Team

Nat Ind

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon George Younger TD MP
Secretary of State
Scottish Office
Dover House
Whitehall
London SW1A 2AU

12 March 1981

Dear George,

SCOTTISH ELECTRICITY BOARDS - TARIFF INCREASES FROM APRIL 1981

Thank you for your letter of 5 March in which you comment on points made in my letter of 12 February about the Scottish Electricity Boards' tariff increases from April 1981.

You suggest that the Boards would produce more reliable forecasts for their EFL if the EFL was set nearer the start of the year to which it related, perhaps in February. As you know, we have considered this before, but decided that EFLs needed to be set in the Autumn if they were to have a restraining effect on wage settlements. If EFLs were set later in the wage round, eg in February, there would be pressure to accommodate the going rate as set by earlier pay settlements. Furthermore, it is highly desirable to set all the EFLs at the same time and not to delay agreement on the limit for each industry until nearer its wage negotiating date. This is because of the importance for public expenditure planning of knowing the total claim by all the nationalised industries on public expenditure. If the EFLs were agreed over a period, the industries at the end of the queue might find their EFL bids judged against different and perhaps more stringent public expenditure requirements than the industries whose EFLs were set early in the Autumn. This would be undesirable.

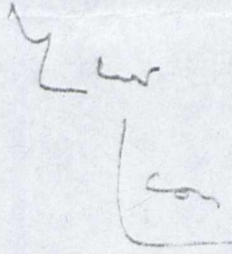
For these reasons I would have difficulty in agreeing that the two Scottish Boards' EFLs should be set in February. The industries should now accept that the setting of EFLs in the Autumn is likely to be a regular feature of the public expenditure planning process and they ought to tailor their forecasting

cycle with that in mind. Quite how they do this is for each industry to decide, but it surely is important that every industry carries out a thorough appraisal of its cash requirements in late Summer so that they are ready to provide sponsor Departments in September with the necessary information for setting the EFL.

I welcome your agreement that the Boards have no authority to vire between their EFLs and I am glad to see that each Board now expects to contain its external financing requirement within its EFL for 1981-82.

Finally, I note that you doubt whether it will be possible to agree the financial targets with the two Scottish Boards before the end of the current financial year. This may indeed prove to be the case, but we really ought to do everything possible to put the two financial targets in place in the very near future. I hope therefore that David Howell can quickly give you the information which you seek about the future of the target set for the electricity supply industry in England and Wales.

I am sending a copy of this letter to the Prime Minister, David Howell, Keith Joseph, Francis Pym, Nicholas Edwards and to Sir Robert Armstrong.



LEON BRITTAN

DEPARTMENT OF
ENERGY

Reference No 38

March 10, 1981

Thames House South, Millbank, London SW1P 4QJ. Telephone: 01-211 3000
Press Office Direct Line: 01-211 4545 (10 lines)

PRESS NOTICE

(Out of hours: 01-215 7877)

INDUSTRIAL ENERGY PRICES: GOVERNMENT ANNOUNCES £168M PACKAGE

A £168 million package aimed at helping large industrial energy consumers, was announced by the Government today.

Industrial consumers of both gas and electricity will benefit. And new incentives are offered to industry to convert costly oil-fired boilers to coal.

Main points from the package are:

Gas: British Gas Corporation will hold the prices at which they renew industrial contracts at present levels until December 1981.

Coal: Industry is to get Government grants to convert boilers from oil to coal.

Electricity: The electricity supply industry in England and Wales is to offer new flexibility in its pricing arrangements.

Gas

The British Gas Corporation is not increasing renewal prices for interruptible gas supplies from their December 1980 level despite recent fuel oil price rises.

The new measures announced today will extend the relaxation of industrial pricing policy introduced last year and will be particularly helpful to large and energy intensive users. Under the new measures:

- renewal prices for all gas purchased on contract by industrial customers will be held at their present levels until December 1, 1981

- the existing provision for price escalation of 1p/therm per quarter in firm gas contracts (ie gas supplied on a continuous basis) will not be applied in the period to December 1, 1981.

The Government is adjusting the previously published 1981/82 External Financing Limit for the British Gas Corporation of minus £390 million by £73 million.

Coal

The Government is committing £50 million over two years for grants to industry towards the eligible cost of converting boilers from oil to coal. Coal is the cheapest fuel for bulk industrial use and today's move will help industry take advantage of this. Expenditure in 1981/82 will be found from the Contingency Reserve. The Government is consulting urgently with the European Commission, NCB, NUM, boiler-making industry and other interested bodies about details of the scheme which will be announced as soon as possible.

Electricity

The package for large industrial electricity consumers is:

- The electricity supply industry in England and Wales will offer a new arrangement to customers who can take advantage of load management terms. This will mean that larger industrial consumers who can adjust their demand at short notice can cut their electricity costs.

- Additional flexibility will be introduced by area boards into their special agreements with industrial customers with the aim of reducing as far as possible the impact of rising electricity costs.

These measures could yield benefits of up to eight per cent on costs to some large industrial consumers. They will affect the industry's ability to meet its financial target and the Government is adjusting its 1981/82 External Financing Limit of minus £210 million by £45 million.

At the request of the Energy Secretary, the supply industry has been reviewing the bulk supply tariff under which the CEGB supplies power to area boards. The position of large consumers is being covered in this review.

Measures already in operation

Today's moves are additional to steps which have already been taken by the gas and electricity industries over the past year to assist their customers. The measures already in force are:

- BGC has relaxed its market related pricing for existing firm gas customers. The renewal price is currently some 70% of the gas oil price.
- In the case of firm gas consumers who are on new three year contracts at higher prices BGC has arranged that the price will fall to the general firm contract renewal level after the first year of the contract.
- Area Electricity Boards have been taking an active role in ensuring that their industrial customers obtain maximum benefit from the flexibility availabile in existing tariffs.

Background

1. The measures announced today follow the Government's consideration of the NEDC Energy Task Force's report, published on March 4. This found that, while prices for the vast majority of industrial customers remain in line with Europe, a limited but important number of large users of electricity and gas are paying more for supplies than competitors on the Continent. It also drew attention to industry's difficulties during the recession in finding the capital to convert equipment to coal use.

2. Ministers have made clear that the Government remains committed to economic pricing of energy and that it would not be appropriate to base prices on cost structures in other countries or adjust them to take account of fluctuations in exchange rate. The Task Force found that these were major causes of disparity for large users.

3. BGC's renewal prices for the first quarter of 1981 were 29p/therm for firm gas and about 24p/therm for interruptible gas. BGC planned to raise the firm gas renewal price by quarterly stages to 32p/therm in September 1981. Existing firm gas contracts provide for an escalation in price by 1p/therm a quarter to keep in line with this planned renewal price. Since the renewal price is now to be held, this provision will not now be applied in the period to December 1, 1981.

From the Minister

MINISTRY OF AGRICULTURE, FISHERIES AND FOOD
WHITEHALL PLACE, LONDON SW1A 2HH

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

5 March 1981

INDUSTRIAL ENERGY PRICES

I have naturally been following closely the work of the Neddy Task Force on this matter, and the reports of the meeting of the NEDC which you chaired yesterday. The two most vulnerable industries - fishing and the glasshouse sector - are my particular concern.

Three things strike me forcibly:-

1. Those two industries are considerably more energy intensive than any other major sector (for convenience I enclose table 2 of the Task Force's report).

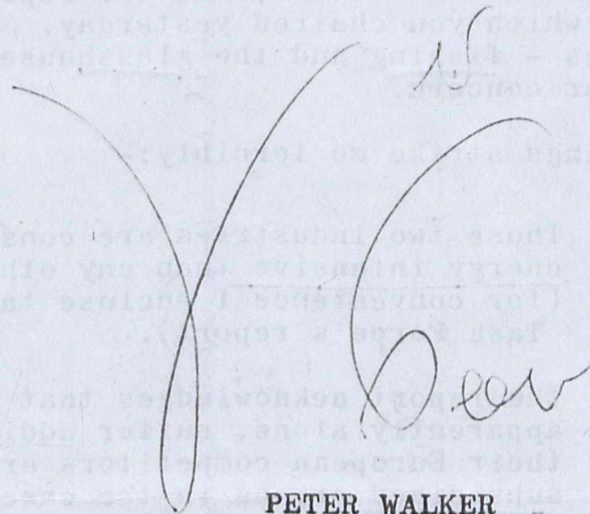
2. The report acknowledges that these two industries, apparently alone, suffer additionally because their European competitors are either directly subsidised or, as in the case of Dutch gas, pay uneconomically low prices (the latter despite the fact that the Commission have found the Dutch policy on gas prices for horticulture to be in breach of the Treaty of Rome).

3. I am not privy to your thinking, but there is much speculation that the Government is thinking in terms of action on the excise duty on fuel oils for industry and on the re-structuring of gas and electricity tariffs to major industrial users. Neither measure would offer any alleviation to horticulture or the fishing industry, which do not pay the excise duty on fuel oils nor are major users of gas and electricity.

I fully share the view that the right answer is to stop our European competitors from subsidising energy costs. As far as the glasshouse industry is concerned, I have been pressing Brussels to take action on this for the best part of the past year; but despite the Commission's findings against the Dutch and the fact that they started legal proceedings some four months ago, nothing has happened and it would be quite unrealistic to expect early effective action in Brussels. In the meantime much of these two industries, already in a critical condition by this distortion of competition, could be going out of business.

If the Government were to take action which benefitted other sectors of industry but not these two, it would add insult to injury. Already they are very restive and the situation would become impossible. My officials are ready to start work at once with yours on what relief can be offered to the glasshouse and fisheries industries parallel to anything being offered to the other energy intensive industries.

I am sending copies of this letter to the Prime Minister, David Howell, the other members of E Committee, George Younger, Nicholas Edwards and Humphrey Atkins.



PETER WALKER

TABLE 2.

INDIVIDUAL FUELS AS A SHARE OF TOTAL FUEL COST BY INDUSTRY

	Coal & Coke %	Fuel Oil Gas Oil Derv %	Gas (interruptible % in brackets) %	Electricity (load factor% in brackets) %	LPGs %	TOTAL %	fuel costs as % of operating costs for each industry.
Iron & Steel	57	16	5 (35%)	22 (27–67%)	–	100	18
Paper & Board*3	25	40	24 (94%)	11 (60%)	–	100	11–18
Chemicals Allied Inds.	6	40	12 (70–80%)	40 (40–80%)	2	100	6
Bricks, Pottery Glass, Cement	20	34	12	24	10	100	18
Textiles	11	46	6	37	–	100	6
Fisheries *4	–	100 *1	–	–	–	100	c.30
Glasshouse *2 production (Horticulture)	6	93 *5	1	–	–	100	40

Source: Estimated up-date of 1974 BSO Purchases Inquiry (Except Horticulture, Paper and Board and Fisheries – see notes below).

* 1 Marine Diesel and Gas Oil
* 2 Source: MAFF Special Inquiry, England and Wales Dec. 1976, Glasshouse and Glasshouse Equipment.
* 3 Source: BPBIF: Report on Energy Consumption and Cost 1979.
* 4 Figures are MAFF estimate.
* 5 Including 5% paraffin.

CONFIDENTIAL

Noted

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

The Rt Hon Leon Brittan QC MP
Chief Secretary
HM Treasury
Treasury Chambers
Parliament Street
LONDON SW1

5 March 1981

SCOTTISH ELECTRICITY BOARDS - TARIFF INCREASES FROM APRIL 1981

Thank you for your letter of 12 February about the Scottish Electricity Boards' forthcoming tariff increases. I have also seen David Howell's letter to you of 23 February.

I agree that it is unsatisfactory that the Boards' EFLs should have been set on the basis of out-of-date information. This problem is however likely to recur as long as the Boards adhere to their present budgeting timetable and their EFLs continue to be set in November. The Boards' annual budgeting exercise is geared to producing medium-term investment and financing proposals for submission to our respective Departments in February, which means that until December at the earliest they have no precise estimates of expenditure and income for the following year, while we require such estimates by the end of September for the purpose of setting EFLs. I think the Boards would resist strongly any proposal that they should advance their long-standing timetable by the necessary three months, because it would make their budgets that much less reliable, and such a change would also mean that their investment and financing review forecasts would be nearly a year out of date by the time we considered them collectively. We therefore have to fall back, for EFL purposes, on asking the Boards to review in the early autumn, during the preliminary stages of their annual budgeting exercise, their earlier forecasts for the following year. This review inevitably produces unreliable results, firstly because the Boards do not have the manpower resources to conduct a comprehensive review at that stage, secondly because key information such as load and capital expenditure forecasts is not available and thirdly because forecasting external financing requirements 18 months ahead is an intrinsically hazardous task. It is worth mentioning in passing that the industry in England and Wales appears also to have been afflicted by uncertainty since its forthcoming tariff increase is 1% higher than that assumed for the purpose of setting EFLs last November.

I have suggested in the past that the solution to this recurring problem lies in setting the Boards' EFLs nearer the start of the year to which they relate, perhaps in February. In this way we could take into account the outcome of the Boards' annual review of their budgets, while still fixing the EFLs well in advance of the settlement dates for the

electricity industry's pay negotiations. The only argument for the present timetable seems to be that of preserving uniformity for all the nationalised industries, which I would regard as increasingly questionable now that, for instance, the settlement dates for the NUM and for the majority of the electricity unions are 5 months apart.

Turning to the other points in your letter, I accept that the Boards have no authority to vire between their EFLs, although you will appreciate that, because of their joint generating arrangements, changes in their generation budgets can have the effect of reducing one Board's external financing requirement at the expense of the other Board. I can now confirm, however, that on the basis of the proposed 11% average tariff increase each Board expects to contain its external financing requirement within its EFL for 1981/82. Discussion between our officials on the Boards' proposed financial targets has been help up to some extent because of uncertainty over the future of the target set for the electricity supply industry in England and Wales. I understand that the proposed 13% tariff increase takes the industry significantly below its "target path" for 1981/82 and I would be grateful if David Howell could let me know whether he has any plans to revise the target on this account. In view of the complex problems concerning pricing policy for the Scottish Boards which I explained in my letter to John Biffen of 4 August I am doubtful whether it will be possible to agree targets with the Boards before the end of the current financial year. I accept, however, that targets must be in place long before we come to consider the Boards' next tariff increase proposals and my officials will be in touch with yours on this issue in the near future.

I am copying this letter to the recipients of yours.

GEORGE YOUNGER

RESTRICTED

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ

01 211 6402

T P Lankester Esq
Private Secretary to the
Prime Minister
10 Downing Street
LONDON
SW1

2 March 1981

Dear Tim,

NEDO TASK FORCE ON ENERGY PRICES

As foreshadowed in my Secretary of State's letter of 25 February to the Prime Minister I enclose a final version of the Task Force's report, which will be considered by the NEDC on 4 March. It will be published after the Council meeting.

I am sending copies of this letter to the Private Secretaries to other members of E and to the Secretaries of State for Scotland and Wales, Sir Robert Armstrong and Mr Ibbs.

Yours sincerely

Geoff Dart

G S DART
Private Secretary

RESTRICTED

REPORT OF THE NEDC ENERGY TASK FORCE

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NEDC ENERGY TASK FORCE

REPORT ON INDUSTRIAL ENERGY PRICES

A CONCLUSIONS

1. This has been an exercise of great difficulty and complexity. We have examined all the available information which industrial consumers and the energy supply industries have been able to provide. In some areas it has been possible to reach reasonably soundly based conclusions on representative comparisons. In other areas the information base for establishing up to date and representative price relativities has been less firm. We have attempted to reach an agreed judgement, but where this has not been possible differences are recorded.

2. Our general conclusions are that:

(a) Prices of electricity and gas to over 95 per cent of individual industrial customers remain broadly in line with those on the Continent. These, however, account by volume for some 50 per cent of industrial electricity consumption and 15 per cent of industrial gas consumption.

(b) For an important group of energy-intensive users (representing some of the remaining 50 per cent of industrial electricity and a significant proportion of gas by volume) UK gas and electricity prices had moved significantly ahead of those being charged to some major competitors on the Continent by the end of 1980. This situation continues. Heavy fuel oil was cheaper to Continental competitors for most of 1980, though the position had improved by the end of the year but remains volatile. These developments have worsened the competitive position of this group of users.

(c) While the conclusions of (a) and (b) are agreed to represent the bulk of the situation, there is a grey area between the two categories on which we have not reached conclusions.

(d) The causes of disparity are not uniform fuel by fuel, or country by country, but they include:

(i) exchange rate movements which have dominated the last year.

(ii) energy resource differences between countries, whether stemming from natural endowment or energy programmes.

(iii) differences in market structures and pricing practice.

3. Our conclusions on the individual fuels are as follows.

Oil

4. UK industrial oil product prices were higher than those prevailing on the Continent for most of 1980 though recently heavy fuel oil has been in line, but the position remains volatile. This was attributable to both:

(i) the level of taxation on derv and fuel oil

(ii) the structure of the UK oil products market and, particularly for fuel oil, relative isolation from the Rotterdam spot market.

Gas

5. For the vast majority of industrial gas consumers, as indicated in paragraph 2(a) above, prices remained broadly in line throughout the year. The ranges of industrial gas prices being charged in Britain and on the Continent were similar in mid-1980. There are, however, differences between BGC and consumers on the disparities, positive or negative, experienced by large UK consumers in this period. By the end of the year gas price disparities with Europe had emerged for these large users which on average are estimated by the secretariat to be of the order of 2-3p a therm (10 per cent) for interruptible gas and 3-5p a therm (10-20 per cent) for firm gas.

If these figures are weighted to reflect the proportionate usage between firm and interruptible this represents an average cost disadvantage of 10-15 per cent. Many industrial consumers believe these ranges to be low and report individual cases where disparities are significantly greater. BGC consider that many customers will face smaller disparities than indicated in the ranges.

6. These disparities have been due to:

(i) the continued hardening of sterling against other European currencies.

(ii) the linkage of interruptible gas prices to fuel oil.

(iii) the renewal price levels set for UK firm gas from September 1980.

(iv) There is disagreement between BGC and consumers on the impact and degree of the linkage between firm gas and gas oil or other oil products in different countries.

Coal

7. At current price relativities UK steam coal is broadly competitive with imports for most users, though this is not necessarily the case for volume users at coastal sites. Other EEC countries subsidise their home production by at least £30 a tonne more than does the UK. This has the effect of making higher cost coal than the UK's competitive with imports.

Foundry Coke

8. UK foundry coke prices are some 30% higher than in the rest of Europe. The reasons are:

(i) exchange rate which has pushed up relative costs.

(ii) the degree of subsidisation existing elsewhere.

(iii) the problems National Smokeless Fuels Ltd face in adjusting to a reduced size of market and their requirement to recover costs through prices without recourse to NCB.

Electricity

9. Industrial electricity prices in England and Wales to most consumers remain in line with those on the Continent. Large, mainly high load factor users, however, face important disparities particularly in relation to France and Germany (a wide range of disparities from 10-35% or more). The reasons are:

(i) exchange rate factors.

(ii) France's greater hydro-electric resource endowment and growing reliance on nuclear power and Germany's cheap brown coal resource.

(iii) the structure of German pricing which favours large, especially high load factor consumers.

(iv) the existence in some Continental countries, notably Germany, of favourable special contracts for large users.

NORTHERN IRELAND

10. Industry in Northern Ireland faces additional disparities for fuels other than electricity. Industrial energy costs are some 7% higher than for the UK as a whole.

OTHER COUNTRIES

11. While the above comparisons have concentrated on the position of large UK energy intensive users compared with the rest of the European Community, many of these consumers face strong competition from outside the EEC. Some of these competitors appear to have overcome energy supply disadvantages greater than our own (Japan). Energy costs in other countries are significantly lower for resource reasons e.g. Scandinavia (hydro power) or North America (stripmined coal and hydro power). In addition there are major energy price distortions in the United States and Canada.

REPORT

B INTRODUCTION

1. The Task Force was established by the National Economic Development Council at its meeting on 7 January. Our objective has been to concert a common view on disparities in the price of energy to industrial consumers in the UK and elsewhere. The membership of the Task Force is at Annex A.

Method of Working

2. Our work has concentrated on the problems of the energy intensive industries and on resolving outstanding differences of view. We have attempted, in particular, to form a common assessment of relative energy prices for fuel use in the UK and the other main European Community countries and to identify reasons for disparities found. The facts about comparative energy prices in North America and Scandinavia are not in dispute. These disparities remain of acute concern, especially for certain sectors of British industry, and we deal with them at paragraphs 5-6 below.

3. Detailed discussions have taken place with each of the main fuel industries and with the trade associations and representatives of the energy intensive industries who have collected data on comparative energy prices over recent months. A list of those from whom we have taken oral evidence is at Annex B. The Task Force itself has met five times to consider the evidence and prepare this report. As a result of these discussions a considerable measure of agreement as to matters of fact has been achieved. We are grateful to all concerned, consumers and suppliers, for the considerable efforts they have devoted to this work at short notice and for the information they have provided, much of it of a commercially confidential nature.

UK Industrial Fuel Market

4. Industry accounts for nearly 40% of final energy consumption in the UK (heat supplied basis). Consumption statistics by fuel are at Table 1. The main fuels generally used, in order of their share of the market, are oil (mainly fuel oil and gas oil), natural gas, electricity and solid fuel (coal and coke). Industrial process uses depend principally on electricity, natural gas and gas oil. The alternative fuels for bulk heating and steam raising

are fuel oil, natural gas and coal. In the iron and steel sector, however, the most important fuel is coke, followed by oil, electricity, and natural gas. In the steel industry low sulphur heavy fuel oil, gas oil and gas are alternative fuels for furnace use.

5. Because oil and natural gas are close substitutes over a range of uses, the price and availability of the one exercise an important influence on the other. In the 1970s oil's share of the industrial market has been in decline as a consequence of both rising crude oil prices and strong competition from natural gas. We have now reached the point at which the rate of increase in natural gas supply has, at least temporarily, slowed. This means that natural gas' role as price setter in the markets where it competes with fuel oil and gas oil has diminished correspondingly. The result has been to ease pressure on prices of the two oil products and, in turn, to influence natural gas prices upwards as consumers seek to move from oil to gas.

6. Coal, which is today the cheapest and most readily available fuel for bulk industrial use, is not yet successfully penetrating this market. One important factor is the capital cost of converting equipment to coal use. Although 3 year paybacks are obtainable in many cases, investment frequently cannot be funded during the recession and is not taking place. Similar liquidity constraints apply to other conversions e.g. installing oil/gas dual firing or switching from gas to fuel oil

Energy Costs and Operating Costs

7. Energy costs represent only 4-5% of total operating costs on average for British industry. But in energy intensive manufacturing sectors (Table 2) this proportion can rise to nearly 20%. Shares of total costs, including capital will be smaller. But within these sectors the proportion for individual highly energy intensive processes can be higher still. For example, in chlorine production, energy costs can account for as much as 60% of total cost. In the fishing industry energy costs represent about 30% of total operating cost and in glasshouse horticulture 40%. More detailed sectoral aspects arising from discussions with the more energy intensive users are discussed at Annex C.

Exchange Rate

8. Exchange rate movements have dominated the last year. During 1980, as debate about energy prices has grown, sterling appreciated by 5% against the US dollar, by 18% against the French franc, by 23% against the Deutschmark and by 25% against the Italian lira. Higher UK inflation means that appreciation in the "real" exchange rate against France and Germany was greater still. The effect of the stronger pound on the different fuels differs:

a. Oil, both North Sea and imported, is priced in dollars and, for a given percentage rise in the dollar based cost of crude, sterling oil product prices could be expected to increase by less than their equivalents in other currency. (Conversely others' greater local currency increases will reduce when expressed in sterling).

b. Natural gas prices are influenced through their links to oil product prices and so by differences between countries both in the level of oil prices and the pace at which gas prices follow oil.

c. The costs and prices of electricity and coal are largely determined in local currency and will vary between countries, when compared in a common currency, in line with exchange rate movements, within the limits of the influence exerted on local coal prices by the price of imported coal.

9. These effects are dealt with in the individual fuel sections below.

C OIL

Incidence and Size of Disparities

10. Figures 1-5 attached show relative pre-tax prices for the main oil products, petrol, derv, gas oil and fuel oil, in the UK, France, Germany, Italy and the Netherlands. Table 3 gives a comparison of taxes and duties. Figures 6-10 illustrate relative post-tax prices for the same products and countries. An EEC price comparison for heavy fuel oil (which was not designed for comparative purposes but accords with consumer data) is at Table 4.

11. As is evident, UK tax on fuel oil and derv is higher than the other countries', on gas oil around average and on petrol below average. UK net product prices were, until 1979, about average "across the barrel" (all products) - with the UK paying less for its petrol, slightly more for its derv and gas oil than others and around average for its fuel oil. But in 1979 and, more markedly, 1980 net price relativities altered. During 1980 we were paying more, pre-tax, across the barrel for most of the year than the other countries shown (Figure 1). Among the individual products this was true of derv (Figure 3) and gas oil (Figure 4). In the case of fuel oil (Figure 5) UK pre-tax prices were below others' at the beginning and end of the year but for nine months during 1980 were higher than elsewhere. UK net petrol prices (Figure 2) have been around or slightly above other countries' instead of, as pre-1979, consistently below. In January 1981 the oil companies increased UK prices for various products by 1p/litre. This represented an increase of about 10% on fuel oil and 4% on petrol (11% and 7% pre-tax respectively). Price increases in other European countries have also been working through following the last OPEC crude oil price increase and, on fuel oil (pre-tax), the UK is currently in the lower part of the European range, though the situation remains volatile.

12. Neither the horticulture industry (which uses fuel oil) nor the trawler industry (which uses gas oil and marine diesel oil: Table 5) pay duty. But both are adversely affected, apart from net price relativities, by fuel subsidies which certain other European Community Governments provide to their competitors. Low sulphur heavy fuel oil is a relatively small, quality sensitive market in the UK compared with the Continent. It is of particular importance to the steel industry which is a bulk buyer. User evidence (Table 6) suggests UK consumers of this product may be at a more regular price disadvantage vis a vis the Continent than the majority of industrial consumers who take high sulphur heavy fuel oil.

13. Divergent prices for oil products, particularly derv, gas oil and fuel oil, affect the competitiveness of British industry directly through its fuel bill, indirectly through its transport costs and through effects on the demand for industry's output. Price relativities for fuel oil and, to a lesser extent, gas oil are also important for their indirect effect on natural gas prices. Interruptible gas prices are linked to the price of heavy fuel oil and firm gas prices are partly related to the price of gas oil.

Reasons for Disparity

14. These adverse price relativities came about during a period in which sterling was appreciating against the US dollar. Crude oil costs account for some 85% of total oil product costs across the barrel and, other things being equal, UK product prices overall could be expected to rise more slowly than other countries' in local currency terms. Several factors contributed to the actual direction of events:

(a) the refining and distribution of oil products (as distinct from the winning of crude oil) is currently reported a loss making activity for a number of companies here and on the Continent. If, as has been suggested to us, there are differences in the degree of unprofitability between the UK and Europe this may, in turn, partly reflect the working of price controls in European countries other than the UK and Germany.

(b) the UK market for the heavier products has traditionally been a fairly self-contained contract market, with relatively little spot purchase and sale, aggressive purchasing by consumers or competitive activity by independents as on the Continent and particularly the area served by the Rotterdam spot market. UK contracts include certain services not normally provided with spot sales. The system has served reasonably well during stable times in the past. In periods of crisis it offers some security of price but cannot finally ensure a supply. Conversely, when prices elsewhere are slack, the UK contract price is slow to follow. There are costs as well as benefits at stake in moving to greater reliance on spot supplies, but in the circumstances of today's oil markets some larger users are beginning to see investment in storage and means of importing product as a necessary form of insurance. There is also scope for more flexible pricing arrangements with suppliers and some companies have indicated willingness to discuss these.

(c) there are differences in individual companies' cost structure and access to cheaper Saudi crude. Greater reliance on higher value North Sea crude means more increase in input costs, though

the consumer sees no advantage to himself from this. The mix of products sold has also tilted away from heavier and towards lighter products more rapidly in the UK than elsewhere: the companies see fuel oil in particular (sales of which have continued to decline) increasingly as a feedstock for obtaining higher value products by secondary refining. Users, on the other hand, are mainly conscious, despite the presence of a number of suppliers in the market place, of being ultimately dependent on a smaller number of UK refinery sources and of the floor to net prices which the present structure of the market and the facts of geography can set.

(d) there are also differences in transport and distribution costs, particularly compared with the Rotterdam hinterland where delivery can be made by barge.

(e) the duty on heavy fuel oil and the level of competition from natural gas.

(f) in the petrol market competition in the UK has in the past been keener than on the Continent. But independent traders suffered during the period of supply disruptions when spot prices were high. Oil companies also report improved cost-effectiveness in distribution and retailing and increased competitive activity, compared with the past, in Continental petrol markets.

D. GAS

15. Figures 11-16 present the material we have obtained from the British Gas Corporation (BGC) and consumers on the course of gas prices in Britain, Belgium, France, Germany, Italy and the Netherlands during 1980. Table 7 sets out the picture for larger consumers in the range 1-10 million therms a year. Table 8 shows average gas prices in earlier years. We have not dealt with gas sold for feedstock purposes which accounts for 15% of total sales.

16. We have had particular difficulties in arriving at representative comparisons for gas. These arise for several reasons:

(a) Until July 1980 BGC sold most gas to industry on contract with only one annual price variation. This contrasts with practice on the Continent where price variations (on tariff or in Germany under contract) are more frequent, six-monthly, quarterly or even monthly. During the rapid price changes of the past year this has meant a much wider span of prices being paid by individual firms within Britain and a greater gap between renewal prices of contracts, as they came up for renewal, and average prices than is general in those EC countries where gas is sold on tariff. BGC have since moved to quarterly escalation of 1p/therm for renewed firm gas contracts and renewal terms for interruptible contracts which involve a price increase of 1p/therm after the first quarter which then runs for the remaining nine months of the year.

(b) Our basic comparison has been between "firm" (i.e. with no agreed discontinuity of supply) and "firm" and "interruptible" and "interruptible" here and on the Continent. However, the prevalence of the two types of contract varies between countries. "Interruptible" also means different things in different countries. In Britain it means provision for dual firing with fuel oil and liability limited to up to 60-90 days interruption during the year. In France and Italy it means liability to indefinite interruption and in France interruptible supplies were, reportedly, discontinued for four months last summer. "Strategic interruptible" supplies in France are currently priced at the firm gas level. Firm gas consumers in the UK whose alternative fuel is fuel oil have the option of installing dual firing or switching to fuel oil but there are liquidity problems in funding capital costs during the recession.

(c) We have received conflicting reports about the position in Germany. BGC understand that the German gas utilities are pricing gas at the price of the alternative fuel (gas oil or fuel oil) and expect to have phased out all existing firm gas contracts at lower prices where the alternative fuel is fuel oil or coal by the end of 1982.

Users' information is that progress towards this objective will in practice be slower - they have given examples of firm gas contracts at fuel oil linked prices which run for longer periods. This leads to differences in interpretation about where representative prices lie within the range of prices currently being charged.

(d) In France gas prices vary depending on whether consumers are supplied direct from the main transmission artery, from spurs off it or further local distribution systems. The additional charges are up to 15% for spur supplies and a further 10% for smaller networks. These are maximum figures. Gaz de France have ceased offering new firm gas supplies, except in special cases where it can be demonstrated that no other fuel can be used. In France customers have to pay the cost of connection.

Incidence and Size of Disparities

17. The majority (some 95%) of BGC's 75,000 industrial gas consumers buy gas on tariff but account for only about 15% of total industrial gas consumption for energy purposes. Among the remaining 5,000 or so customers the median level of consumption during 1980 was about 300,000 therms a year and we have not attempted to reach conclusions on this class of consumer.

18. Our work has concentrated on those large consumers who take over 1 million therms a year and account for about 70% of total industrial consumption for energy use. Table 7 indicates that the ranges of prices being charged to these consumers here and on the Continent were similar in mid-1980. Reports from energy intensive users (drawing on the CEFIC survey for the chemical sector and the IMR report for the steel sector) are that prices to competitors in a number of Continental countries lay in or below the lower part of the range and that there were disparities for their industries at that stage. BGC's information, on the other hand, is that prices to equivalent consumers elsewhere were more broadly spread within the ranges and were in line with our own.

19. By late in the year, however, Britain had moved ahead of other EC countries - Germany being an exception in some respects to the general picture - on both firm and interruptible prices. Gas price disparities with Europe for these large users on average are estimated by the Secretariat to be of the order of 2-3p/therm (10%) for interruptible gas and 3-5p/therm (10-20%) for firm gas. Many industrial customers believe these ranges to be low and report individual cases where disparities are significantly greater. BGC consider that many customers will face smaller disparities than indicated in the ranges. A comparison for gas purchased by the steel industry is at Table 9, although agreement between the parties could not be achieved in the time available; BGC do not accept the figures as representative for the steel industry.

20. In Britain two thirds of consumption at levels above 1 million therms takes place on interruptible terms. In the paper and board industry over 90% of gas consumed and in the chemical sector 70% is interruptible. For the steel sector as a whole 35% of total consumption - and 40% of the British Steel Corporation's - is on interruptible terms. On the Continent, by contrast, many more larger gas consumers take firm gas. On a basis of weighted average costs for users in Britain taking above 1 million therms a year the weighted average cost was about 20.5p/therm in mid-1980 and about 22.7p/therm by November. It has not been possible to determine similar average costs for Continental countries and consumers stress this is necessary for a valid comparison. If, however, the figures in the previous paragraph are weighted, allowing for the costs of dual firing to take interruptible gas, to reflect the proportionate usage between firm and interruptible, the Secretariat estimate this represents an average cost disadvantage of 10-15%.

Reasons for Disparity

21. A major factor has been the continued hardening of sterling against the main Community currencies. By the end of the year a Continental consumer was, in his own terms, (i.e. local currency held at mid year exchange rate), paying about 3p/therm (15%) more for his gas than he had been paying in the summer. But as Figures 12-16 show, the actual sterling level of these prices was the same as, or lower than, in the summer.

22. Another factor lies in the oil market, in the quantities of fuel oil and gas seeking new bulk heat business and in the inter-relationship between fuel oil and interruptible gas prices. There is a difference of opinion between consumers and producers as to the degree of competition between the two fuels. The adverse relativity between UK and others' net fuel oil prices, to which must be added differences in duty, has contributed importantly to raising UK interruptible gas prices ahead of those elsewhere.

23. In the case of firm gas, the influence of oil prices has been much less direct. BGC have, for some time now, set firm gas renewal prices at discretionary levels short of the full gas oil price (currently about 70%). The sterling prices set, however, have, as they have been progressively applied, taken together with actual exchange rate movements, had a cumulative effect in placing major British firm gas consumers at a disadvantage vis a vis many Community competitors. In part this also reflects the longer lags with which gas prices in some countries on the Continent respond to major oil price change. Consumers believe that in many Community countries firm gas prices are in practice related to fuel oil prices. BGC say that in Germany firm gas is increasingly related to gas oil and that in other countries it is indexed to, but not necessarily equivalent to, the fuel oil price, often carrying a premium above fuel oil. We have not attempted to form a view on gas price prospects for 1981.

24. It has also been clear in considering gas price comparisons that there are structural differences between energy intensive industry in the UK and elsewhere. This is particularly so in relation to Germany where industry is more concentrated, both geographically and in terms of size of plant and demand for gas. There are also historic links between the energy supply and energy intensive consuming industries in the Ruhr, originating for example in coke oven use both for steel and gas manufacture, of a kind that once existed in Britain but no longer survive.

E COAL AND COKE

Coal

25. Coal is today used predominantly in power stations in the UK (see Table 1) and to a lesser extent in the rest of Europe (Table 17). The UK industrial market for direct coal use currently consumes less than 10 million tonnes a

year. We have the cheapest indigenously produced coal in the European Community. EEC rules only allow subsidisation down to the level of the imported price of coal. Other countries both subsidise their home production more heavily and import more from third countries. Government aids to indigenous production in the Community are listed in Table 10: total aid to coal in Germany is £36/tonne, in France £66/tonne and in Belgium £106/tonne compared with £2/tonne in the UK. These subsidies have the effect of making higher cost coal than the UK's competitive with imports.

26. At current price relativities UK steam coal is broadly competitive with imports, for most users, though this is not necessarily the case for volume users at coastal sites. CEGB is decreasing its imports of coal. The Task Force has received representations from firms in the cement industry with access to import facilities and sources of supply who are currently negotiating with the National Coal Board to establish the effective delivered price of imported coal to their plant and whether the Board can match this.

27. Some other countries are beginning to offer assistance to industrialists with the capital costs of conversion from fuel oil or natural gas use to coal. In France, for example, a 25% grant is available. On present payback periods, generally about three years, and in the current financial climate this can make the difference between investment proceeding and being postponed.

Foundry Coke

28. Foundry coke sales amounted to 16% of total sales of coke in the UK (including exports) in 1979/80 and are important to the foundry industry where coke costs represent 6-7% of the selling price of castings. Discussions with the Council of Ironfoundry Associations and with National Smokeless Fuels Ltd have established significant disparities between prices of foundry coke in the UK and elsewhere in Europe. A comparison is at Table 11. UK foundry coke is (ex-coke oven) some 30% more expensive than the average for the other countries shown and more than 50% dearer than in France.

29. Exchange rate movement has made a major contributeion towards this disparity. But other factors have also been important:

(a) the higher level of subsidy applied elsewhere to basically higher cost coal production and also indirect aids to coke oven operation. UK subsidies are less than the maximum which ECSC rules would permit.

(b) NSF Ltd's requirement to operate at arm's length from the Coal Board and to recover costs through prices, against a background of falling demand and rising unit costs.

NSF Ltd currently hold over a year's stocks of foundry coke and are exporting small quantities at prices some 35% lower than they sell within the UK.

F. ELECTRICITY

Incidence and Size of Disparities

30. Of the 210,000 industrial customers in Great Britain over 99%, representing half the total industrial electricity consumption, have demands below 2.5 MW. Table 12 shows distribution of consumers above 1 MW by size and load factor and gives details for three of the sectors we have examined. An electricity price comparison for consumers at 2.5 MW in the European Community countries is at Table 13. A similar comparison for large consumers at 25 MW is at Table 14. Before we began work the Chemical Industries Association (CIA) were discussing with the Electricity Council representative comparisons for prices to large consumers in the chemical sector in England and Wales, France and Germany. These have since been agreed and are at Table 15. We have extended this work, in dicussions with the Electricity Council and the steel industry, to show a similar comparison for that sector: tables prepared by the Electricity Council and the steel industry are at Tables 16A and 16B respectively.

31. The main points to emerge from these comparisons are that:

(a) electricity prices to industrial consumers remain broadly in line with those in the rest of the Community, except for some large consumers particularly at high load factor; but

(b) French electricity prices are consistently lower than others; they now stand some 20-35% below equivalent prices in England and Wales compared with 10-20% a year ago; and

(c) German electricity prices decline more sharply, as load factor rises, than elsewhere. Their prices remain comparable to ours for high loads and at low load factors but are now up to 25% lower at high load factors. A year ago the German tariff structure barely fell below our own even at high load factors.

(c) In addition the steel industry have brought forward evidence of special contracts in Germany, and also the Netherlands, whose effect is to increase disparities for large high load factor consumers compared with the tariffs. The most favourable of these would give a disparity at 80 MW, 80% load factor, of 37%. In the time available it has not been possible to resolve outstanding points on interpretation and proper comparability of terms. The Electricity Council's understanding is that the leading German utility, Rheinisch-Westfälisches Elektrizitätwerk (RWE), plan to phase out such contracts by mid-1983 and transfer consumers to the standard tariff. Users' information is that this is at best an objective.

32. A particular problem in arriving at representative comparisons has been that the UK contains relatively few large, high load factor consumers. As Table 12 shows both the chemicals and paper and board sectors are well represented among higher load factor consumers but loads are concentrated in the range below 20 MW and, in the case of paper and board, below 10 MW. The steel industry is strongly represented among the largest consumers but in few cases do load factors exceed 60%. The industry explain this in terms of the lesser incentive here to operate at high load factor, particularly compared with Germany. They also believe that aggregation of demands from different sites for tariff purposes in other countries assists in achieving a higher overall load factor to the mutual benefit of consumer and supplier.

The Electricity Council's understanding is that this facility is extremely limited and is only available in Belgium, where sites must be supplied from the same transformer, and in West Germany, where the consumer bears the costs of installing links between sites and the necessary metering.

Reasons for Disparity

33. The strengthening of sterling against the franc and the Deutschmark (paragraph 8 above) has had a major influence on electricity price comparisons over the short run. Other factors underlying present disparities include:

(a) the relative cost advantage of French nuclear power (16% of total supply) and hydro-electricity (29%) which together account for nearly half of power generation compared with a total of 14% for both in the UK (see Table 17). The proportion of nuclear and hydro in France is expected to grow to 78% by 1985. (Table 18). Both these sources involve a higher ratio of capital to running costs than fossil fired capacity whose lifetime costs are relatively more dependent on movement in the cost of the fuel. Electricité de France are believed to apply broadly similar marginal cost pricing principles to the electricity supply industry in England and Wales. But they calculate prices on the basis of a long run marginal cost which is nuclear whereas the industry here carries out the calculation at present on the basis of coal. Given long lead times in construction of new power stations and in the opening of new high productivity, low cost, coal mines in the UK, the implication is that French electricity costs will continue to lie below, and very probably fall further below, our own during the 1980s. EdF are, nevertheless, currently running at a loss in accounting terms and also received Government assistance in 1980 in the form of a £1.4bn capital restructuring whose effect is to reduce the interest paid by the utility.

(b) the degressive nature of the Germany tariffs examined. The Germans have said that they intend to reduce degressivity and there is a draft EEC recommendation that tariff structures should

reflect costs. RWE (the main supplier to Germany heavy industry in the Ruhr) are 60% dependent on brown coal, an opencast coal they own whose cost on a thermal equivalence basis, and without subsidy, may be as low as half that of UK deep mined coal and whose capital costs of extraction RWE are believed to treat as a fixed cost. Other German utilities are either heavily reliant on low priced natural gas whose costs are likely to rise substantially following Dutch gas price renegotiation or on nuclear power (50% in Munich, 40% in Esslingen).

(c) the levels of subsidy on high cost indigenous hard coal in Europe relative to UK subsidy on generally lower cost coal.

34. Notes on comparative thermal efficiency and availability of power stations prepared by the electricity supply industry are at Annexes D and E. We have not considered the structure of the Bulk Supply Tariff which is at present under review by the supply industry. The Monopolies and Mergers Commission are currently examining the efficiency and costs of the Central Electricity Generating Board.

G OTHER ISSUES

Energy Pricing in North America

35. President Reagan has now ended US price control on oil. But controls on gas prices remain and, on present plans, will not be phased out till 1985 or 1987. This would mean continuing major distortions in the terms of trade particularly for chemicals and man-made fibres. Canada at present has no plans for phasing out price controls on either oil or gas and is alone among the countries represented in the International Energy Agency in taking this stance. Competition from Canada, on the basis of controlled energy prices, has hit the UK paper and board industry especially hard. These are common problems also for our partners in Europe and are likely to yield only to sustained bilateral and multilateral pressure on the countries concerned.

Scandinavia

36. Electricity prices in Scandinavia reflect a much higher availability of hydro-electricity than in the UK or most other European countries. Sweden meets 64% of its electricity needs from this source and Norway 40% of total energy demand. This is a natural resource endowment but has worsened the competitive position, particularly of the paper and board industry.

Northern Ireland

37. The Task Force has received representations from the Northern Ireland Economic Council about energy costs in the Province. Northern Ireland is more heavily dependent than the rest of the UK on oil, both for direct use and electricity generation. It also lacks access to natural gas. Industrial electricity prices are maintained by Government direction at the levels prevailing in England and Wales. The Council estimate that average industrial energy costs are some 7% higher than for the UK as a whole.

Japan

38. At the opposite extreme from the UK Japan imports virtually all its energy and is believed to pay relatively high prices for fuel, particularly electricity and gas, though we have had no opportunity to examine the Japanese situation. Japanese industry appears to demonstrate more clearly than is generally the case elsewhere absorbtion of higher energy costs through offsetting gains in other aspects of productivity.

Energy Intensity and Conservation

39. The relationship between industrial production and energy consumption suggests that there is a greater energy intensity on average in British industry than in Europe. This suggests considerable scope for reducing energy costs through conservation measures.

TABLE 1

UK INDUSTRIAL ENERGY MARKET

Million therms

Final Consumption by User

	1978	1979	1979Q3	1980Q3(prov.)
Iron and Steel Industry				
Coal	50	77	20	8
Other Solid Fuel (1)	2,239	2,458	597	383
Other Coal Derived Fuel (2)	318	295	79	55
Gas	446	538	126	107
Electricity	448	455	103	78
Petroleum	1,161	1,168	238	132
Total	4,662	4,991	1,163	763
Other Industries				
Coal	2,184	2,337	517	409
Other Solid Fuel (1)	143	147	34	24
Other Coal Derived Fuel (2)	70	71	15	16
Gas	5,574	5,687	1,189	1,089
Electricity	2,419	2,533	581	536
Petroleum	7,402	7,409	1,356	1,144
Total	17,792	18,184	3,692	3,218

FUEL USED IN ELECTRICITY GENERATION (to supply all consumers) mtce

	1978	1979	1979Q3	1980Q3(prov.)
Coal	81	89	21	22
Oil	19	18	4.3	2.6
Gas	1	0.6	0.18	0
Nuclear	12	12	3	3
Hydro	2	2	0.5	0.6
Total	115	122	29	28

(1) Coke and other manufactured solid fuel

(2) Coke oven gas, creosote/pitch etc.

source: Energy Trends, Department of Energy

TABLE 2. INDIVIDUAL FUELS AS A SHARE OF TOTAL FUEL COST BY INDUSTRY

	Coal & Coke %	Fuel Oil Gas Oil Derv %	Gas (interruptible % in brackets) %	Electricity (load factor% in brackets) %	LPGs %	TOTAL %	fuel costs as % of operating costs for each industry.
Iron & Steel	57	16	5 (35%)	22 (27–67%)	–	100	18
Paper & Board*3	25	40	24 (94%)	11 (60%)	–	100	11–18
Chemicals Allied Inds.	6	40	12 (70–80%)	40 (40–80%)	2	100	6
Bricks, Pottery Glass, Cement	20	34	12	24	10	100	18
Textiles	11	46	6	37	–	100	6
Fisheries *4	–	100 *1	–	–	–	100	c.30
Glasshouse *2 production (Horticulture)	6	93 *5	1	–	–	100	40

Source: Estimated up-date of 1974 BSO Purchases Inquiry (Except Horticulture, Paper and Board and Fisheries – see notes below).

* 1 Marine Diesel and Gas Oil
* 2 Source: MAFF Special Inquiry, England and Wales Dec. 1976, Glasshouse and Glasshouse Equipment.
* 3 Source: BPBIF: Report on Energy Consumption and Cost 1979.
* 4 Figures are MAFF estimate.
* 5 Including 5% paraffin.

TABLE 3

TAXES AND DUTIES ON OIL PRODUCTS IN THE EUROPEAN COMMUNITY

1. EXCISE DUTY

	p/10 litres			£/tonne
	Petrol (premium)	Derv	Gas Oil	Fuel Oil
UK	100	100	7.7	8.0
Belgium	105	43	-	-
Denmark	125	24	24 (1)	27 (1)
Germany	88	83	3.4	3.0
France	126	66	13	0.1
Ireland	101	59	11	12
Italy	151	11	11	0.4
Netherlands	98	34	6	3

2. OTHER TAXES

Germany				0.7
France				0.9

3. VAT (%)

	Petrol (premium)	Derv	Gas Oil (2)	Fuel Oil (2)
UK	15	15	-	-
Belgium	25	22	16	16
Denmark	22	22	22	22
Germany	13	13	13	13
France	17.6	17.6	17.6	17.6
Ireland	10	10	-	-
Italy	18	18	14	14
Netherlands	18	18	18	18

(1) Duty rebated to VAT registered traders

(2) Rebated to industry in all countries except gas oil in France.

TABLE 4

EEC CONSUMER PRICE COMPARISONS FOR HEAVY FUEL OIL (1)

£/tonne

1980	UK	France	Germany	Italy
15 January	87.9			
15 February	92.3	79.2	84.8	81.9
15 March	91.5	76.4	84.0	81.0
15 April	93.0	74.0	80.2	77.4
15 May	93.3	80.6	82.6	78.5
15 June	85.2	91.5	81.4	80.5
15 July	95.0	77.4	80.5	82.0
15 August	93.6	75.4	80.5	77.9
15 September	93.4	71.1	77.3	86.2
15 October	92.6	77.8	79.5	77.8
15 November	92.5	95.2	83.7	83.4
15 December	92.6	95.1	95.1	88.8
1981				
5 January	92.3	93.4	97	87.9
12 January	92.3	92.4	95.9	88.0
19 January	104.0	90.7	94.1	86.8
26 January	104.0	88.9	91.9	88.9
2 February	104	92.9	92.7	89.4
9 February	103.7	92.4	93.0	90.9
16 February	103.5	96.3	91.7	91.2
23 February	103.3	101.4	97.4	96.3

source: EEC monthly/weekly published prices for small consumers up to 24,000 tonnes a year or 2,000 tonnes a month.

(1) High sulphur fuel oil, including taxes paid. These series do not represent prices to larger consumers. There are also a number of statistical problems affecting comparability between countries. But they do give a broad indication of price movement within countries. Series which are more closely comparable between countries are illustrated in index form at Figures 5 and 10.

TABLE 5

PRICES PAID BY TRAWLER INDUSTRY FOR MARINE DIESEL OIL

£/tonne

	Aberdeen	Lowestoft	Fleetwood	Humber Ports
1980				
January	134.4	132.7	133.7	113.61
April	151.7	141.1	142.1	138.0
July	160.9	149.0	150.0	141.0
October	160.9	145.5	140.0	128.5
1981				
January	172.0	153.0	147.5	131.0
(February		143.0)		

The industry pays no duty. The coastal trawler fleet uses mainly gas oil, the high seas fleet marine diesel. Recent prices paid by trawlers refuelling in foreign ports have been:

	£/tonne	
Netherlands	130	(marine diesel)
Germany	112	(gas oil)
France	116	(gas oil)

The French Government pays a subsidy of 10 centimes per litre to its fleet. The Italian Government also provides a subsidy.

TABLE 6

LOW SULPHUR HEAVY FUEL OIL

SOME INDIVIDUAL PRICE COMPARISONS FOR LARGE CONSUMERS (PRE-TAX)

UK price = 100
(2% max. s.c.)

	Germany (1.5% min)	Holland (2% max)
1977	89	90
1978	93	93
1979	112	97
1980	85 (1)	90

The market for low sulphur heavy fuel oil is relatively small and undeveloped in the UK as compared with the Continent.

(1) first nine months only

source: consumer data

TABLE 7

PRICES FOR INDUSTRIAL GAS CONSUMPTION OF 1-10M THERMS PA

	May/June 1980	November 1980
FIRM GAS		
Great Britain		
renewal	24.5-26	28.3
range	16-26	22.4-28.3
average	22.5	25.0
Belgium		
range	21-24	19-22
France		
range	(18)19-24	18-23
Germany		
range	(16.5)18-30	(15.5)18-31
Italy	(20)21	20
Netherlands		
range	(14)20-22	(16.5)19-21
INTERRUPTIBLE GAS		
Great Britain		
renewal	22.5-23	23.5-24.5
range	13-22.5	19-24.5
average	19.5	21.5
Belgium	(17)21	(15)19
France	(18)19	18
Germany	17	17
ItalY	(19)20	19

source: Unbracketed figures are BGC estimates. Bracketed figures are consumer information lying outside BGC's range of estimates (see Figures 11-16). Higher prices (fully linked to gas oil) were applicable in both May/June and November for a number of new firm gas customers in Britain on three year contracts. The basis of pricing to these customers was revised in January 1981 so that prices fall to the general renewal level in the second and third year of their contract.

NOTES ON BGC ESTIMATES IN TABLE 7

1. General

1.1 Industry Sector

The ranges of price shown for all countries are applicable to loads in all sectors of industry.

1.2 Load Size and Load Factor

The ranges of price shown for firm gas supplies are for loads of 1 to 10 m.th.p.a., Size of load is not important in all cases - see notes below on individual countries. Load factor is mainly of significance in Belgium and comment is made on this below.

For interruptible supplies load size is not an important consideration.

1.3 Exchange Rates

The exchange rates used are the monthly average rates from CSO "Financial Statistics" for May/June 1980 and November 1980 respectively. The assumptions used in estimating exchange rates for July 1981 and December 1981 are given below.

1.4 Rounding

Except for Great Britain all prices are rounded to the nearest whole number.

1.5 Location

Except in the case of France all supplies are assumed to be taken from transmission companies. The prices do not reflect, therefore, the higher charges made by local distribution companies in other countries for supplies taken from them.

2. Notes on Price Ranges by Country

2.1 Great Britain

The price ranges shown represent the upper and lower limits of prices being paid in one year renewal contracts in force for existing supplies at the dates shown. Average prices for firm and interruptible gas supplies at the respective dates are also shown.

2.2 West Germany

In West Germany gas prices to industry are generally individually negotiated at levels approximately equivalent to and escalated in relation to the prices of the alternative fuel(s) which could be used on the customer's plant. Thus the price range for firm gas supplies is representative of the prices of gas oil at one extreme and low sulphur heavy fuel oil at the other. Prices between these levels are appropriate where a mix of alternative fuels can be used on the various items of plant on a customer's site. BGC's understanding is that the ranges shown are applicable to energy intensive industries as well as to industry in general. Most of the data received from the industrial users were at the lower end of this range.

BGC also understand that firm gas supplies are being diverted from non-premium HFO related consumers to premium gas oil related consumers.

For interruptible supplies it is assumed that gas prices are equivalent to, and escalated in accordance with, the prices of high sulphur HFO.

2.3 France

All prices have been calculated from tariffs applicable. For the the higher figures it is assumed that supplies are from pipelines other than the main transmission system.

No allowances have been made for the costs of installing pipelines to factories which have to be borne by customers. In one case known to the Task Force this was equivalent to 1% on the price.

....4

Interruptible gas prices are at present constrained by firm gas tariff prices.

2.4 Belgium

The prices shown have again been calculated from the existing Belgium tariffs although it is possible that these will have to be amended during the year in the light of the outcome of negotiations on the contracts for the import of gas from the Netherlands. The premium factor used in all the calculations is 1.0.

In calculating the prices at the high end of the range a lower load factor has been used. This reflects British Gas experience that many energy intensive industries also use substantial quantities of gas for space heating purposes.

Interruptible gas prices are currently restrained by firm gas tariff prices, as in France.

2.5 Netherlands

The prices shown have been calculated using the standard industrial tariff.

Interruptible loads are not applicable.

2.6 Italy

Prices shown are based on the standard industrial tariff.

TABLE 8

AVERAGE GAS PRICES TO INDUSTRY 1978-79

p/therm

	1978	1979	source
Great Britain	11.9 (1978/79)	14.1 (1979/80)	BGC Annual Reports
Belgium	12.1	-	EEC Studies
France	12.9	13.6	GdF Annual Reports
Germany	15.8	16.1	Economics Ministry Reports
Italy	10.9	-	EEC Studies
Netherlands	12.1	-	EEC Studies

TABLE 9

COMPARISON OF GAS PRICES FOR THE STEEL INDUSTRY (as at November 1980)
(not agreed by BGC as representative)

2 million therms
a year supply

	Firm	Interruptible
UK (1)	25.1	21.8
Belgium (2)	19.5-20.5	17-18
France (3)	20	20
Germany (4)	19.4	17.7
Italy (5)	19.5	18.5
Netherlands (6)	20	-

(1) average for BSC contracts. BGC's renewal prices were 28.3p/therm and in the range 22.5 - 24.5p/therm for interruptible. Many steelworks would have been paying these prices in November. Others would have been paying a spread, of prices, depending on date of annual contract renewal, down to and below the averages shown. Quarterly escalation of 1p/therm for firm gas will in future reduce the gap between renewal and average prices.

(2) The bottom end of the range represents load factors over 3000 hours and the top of the range load factors of 2000 - 3000 hours. BSC's load factor is 2600 - 3700 hours. BGC's understanding is that the range of prices for steel industry firm gas consumers was 19-22p/therm and that 17-18p/therm represents seller's option gas.

(3) Includes 6% out of a possible 10% charge for distribution via spurs off the main transmission artery. Interruptibles are indefinitely interruptible. The French formula for interruptible prices (linked to fuel oil) would produce a higher price but the interruptible price has been held to the ceiling set by the firm price. Firm gas has normally been priced higher and the present relativity is unlikely to continue indefinitely. BGC's understanding is that the range of prices paid for firm gas by steel consumers was 18-23 p/therm.

(4) Prices for large steel industry users whose alternative fuel is fuel oil. Existing contracts known to the industry range down to 15.6p/therm. Small steel works would have paid above 19.4p/therm but may, the steel industry say, have benefited either through aggregation of accounts with larger firms or, to some extent, from the position established by them for the sector. BGC's understanding is that steel works whose alternative fuel is gas oil are currently paying or being moved to gas oil related prices (up to 31p/therm) and that the range of prices applicable to the industry was 18-31p/therm. The steel industry do not accept this and would wish to see firm evidence.

(5) agreed figures between the industry and BGC. Interruptibles are indefinitely interruptible. A revised pricing formula is being negotiated between SNAM and Confindustria, with the former seeking to increase and the latter to reduce the low sulphur fuel oil weighting. BGC's understanding is that when implemented this will apply retrospective escalation from mid-1980. The steel industry's understanding is that this will not be the case.

(6) Subject to quarterly escalation linked to fuel oil. Gasunie intend moving to gas oil related pricing for firm gas.

TABLE 10

STATE AID TO COMMUNITY COAL INDUSTRIES IN 1979

£m

	UK	Belgium	France	Germany
1. Aid to current production	196	208	334	716
(£/tonne	1.6	34	18	7.7)
2. Social Security Aids	37	440	841	1,755
3. Other	19	0.5	55	811
TOTAL	251	648	1230	3283
(£/tonne	2	106	66	36

COMPARISON OF FOUNDRY COKE PRICES - JANUARY 1981

	£/tonne ex-coke oven
Austria	84.2
Belgium	75.2
France	63
Germany	77
Great Britain	103.8 (delivery by rail) (a)
	105.3 (delivery by road) (a)
Italy	81.8 (b)
Netherlands	93.4 (c)
	81.6 (d)
Switzerland	87.4

(a) the difference reflects higher stocking costs at National Smokeless Fuels Ltd in the case of delivery by road.

~~(b) supplies insufficient~~

(c) imported from Germany

(d) imported from France

TABLE 12

PROFILE OF LARGE INDUSTRIAL CONSUMERS

1 Distribution of Consumers by size and load factor

Max Demand in MW:-	1.0-2.5	2.5-5	5-10	10-20	20-40	40+	Total
load factors:-							
under 30%	349	92	35	13	5	9	503
30-50%	921	345	148	45	17	13	1489
50-70%	339	203	92	30	12	6	682
over 70%	47	44	34	24	8	4	161
Totals	1656	684	309	112	42	32	2835

2 Distribution in Major Industry Sectors

a by maximum demand (MW)

	1.0-2.5	2.5-5	5-10	10-20	20-40	40-100	over 100	Total
Chemicals	34	23	11	5	12	5	1	91
Iron & Steel	84	49	22	18	8	14	9	204
Paper & Board	38	37	13	3	3	-	-	94

b by % load factor

	Under 20	20-30	30-40	40-50	50-60	60-70	70-80	over 80	Tot[illegible]
i Over 1 MW									
Chemicals	9	10	12	8	21	20	6	5	9[illegible]
Iron & Steel	42	52	59	26	19	4	2	-	20[illegible]
Paper & Board	1	3	7	21	25	24	10	3	9[illegible]
ii Over 20 MW									
Chemicals	3	-	2	-	2	1	4	6	1[illegible]
Iron & Steel	-	6	11	2	7	5	-	-	3[illegible]
Paper & Board	-	-	-	2	1	-	-	-	

Sources:-

Electricity Council Surveys for 1977/78 and 1978/79

ELECTRICITY PRICE COMPARISONS FOR 2.5 MW LOADS

I Comparison at 1 August 1980

load: 2.5 MW — p/KWh

load factor	40%	60%
Belgium	3.41	2.85
Denmark	3.12-3.44	2.93-3.33
Eire	3.25	2.95
France	2.6	2.26
Germany	3.27-3.75	2.58-3.35
Italy	3.33-3.34	3.11-3.12
Luxemburg	2.97	2.48
Netherlands	2.45-3.66	2.28-3.29
UK	2.87-3.57	2.60-3.26
England and Wales	2.94-3.36	2.70-2.96

Source: The Electricity Council, "A Comparison of Electricity Prices in the Countries of the European Community" Issue No.9, December 1980.
All prices at 1 August 1980 exchanges rates and excluding VAT.

II Provisional Comparison at 2 January 1981

load: 2.5 MW — p/KWh

load factor	47%
Belgium	3.0
France	2.4
Germany	2.9-3.4
Italy	2.9
Netherlands	2.1-3.1
England and Wales	3.0-3.4

Source: Electricity Council provisional updating of January 1980 UNIPEDE survey.
Prices expressed at 2 January 1981 exchange rates.

TABLE 14

ELECTRICITY PRICE COMPARISON FOR LARGE LOADS

Load: 25 MW

	Comparison at January 1980		Provisional Comparison at January 1981	
load factor	58%	82%	58%	82%
Belgium	-	-	2.5	2.2
France	2.1	1.8	1.8	1.6
Germany (RWE)	2.5	2.1	2.3	1.9
Italy	2.3	2.1	2.4	2.2
Netherlands (PEN)	3.0	2.8	2.8	2.6
England & Wales (YEB)	2.3	2.2	2.7	2.5

Source: January 1980 UNIPEDE Survey and provisional update by Electricity Council.
Prices expressed at 2 January 1980 and 2 January 1981 exchange rates.

Electricity Council/Chemical Industries Association — TABLE 15

PRICE OF ELECTRICITY TO THE UK CHEMICAL INDUSTRY

The agreed position (30.1.81) following meetings between the CIA and Electricity Council

The position in England and Wales, France and West Germany has been compared on the basis of representative tariffs applying in the 'tariff year' 1980/81 for supplies to typical chemical industry consumers. The results, on the basis of exchange rates as at 2.1.81, are shown in the table below.

Demand	% Load Factor	E&W YEB/NORWEB	France EdF	W. Germany RWE
	tariff:	*	'Vert'	L.120
4 MW	40	2.91	2.25	2.82
	60	2.75	2.04	2.31
	80	2.67	1.89	1.99
10 MW	40	2.87	2.22	2.74
	60	2.72	2.05	2.26
	80	2.64	1.87	1.95
40 MW	40	2.74	1.87	2.70
	60	2.60	1.73	2.23
	80	2.53	1.61	1.94

* 4 and 10 MW loads priced on Norweb monthly maximum demand tariff
40 MW load priced on YEB load management warning terms.

Notes

1. Tariff Rates Employed

Seasonal variations in tariffs (where applicable) have been averaged over the respective tariff years (beginning April 1980 in E&W, August 1980 in France and September 1980 in West Germany. England and Wales figures are at a fuel cost of £39.50 which we believe is a fair basis for comparison.

2. Load Patterns

The table shows the costs applicable to a load distribution as found within the UK for a sample of 15 large chemical plants. The average load pattern derived related to a 27 MW load with a 76.5% (6700 hours) load factor, and it is assumed that a similar pattern will apply in France and Germany. Whilst it is acceptable to assume this pattern will apply to the 80% load factor, it is unlikely to be appropriate at the lower load factors. In all cases this is likely to lead to somewhat different prices at 40% load factor than shown in the table.

The price calculated for the 27 MW, 76.5% load factor load on the YEB load management terms was:

on the 'as found basis'	2.55p/kWh
on the original CIA basis (as subsequently amended)	2.58p/kWh

3. Load Management

Load reduction by 25% (the observed average in the sample) has been taken in calculating the 40 MW prices, but no adjustment for reduction in demand in response to a warning is made for France and Germany since this is not a feature of the French and German tariffs. Large UK chemical firms show considerable variation in their response, dependent on technical and marketing opportunities and constraints. On the YEB terms the average price of the 27 MW load at 76.5% load factor would move as follows:

No load management	2.60p/kWh
25% reduction in LMW periods	2.55p/kWh
100% reduction in LMW periods	2.42p/kWh

4. Exchange Rates

The table has been calculated using exchange rates at 2 January 1981. It is noted that the movement in exchange rates since the first CIA submission is:

	15/09/80	02/01/81	% change
F/£	9.9275	10.866	+ 9.5%
DM/£	4.275	4.702	+10.0%

and that from 2/1/81 to 29/1/81 there have been further changes of +6.4% vs. the Franc and +6.9% vs. the DM, which are not included in the table.

5. Price Variation

France

The re-calculated prices for the 40 MW load are based on the EdF 60/90 kV rates which the EC understands to be appropriate up to 45 MW. Lower prices (perhaps up to 10%) could apply for loads over 45 MW supplied at a higher voltage. The CIA is advised by member companies that a 40 MW load could possibly be supplied at 220 kV by negotiation, which would offer a price reduction of 6.8% to 9.7% depending on load factor.

Germany

The West German price calculations are based on the RWE L.120 tariff. The tariff rates may not be appropriate for 40 MW but no reduction has been assumed at this level. However, CIA is advised that a 15% reduction on the 15 MW tariff price was available in 1978 for a 150 MW load and it is estimated by a CIA member company that a 7% reduction could be obtained for a 40 MW load.

ELECTRICITY COUNCIL

TABLE 16 A

Price of Electricity to the Steel Industry

The position in England and Wales, France and Germany has been compared on the basis of representative tariffs applying in the 'tariff year' 1980/81. The results, on the basis of exchange rates ruling at 2 January 1981 are shown in the table below:

Demand	% load factor	E & W	France	Germany	
	Utility:	YEB	EdF	RWE	RWE
	Terms:	MD/LMW	'vert'	L120	sp. contract
4 MW	30	3.13	2.44	3.25	
	40	2.98	2.32	2.83	
	60	2.83	2.04	2.31	
	80	2.75	1.89	1.99	
10 MW	30	2.89	2.42	3.15	
	40	2.76	2.30	2.75	
	60	2.64	2.03	2.26	
	80	2.62	1.87	1.95	
40 MW	30	2.70	2.04	3.10	2.02
	40	2.63	1.97	2.71	
	60	2.54	1.76	2.23	1.74
	80	2.55	1.64	1.94	
80 MW and above	30	2.62	1.89	3.09	2.01
	40	2.5[illegible]	1.76	2.70	
	60	2.50	1.60	2.23	1.73
	80	2.51	1.51	1.93	
Exchange rate:			10.866	4.702	4.702

Notes:

1. Price Variation in Engaland and Wales

The above table shows a central estimate of prices likely to be found. BSC advise that at the 80 MW + level prices in the UK could be as low as:

load factor	40%	60%	80%
p/kWh	2.41	2.37	2.33

YEB prices will depend upon the degree to which the consumer can respond to load management warning periods and a reduction of 0.1p/kWh on the tabulated prices are possible for a greater response

2. Tariff Assumptions

(i) Tariffs used in the table are:-

for France : tarif vert, rates ruling from 16/08/80

for Germany : RWE L120, rates ruling from 01/09/80

for England and Wales:

at 4 MW, YEB monthly MD tariff, rates from 01/08/80

at 10 MW + YEB load management terms from 01/04/80

fuel price taken as £39.50/te.

(ii) Load patterns are derived from those 'as found' for two samples of large steel works in the UK.

(iii) No adjustment has been made to the maximum demand for different integration periods in measuring demand. The appropriate periods are:

France (EdF) 10 Minutes
Germany (RWE) 15 Minutes
England and Wales 30 Minutes

This will lead to an understatement of the French and German demand components in relation to the UK prices.

3. Special Contracts

Figures shown for special contracts in Germany have been provided by RWE, calculated using identical load patterns as required for valid comparisons. RWE advise that these special contracts will be phased out by mid 1983.

4. Voltage of Connection

(i) IMR Ltd, in their study of European steel producer's electricity prices, were assured by EdF that steel producers with loads over 10 MW would receive the benefit of both the 220 kV and TLU rates in the tarif vert. However, the Electricity Council's advice from EdF was that voltages of connection in France were:

Up to 10 MW	5/15/30 kV
Over 10 MW and up to 45 MW	60/90 kV
Over 45 MW	220 kV

and that no exceptions were made for the type of load although consumers in areas supplied by hydro stations may be fed at a higher voltage than normal.

(ii) The Electricity Council is advised by RWE that artbitrary discounts for larger loads (previously given in respect of chemical plants) are no longer available. However, reductions are given for connection at a voltage higher than the 10-30 kV applicable to most HV consumers. Loads over 10 MW may be connected at 110 kV, and those over 40 MW at 220/380 kV. The maximum reduction that can be achieved at the highest voltage is around 4% of the 10-30 kV price. These reductions have not been included in the above table.

B.I.S.P.A./B.S.C. SUBMISSION TO N.E.D.C

PRICES TO THE STEEL INDUSTRY

The economic reason for operating a National Grid is the diversity which exists in the load requirements of customers. Cost savings arise from constructing the system to serve the forecast total system load, rather than to serve the sum of the forecast demands of individual customers.

Low load factor consumers of a non random nature such as individual domestic loads decrease the economics of the grid system. Low load factor, random peaking loads such as those of electric furnaces are good contributors to the diversity.

Continental utilities have applied elements of maximum demand control to large consumers which encourage improved load factors. These load factors then become the norm. U.K. practice is to have a unit cost based system - except for the limited load management tariff - with little incentive for improved load factor. This too becomes the norm. The foregoing is exemplified in the attached tables where U.K. load factors for 40 and 70 MW ranges only alter the price per unit by 4 to 6%, whereas the French and German structures show 25% and 62% respectively on published tariffs.

Cont/...

Megawatt	Load Factor	(1) U.K.	(2) FRANCE	(3) FRANCE	(4) GERMANY	(5) GERMANY	(6) HOLLAND	(7) BELGIUM	(8) ITALY	(9) SPAIN	(10) LUXEMBOURG
4	30	3.13	2.44		3.25						
	40	2.98	2.32		2.83						
	60	2.83	2.04		2.31					4.2	
	80	2.75	1.89		1.99						
10	30	2.89	2.42		3.15						
	40	2.76	2.30		2.75						
	60	2.64	2.03		2.26					2.18	
	80	2.62	1.87		1.95						
40	30	2.7	2.04		3.10						
	40	2.63	1.97	1.84	2.71						
	60	2.54	1.76	1.60	2.23	1.65			2.29	1.89	
	80	2.55	1.64	1.48	1.94	1.49			2.07		
70	30	2.62	1.89		3.09						
	40	2.56	1.76		2.70	1.55		2.0			
	60	2.50	1.60		2.23	1.72					1.65
	80	2.51	1.51		1.93	1.45	2.33	1.7			
UCAR		2.41	1.38			1.27			2.20	1.56	
EXCHANGE RATE			10.866		4.702		5.17	7.7	2,200	195	

Page 3...

For the purposes of constructing the table the following sources and notes are applicable.

Column 1 U.K. England and Wales, based on Y.E.B. "DM" tariff incorporating load management.

Source : Electricity Council
Notes : Working practices can lower the 70MW figures by 0.1p.

Column 2 France, based on Electricité de France "vert" tariff

Source : Electricity Council
Notes : Despite the rigidity of the 'TLU' tariff rules, I.M.R. have been informed that 40MW consumers in the steel industry can avail themselves of these lower rates.

Column 3 Shows these lower rates for 40MW steel consumers in France at the end of 1980.

Source : I.M.R.
Notes : A small electric steelmaking shop in France 40MW 40% load factor - reports a cost of 1.38p in the third quarter of 1980.
Source : UCAR

Column 4 Germany, based on R.W.E. "L120" tariff

Source : Electricity Council
Notes : Few if any of the medium and large steel producers in Germany are covered by the L120 rates. Despite different tariff structures, different load factors and different geopraphical locations, the majority of the companies seem to have average rates between 7 and 8 pF.

Column 5 Germany - Steel Company Actual Contracts.

Source : I.M.R. page 40 and B.I.S.P.A.
Notes : Direct contacts with steel consumers and utilities have shown the special contracts which exist.

The figures shown in Column 5 are for five different consumers.

Union Carbide reports the average price for electric steelmaking shops in Germany at 1.27p for the third quarter of 1980.

Column 6 Holland - Steel Consumers

Source : I.M.R. pages 6 and 138
Notes : Special Steel tariffs were available at high load factors down to 2p in November 1980.

Source : B.S.C.
Integrated plant 70 MW and 80% LF 2.33P

Column 7 Belgium - Steel Consumers

Source : I.M.R. page 5
Notes : Special Steel tariffs are available between 1.7 and 2p depending on load factor.

Column 8 Italy - Steel Consumers

Source : I.M.R.
Notes : Union Carbide report an average for Italian electric steelmaking shops of 2.2p at the third quarter of 1980.

Column 9 Spain - Steel Consumers

Source : B.I.S.P.A.
Notes : An electric steelmaking shop in Spain advises that the current price - December 1980 - was 1.89p for a 45MW 55% load factor at 220 KV

Same source gives rates for 25KV loads for rolling and lighting at 2.18p and 4.2p.

Union Carbide reports an average for the Spanish electric steelmaking shops of 1.56p in the third quarter of 1980.

Column 10 Luxembourg - Steelmaking Companies

Source : I.M.R.
Notes : Steelmaker's tariff given as 1.65p in November 1980.

All plants in Luxembourg are large consumers.

ELECTRICITY PRODUCED (EEC COUNTRIES) FROM PUBLIC SUPPLY & PRIVATE GENERATION

PRODUCTION IN 1979

PERCENTAGE BY TYPE OF FUEL

				CONVENTIONAL THERMAL						
	HYDRO	GEOTHERMAL	NUCLEAR	HARD COAL	BROWN COAL	PETROLEUM PRODUCTS	NATURAL GAS	MANUFACTURED GAS	OTHER	TOTAL
W GERMANY	5.2	-	11.4	28.5	24.6	7.5	19.1	2.7	1.0	100
FRANCE	29.0	-	16.4	26.2	0.2	21.8	3.4	2.4	0.6	100
ITALY	27.7	1.4	1.4	5.5	0.7	54.9	5.7	← 2.7 →		100
NETHERLANDS(1)	-	-	7.2	5.2	-	36.2	48.3	3.1	-	100
BELGIUM	1.1	-	21.8	22.0	-	34.1	13.7	6.6	0.7	100
LUXEMBOURG(2)	26.7	-	-	3.4	-	5.8	30.8	33.3		100
UK	1.9	-	11.9	68.0	-	16.9	1.0	0.3	-	100
EIRE	10.0	-	-	0.5	19.1	69.7	0.7	-	-	100
DENMARK	-	-	-	81.3	-	18.7	-	-	-	100

SOURCE: UNIPEDE - Programmes and prospects for the electricity sector. 10th issue published Sept 1980

	HYDRO	GEOTHERMAL	NUCLEAR	HARD COAL	BROWN COAL	PETROLEUM PRODUCTS	NATURAL GAS	MANUFACTURED GAS	OTHER	TOTAL
RWE	3.9	-	9.1	22.0	59.4	0.4	5.2	-	-	100
E&W (CEGB ONLY)	0.04	-	11.5	76.8	-	10.4	1.3	-	-	100

SOURCE: CEGB STATISTICAL YEARBOOK 1979/80
RWE ANNUAL REPORT 1979/80

NOTES: (1) Figures for Netherlands relate to Public Supply only, which accounts for approximately 90% of total net production.

(2) Hard coal figure for Luxembourg incorporates other fuel sources.

ESTIMATED ELECTRICITY PRODUCTION (EEC COUNTRIES) FROM PUBLIC SUPPLY AND PRIVATE GENERATION

ESTIMATE FOR 1985

PERCENTAGE BY TYPE OF FUEL

	HYDRO	GEOTHERMAL	NUCLEAR	CONVENTIONAL THERMAL						TOTAL
				HARD COAL	BROWN COAL	PETROLEUM PRODUCTS	NATURAL GAS	MANUFACTURED GAS	OTHER	
W GERMANY	4.0	–	26.0	33.0	20.0	5.0	9.0	2.0	1	100
FRANCE	20.3	–	57.4	←		22.3			→	100
ITALY	19.4	1.1	4.0	7.8	0.5	61.9	3.9	← 1.4	→	100
NETHERLANDS(1)	–	–	4.1	18.8	–	43.9	29.5	2.5	1.2	100
BELGIUM	1.6	–	51.5	21.8	–	17.2	5.4	2.5	–	100
LUXEMBOURG(2)	36.5	–	–	2.6	–	–	–	60.9	–	100
UK (3)	2.6	–	18.1	78.0	–	–	1.0	0.3	–	100
EIRE	6.7	–	–	8.1	15.9	50.6	18.7	–	–	100
DENMARK	–	–	–	70.0	–	30.0	–	–	–	100

SOURCE: UNIPEDE - Programmes and prospects for the electricity sector. 10th issue published Sept 1980.

NOTES: (1) Figures for Netherlands relate to Public Supply only

(2) Hard coal figure for Luxembourg incorporates other fuel sources

(3) Hard coal figure for UK incorporates petroleum products

Figure 1

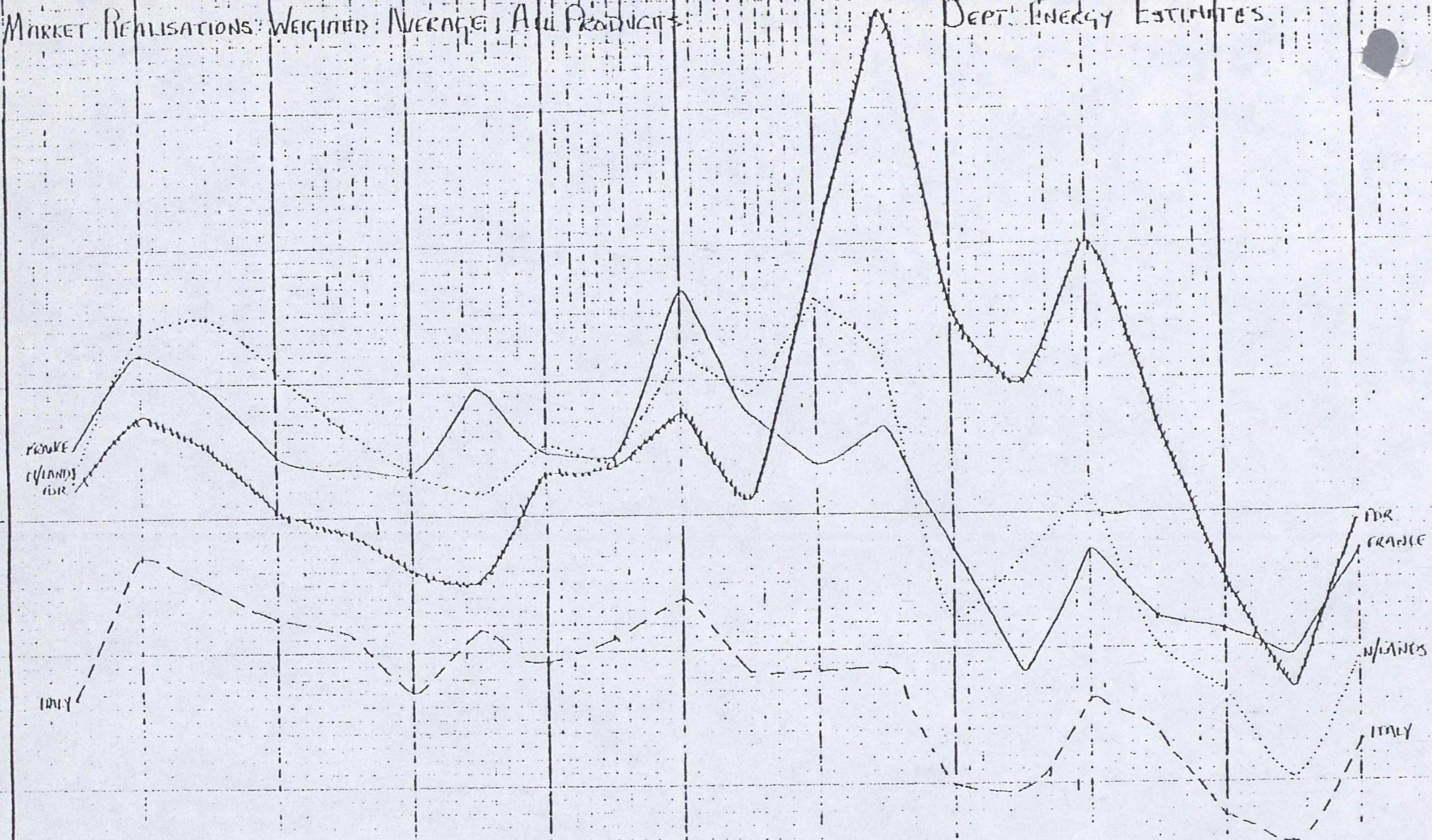


Figure 2

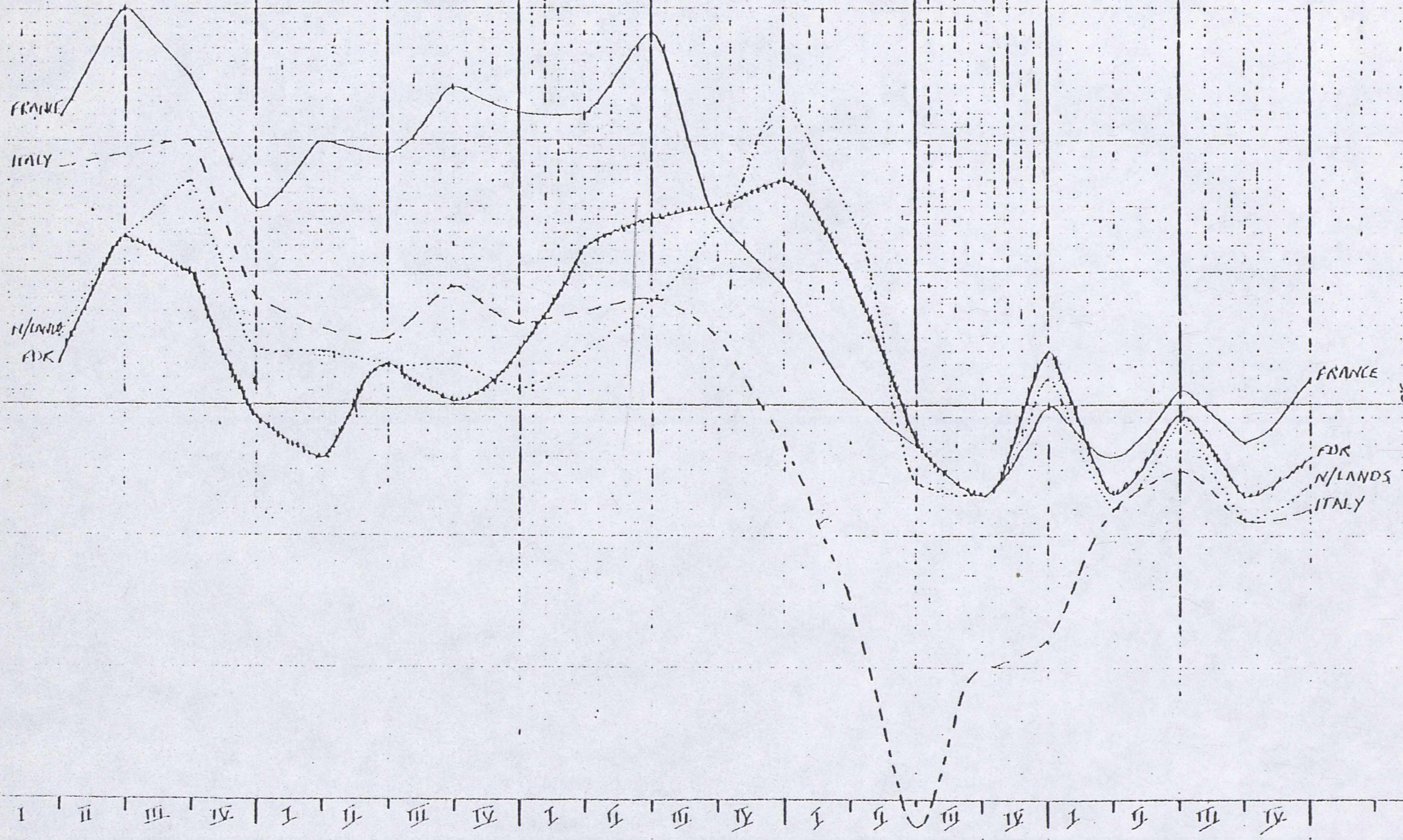


Figure 3

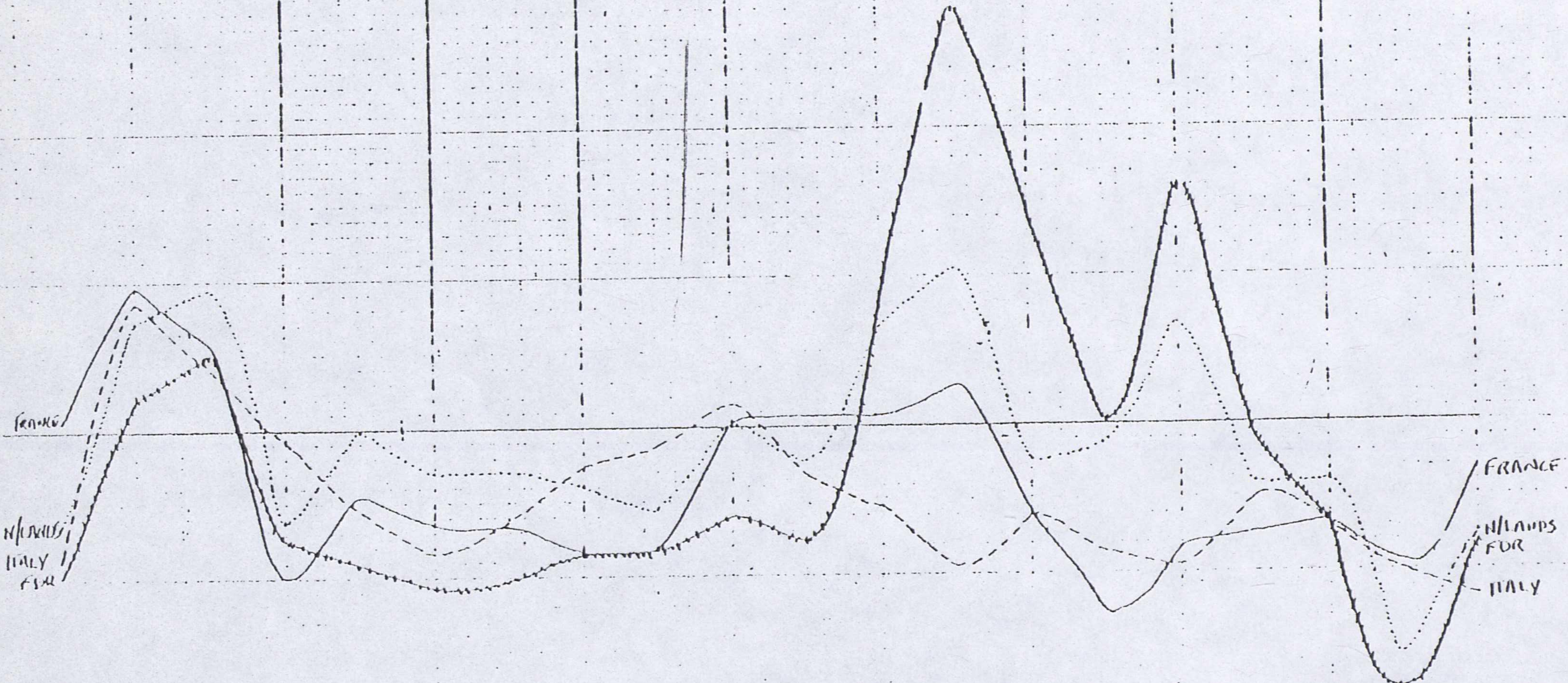


Figure 4

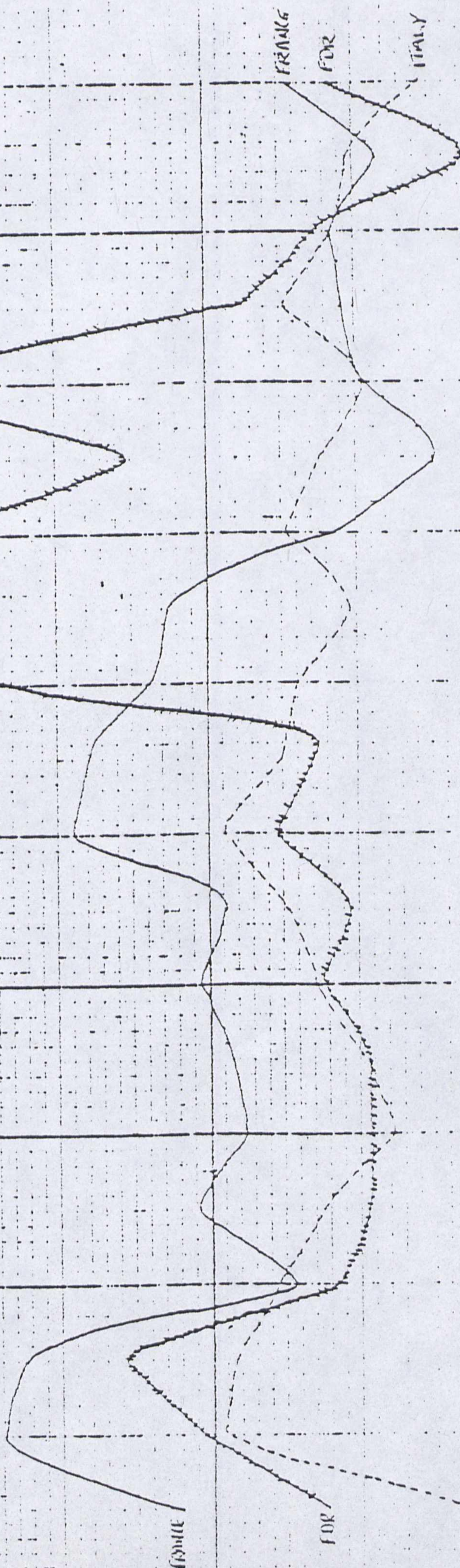


Figure 5

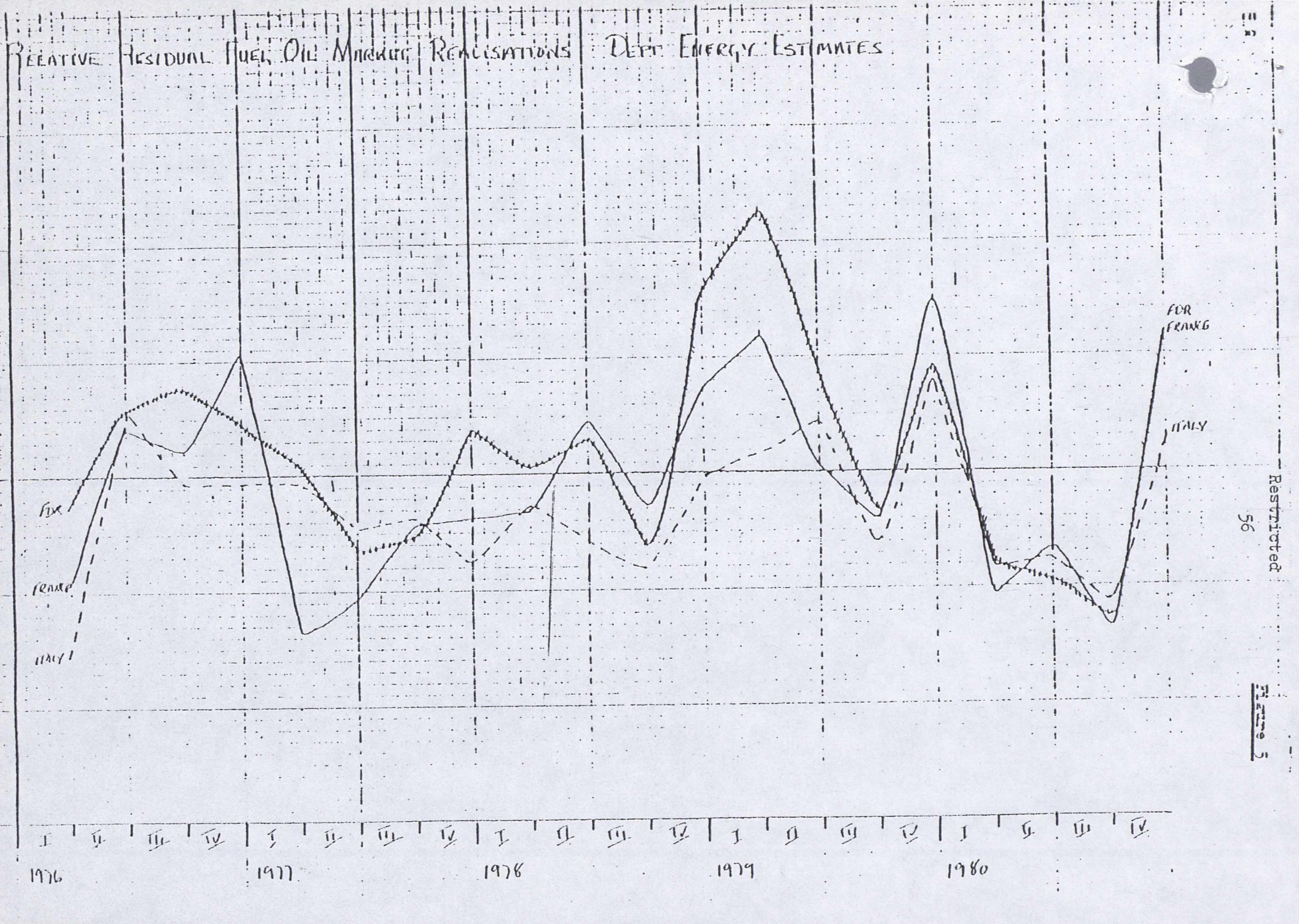


Figure 6

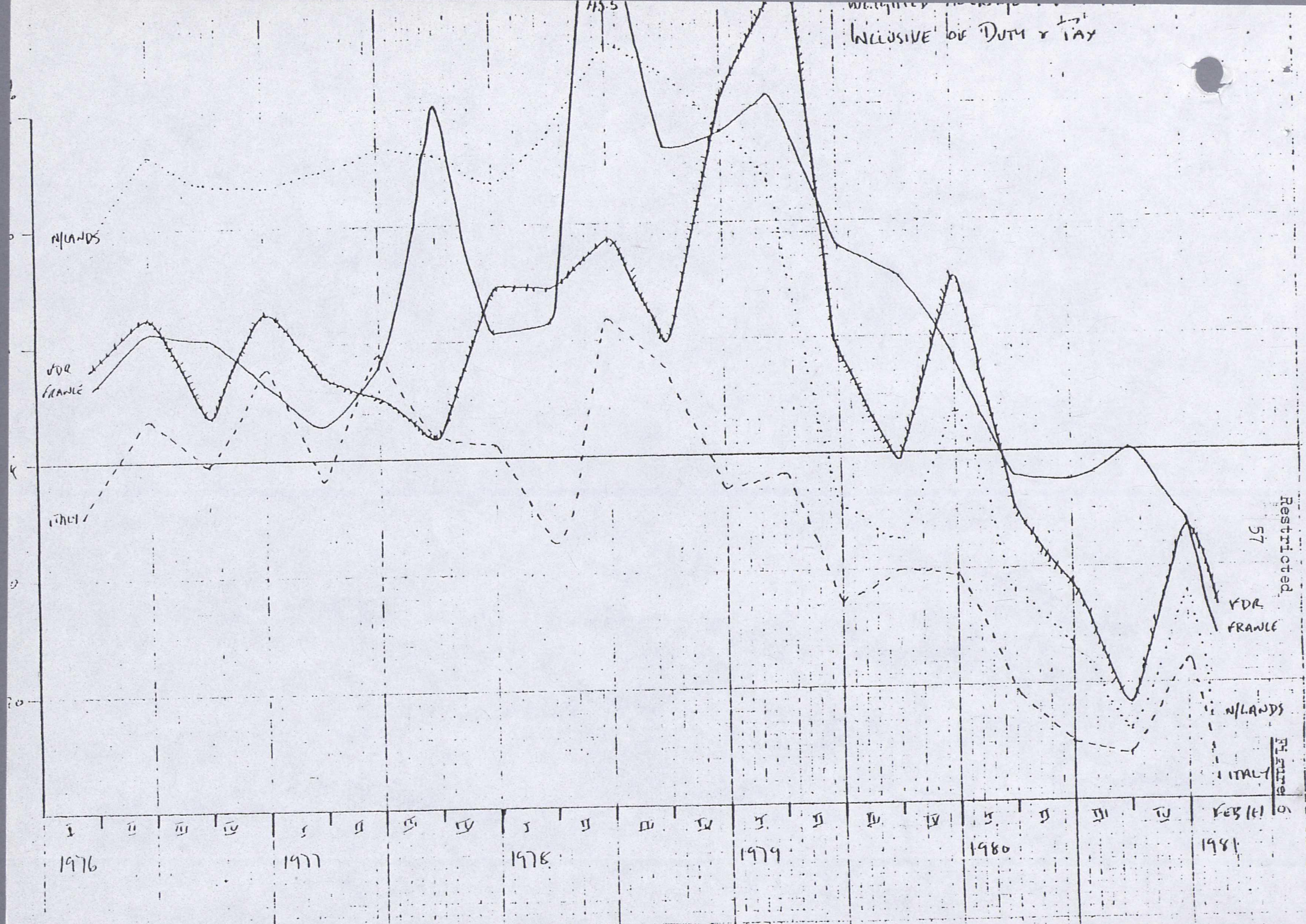


Figure 7

Restricted

Figure 8

AUTOMOTIVE DIESEL OIL CONSUMER PRICES,
INCLUDING TAX AND DUTY. W.W. ICC & RETAIL

Figure 9

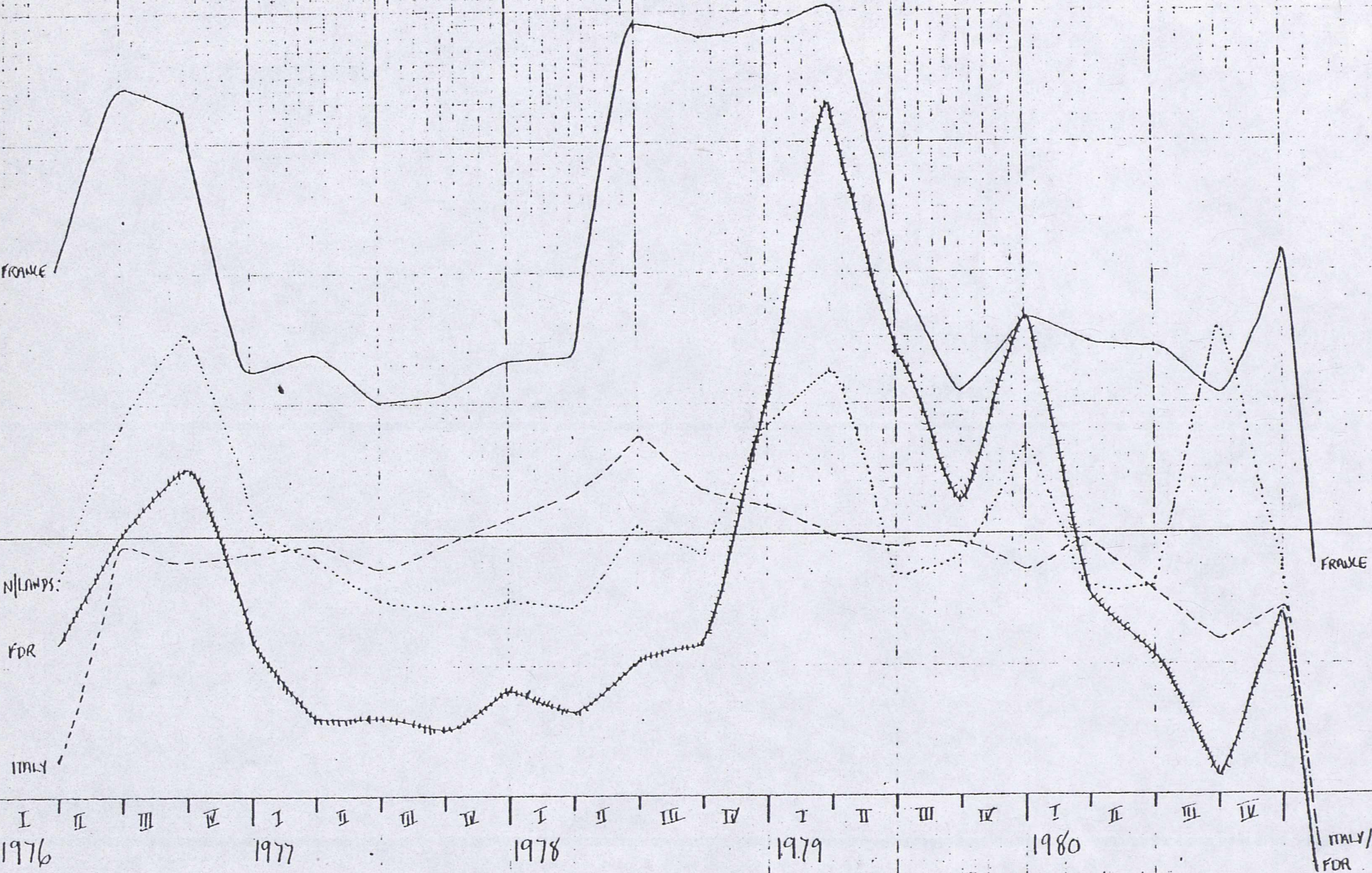


Figure 10

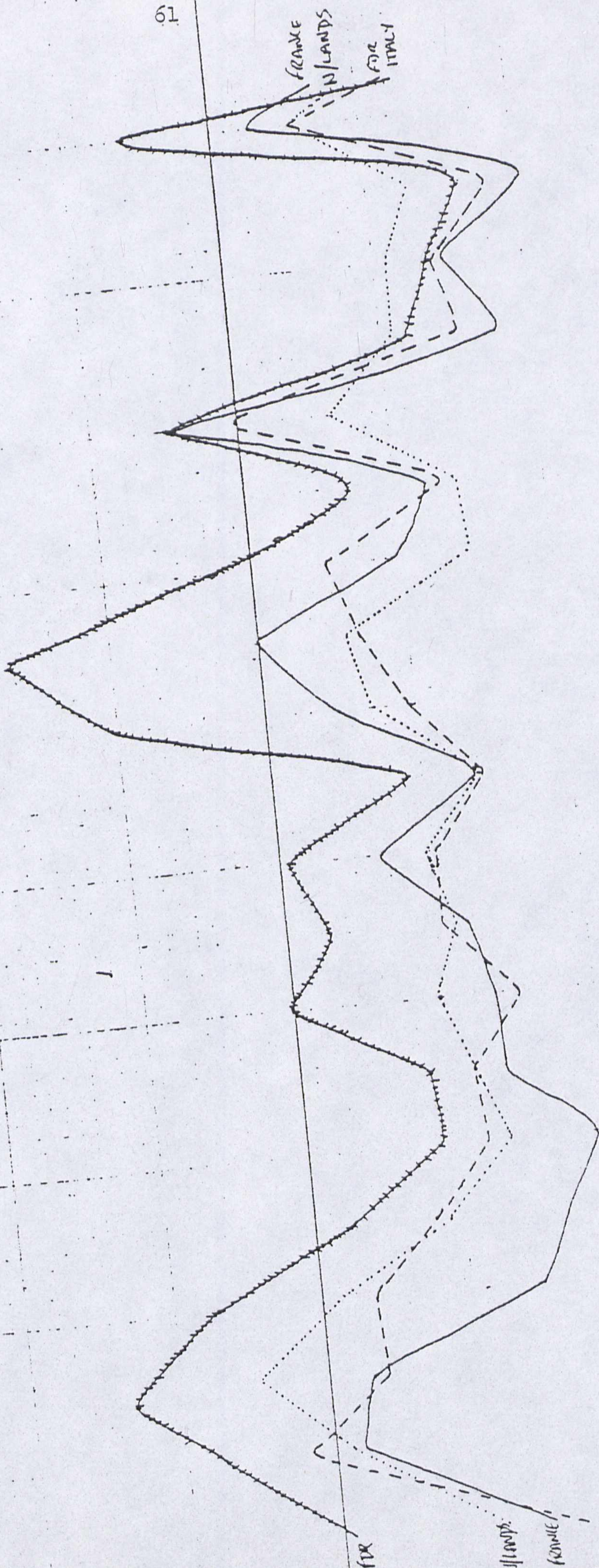
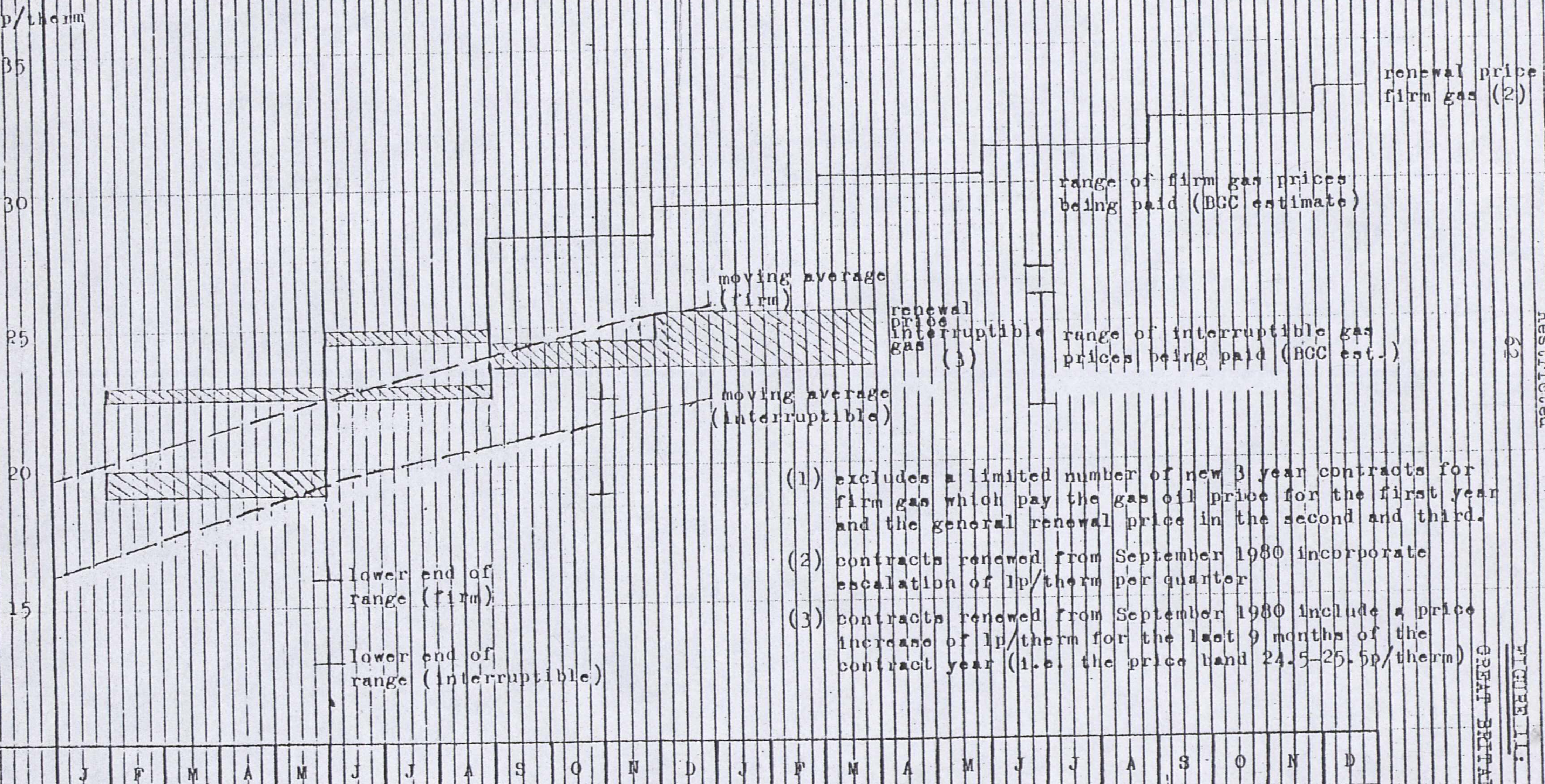


FIGURE 11: GREAT BRITAIN



(1) excludes a limited number of new 3 year contracts for firm gas which pay the gas oil price for the first year and the general renewal price in the second and third.

(2) contracts renewed from September 1980 incorporate escalation of 1p/therm per quarter

(3) contracts renewed from September 1980 include a price increase of 1p/therm for the last 9 months of the contract year (i.e. the price band 24.5–25.5p/therm)

Restricted

63

FIGURE 12:

BELGIUM

FIGURE 13:

FRANCE

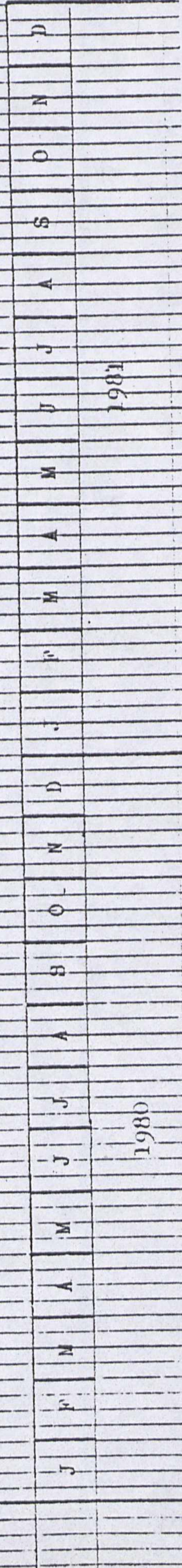


FIGURE 14:

GERMANY

FIGURE 15:

ITALY

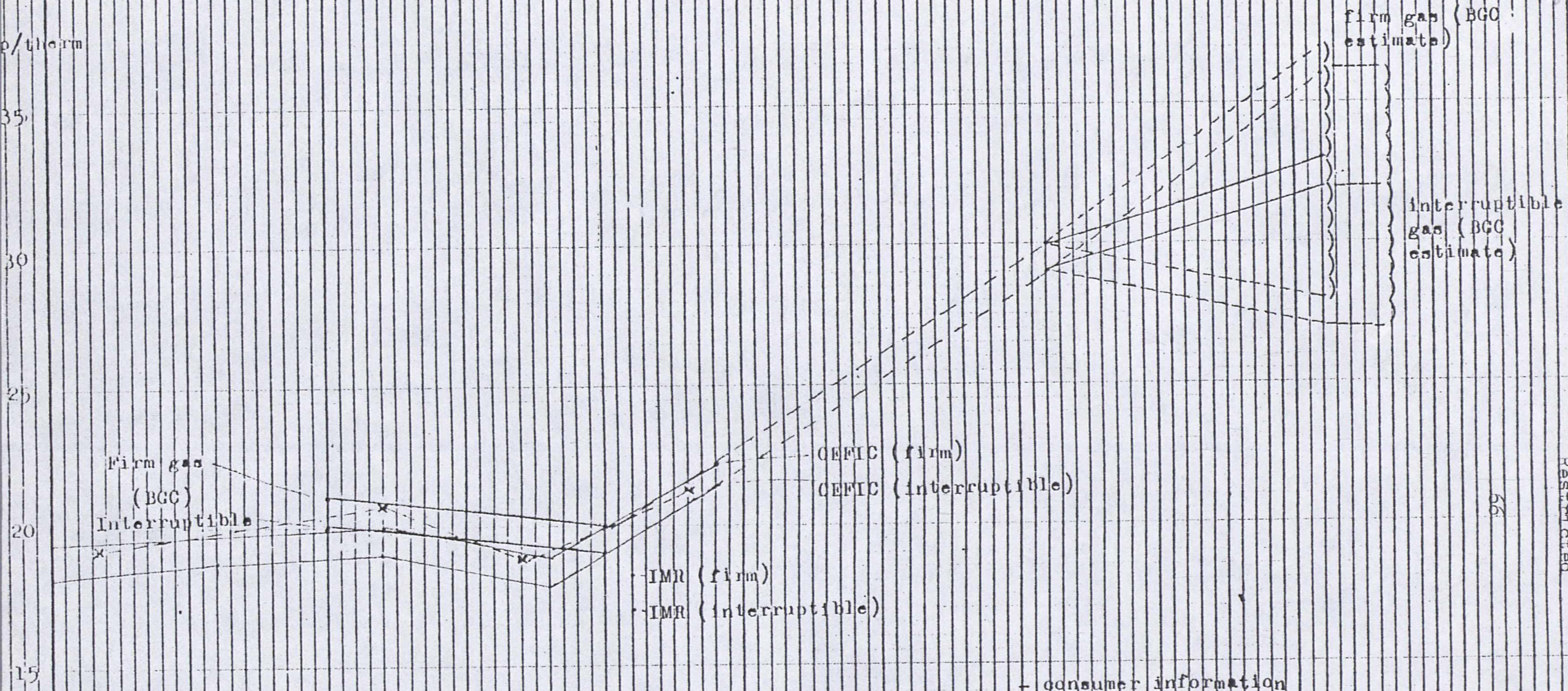


FIGURE 16:

NETHERLANDS

NETHERLANDS

p/therm

35

30

25

20

15

firm gas (BGC)

firm gas
(BGC estimate)

IMR

CEFIC

x – consumer information
–– trade association estimates for
supplies at approx. 0–60,000, 60,000–350,000,
350,000–3.5m, 3.5–17.5m therms a year & above.

J F M A M J J A S O N D J F M A M J J A S O N D

1980

1981

MEMBERSHIP OF THE TASK FORCE

Chairman	Mr G Chandler CBE	Director-General NEDO
Deputy Chairman	Mr J R S Homan	Deputy Industrial Director NEDO
British Gas Corporation	Dr E Clatworthy	Director Industrial and Commercial Gas
CBI	Mr J K Pitts	Chairman Tioxide Group Ltd
alternate:	Mr F Holloway	Member British Steel Corporation Managing Director Supplies
	Mr A P Scott	Head of CBI Fuel and Energy Department
Department of Energy	Mr J R S Guinness	Head of Energy Policy Division
	Mr G A C D Houston	Senior Economic Adviser
Electricity Council	Mr J A Burchnall	Deputy Commercial Adviser
alternate:	Mr T A Boley	Corporate Planning Manager
National Coal Board	Mr M J Parker	Director of Central Planning Unit
alternate:	Mr R J Ormerod	Deputy Director of Central Planning Unit
NEDO	Mrs D M T Oldershaw	Head of Finance for Industry Section
TUC	Mr F J Chapple	Member TUC General Council Chairman, TUC Fuel and Power Industries Committee
	Mr C Jenkins	Member TUC General Council Member TUC Fuel and Power Industries Committee
	Mr B Callaghan	Head of TUC Economic Department, Secretary TUC Fuel and Power Industries Committee
alternate:	Mr D Thomas	Assistant Secretary, TUC Economic Department
Secretary	Mr D R Davis	

ORGANISATIONS FROM WHOM ORAL EVIDENCE HAS BEEN TAKEN

British Ceramic Manufacturers Federation

British Fishing Federation Ltd

British Gas Corporation

British Independent Steel Producers Association

British Insulated Callenders Cables Ltd

British Steel Corporation
BP Oil Ltd
British Paper and Board Industry Federation

Chemical Industries Association Ltd

Council of Ironfoundry Associations

Courtaulds Ltd

Electricity Council
Esso Petroleum Co Ltd
Glass Manufacturers' Federation

Imperial Chemical Industries Ltd

Industrial Market Research Ltd

National Coal Board

National Farmers' Union

National Federation of Clay Industries

National Smokeless Fuels Ltd

Reed Paper Ltd

Round Oak Steel Works Ltd

Scottish Fishing Federation
Shell UK Ltd
Sheerness Steel Ltd

Stavely Industries Ltd

Unilever Ltd

UK Particleboard Association

UK Petroleum Industry Association Ltd

ENERGY INTENSIVE SECTORS

The following sections briefly summarise the main energy use characteristics to have emerged in discussions with the different sectors and their suppliers. Figures for energy costs as a proportion of total costs are at Table 10.

Steel

(a) Gas

2. The steel industry include consumers taking between 25,000 and 50 million therms a year though only five premises take above 10 million therms a year and two thirds of the total number of contracts is for less than 1 million therms a year. The sector as a whole takes 65% firm and 35% interruptible gas. BSC takes 40% interruptible gas. A proportion of the firm gas is used in furnaces where the alternative fuel is fuel oil. This effectively means, in terms of BGC pricing practice, paying a partly gas oil related price for a fuel oil use. The alternatives of switching to fuel oil or installing a capability for using interruptible gas, though in principle attractive, would require capital outlay. The industry point out that on their existing oil and interruptible gas contracts "minimum take" penalty clauses limit their ability to switch between fuel oil and gas to take advantage of price movements.

3. BGC's understanding is that steel industry consumers in Germany whose alternative fuel is gas oil are paying gas oil prices.

(b) Electricity

4. The steel industry have been particularly concerned with prices for loads of 40 MW and upwards where they have some 23 consumers (in England and Wales) as against 6 for chemicals and non for paper and board. Typical load factors for an arc furnace would be about 40% and for a modern integrated steelworks about 60%.

Chemicals

(a) Gas

5. About 70% of the chemical industry's gas supply is taken on interruptible terms. Only about four firm gas contracts exceed 10 million therms a year:

the majority of firm supplies are around 2 million therms a year. This contrasts with Germany where both sites and contract quantities are generally larger.

(b) Electricity

6. The chemical industry is a relatively high load factor user - some 21 sites in England and Wales over 70% load factor and a further 21 sites at 60-70%. A number of smaller consumers, and a few large ones, do operate at lower load factors. The industry's ability to take advantage of load management varies considerably from process to process.

Paper and Board

(a) Gas

7. The greater part of the industry's consumption of gas is on interruptible terms: BGC estimate that 94% of total consumption is interruptible.

(b) Electricity

8. Most UK mills are in the range 2-10 MW. Some take loads up to 20 MW and some below 1 MW. Load factors are generally 50-60% but ranging up to 70% and beyond. About half the electricity consumed in the industry is own generation and, without this, typical load factors would be of the order of 80%.

Clay

9. The clay industry takes about 50:50 firm and interruptible gas with typical consumption of around 1-2 million therms a year.

Glass

10. The glass industry consumes about 60% interruptible and 40% firm gas.

Ceramics

11. Average gas consumption in the ceramics industry is 1.5 million therms a year (a range of 150,000 - 14 million therms a year). The majority of consumers are on firm contracts.

THERMAL EFFICIENCY OF POWER STATIONS

Annual system thermal efficiency is a parameter often quoted in comparisons. It is a measure of the proportion of the input heat energy that is converted into usable electricity and is usually quoted as the average achieved by all plant burning fossil fuel, ie it excludes nuclear, hydro and geothermal plant. It is a useful indicator for examining the performance of a system from year to year. It is however incorrect to assume that an increase in system thermal efficiency is invariably an improvement in performance even during times of high fuel costs. A primary function of any utility is to minimise unit costs, and as a result plant which is highest in the operating cost merit order may not necessarily be the most efficient, because unit production costs are based on a combination of efficiency and fuel costs at the station.

In principle thermal efficiency could provide a useful indicator for making comparisons with other utilities because of its relatively simple definition and freedom from monetary measurement with its inherent complication of inflation indices and currency exchange rates. For such comparisons to be meaningful, however, it is essential that common definitions are used and that they are interpreted against a detailed knowledge of the systems involved.

Comparisons of efficiency which may be made within the EEC using the results published by EUROSTAT are shown in Table 1 below, however this "league" table, should not be taken at face value, for the following reasons:

i There is no single detailed definition of annual system thermal efficiency within the EEC and there are significant differences in the procedures used by each country to arrive at the efficiencies shown.

ii The measurements used in the calculation of thermal efficiency are subject to errors, especially in the case of solid fuelled plant.

iii The table shows efficiencies calculated on a net calorific value (NCV) of fuel basis. The UK power industry uses gross calorific values (GCV) and conversion factors are applied centrally to arrive at the UK figures presented. The difference between thermal efficiencies based on GCV and NCV is only numerical, but when comparing different plant or systems it should be remembered that the use of net calorific value will seem to favour that plant or system which predominantly uses oil, gas or brown coals.

iv There are inherent reasons for differences between national system efficiencies. They can broadly be divided into three categories:

a Geographic, eg sources of cooling water supplies, availability of hydro power sites.

b Historic, eg fuel mix, loading patterns, age of plant, nuclear capacity.

c Economic, eg plant efficiency, unit size.

v EUROSTAT statistics include electricity generation at combined heat and power (CHP) stations. When the thermal efficiency of electrical production at CHP stations is calculated the results are very high due to the necessarily arbitrary division of heat consumption between heat and power production. Consequently in countries where a significant proportion of generation is produced at CHP stations the national thermal efficiency can be enhanced by a few percentage points. Countries where this feature is particularly important are Denmark, Belgium and West Germany.

Eurostat System Efficiencies for 1977

COUNTRY	THERMAL EFFICIENCY % (net calorific value base)
Denmark	38.2
Holland	37.7
Belgium	37.2
France	37.0
Italy	36.8
West Germany	35.1
UK	33.2
Ireland	31.8
EEC - 9	35.2

AVAILABILITY OF POWER STATIONS

Availability is the measure of generating capability that could be called upon for use at a particular time.

Many problems are encountered in making meaningful international comparisons of generating plant availability. These problems can be separated into three broad groups -

i There are wide variations in definitions and reporting standards which are incompatible to a greater or lesser degree. However the definitions in use fall into two basic groups

a West European and

b North American

The CEGB's definitions are similar, but not identical, to other European definitions such as those of Electricite de France or VDEW.

Moreover the published availability figures are averages over classes of plant which contain different numbers and varieties of plants.

ii Another major problem is that plant availability patterns in different countries are affected by system requirements, plant mix, operating regimes and maintenance policies, as well as the quality of engineering design and construction. There are also non-engineering constraints such as staffing levels, the use of contractors for maintenance, the suitability of the fuel, the availability of cooling water and so on.

iii The availability of any individual plant varies considerably from year to year because it is dependent on chance events as well as planned work. The magnitude of the random changes that are typical of individual plant availabilities are sufficient to cause significant variation in the plant class averages from year to year and to hide the differences due to many factors. A small sample size accentuates the problem.

Meaningful international comparisons of generating plant availability cannot be made until data are collected and published on an agreed common basis. The CEGB is actively involved in working towards agreement on such bases.

Table 2 shows a comparison of published CEGB and EdF availability figures. Although these data are the nearest equivalents that are published, there are differences between them and they should be used cautiously. No other utilities regularly publish comparable figures.

INTERNATIONAL COMPARISONS

AVAILABILITY OF LARGE CONVENTIONAL UNITS

UTILITY	COUNTRY	UNITS	1969-1970	1970-1971	1971-1972	1972-1973	1973-1974	1974-1975	1975-1976	1976-1977	1977-1978	1978-1979
CEGB	England & Wales	500-660 MW Units	53.9	62.0	62.5	69.4	69.1	75.2	70.8	74.2	75.3	84.6
EdF	France	600 MW Units	59.2	66.5	82.5	55.7	85.7	83.0	78.1	81.3	68.3	73.1
		700 MW Units	-	-	-	-	-	-	-	-	51.0	78.6

Only CEGB and EdF publish availability data regularly. CEGB figures relate to the Mean Availability of conventional 500/600 MW single shaft machines at times of daily peak for working days during December, January and February.

The nearest, though not, equivalent published EdF figure does not include planned outages of plant or units less than one year old. It is calculated for 0600-2200 h on working days from November to March. Availabilities of EdF's established 600 MW tranche (7 units) and its four recently introduced 700 MW units are displayed.

PRIME MINISTER

ICI: ELECTRICITY COSTS

1 There is a possibility that ICI may shortly be seeking to make a public issue of electricity costs at their Runcorn Chlorine plant and threaten to close it down. I thought you should know the background.

2 The work of the NEDO Task Force has shown that there is at present a marked disparity between the prices charged to large high load-factor chemical users in this country and the sterling equivalent of prices charged to similar users in Germany and France. Figures agreed between the electricity industry and the Chemical Industries Association were annexed to my minute to you of 24 February.

3 Electricity costs at Runcorn have for some time been under active discussion with the local Area Board whose prices to ICI are amongst the lowest in the country, reflecting the importance of the load, and its characteristics. ICI approached the Department a few weeks ago to discuss whether there might be advantage in direct supply from the CEGB. We encouraged them to take this up at Board level even though, since we understood they were buying at not much above short-run marginal costs, it did not seem very likely that significant further advantage would be identified. They are shortly expected to send the Department a memorandum on their discussions. This may suggest the need for a considerable discount (perhaps as much as 50%) on current rates if the electricity-intensive chlorine plant at Runcorn is to be fully competitive on present prices with ICI's similar plant in Germany.

4 We shall need to discuss the memorandum carefully with ICI and establish whether like really is being compared with like: the Electricity Council suspect for instance that special assistance from the Land Government has enabled significantly lower prices

to be given. We have asked ICI for permission to use their data about their German prices in talks with the German Government as we can only point out unfair competitive practices if companies provide us with hard facts and let us use them. Although they refused to agree to our doing so, we shall be pressing them again on this point.

5 We are in fact examining further ways in which ICI might be helped but there seems to be no way in which the Boards could come close to matching German prices for large intensive customers without selling at a very considerable loss. As I mentioned in my letter of 24 February to Geoffrey Howe, I have asked my officials to discuss with DOI and Treasury officials the possibility of DOI providing assistance for Runcorn.

Flag A

6 I am copying this minute to Geoffrey Howe and Keith Joseph.

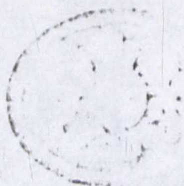
DH.

SECRETARY OF STATE FOR ENERGY
25 February 1981

SECRET

cc Ingham
Walters
Duguid
Wolfson

1 A



01-211-6402

T 24/2

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

24 February 1981

Dear Geoffrey

I have seen your Private Secretary's letter of 20 February. /below

I should first like to express my thanks for your having agreed to my earlier proposals to raise the esi's EFL by some £45m and BGC's by up to £65m in 1981/82. But I agree that the way the Task Force's report is now shaping up makes it unlikely that this alone will appear adequate to Parliament or industry. I believe there should be four elements in the package:

(a) 25% reduction in the HFO duty
The Attorney-General is now considering whether there is any way round the Frigg difficulty. A preliminary meeting between my officials and his did not throw up any new solution to the impasse. However, a 25% reduction would involve a "Frigg cost" of only £3m in 1981/82 and £30m in 1982/83. It should be possible to establish within a year whether the Frigg contract is renegotiable. Given the small sums at risk in the short term I hope you will now agree to this reduction. In view of the expectations of industry - we have both received more representations on the HFO duty than on other aspects of energy prices - I believe there is a strong political case for such limited action. (I would add that with the expected improvement in the economy there could be a case on fiscal and energy policy grounds for raising the HFO duty to its existing level again in 2 years' time, although inevitably there will be some lagged "Frigg cost".)

(b) Electricity prices
My officials have had further urgent consultations with the esi. The industry confirm that they have already gone as far as they can without breaching their statutory obligations not to give undue preference. A reduction of a few extra percentage points would still not bridge the gap between our and French and German prices for large high load factor users. (NEDO's report shows that our prices are still broadly in line with European ones for the vast majority of the esi's 185,000 industrial customers.) As the disparities for this limited but important class of firms are to a large extent created directly by exchange rate movements, it would be wrong to move away from our whole energy pricing policy to compensate for problems caused by a quite different factor. In some cases selective assistance would seem to be a more appropriate solution. I have, for example, instructed my officials to discuss this possibility with DOI and Treasury officials in respect of the problems faced at ICI's chlorine production at Runcorn. (ICI are already involved in discussions with the esi to establish whether there is scope for further reductions in tariffs for the Runcorn plant.)

(c) Gas prices
The current and expected disparities between gas contract prices here and on the Continent which have recently emerged, are more worrying and widespread than those for electricity. I think it would be right to ask the Corporation to hold their existing firm and interruptible prices until the end of the year rather than only for 6 months. On the assumption that prices then moved up at the rate previously planned this would cost a total of £90m, ie £25m above the figure you have already accepted. It would, of course, have an impact on BGC's profits for subsequent years.

(d) Boiler Substitution Scheme
You will see that the Task Force's report lays considerable weight on the fact that British industry uses more energy than its European counterparts and in particular that it could do much to reduce its fuel bills by replacing oil boilers with new coal ones. I therefore attach importance to including in the package my boiler substitution proposal. It clearly makes economic sense to help ensure that the coal which will inevitably be produced is used by British industry rather than added to stock and as long as we ensure that British coal stays competitive while overseas prices seem set to rise, it will indeed be British coal that is used.

Presentation

We shall need to devote very careful attention to the presentation of the Task Force's report and our reactions to it. Industry and the media will inevitably forget that the Task Force has concentrated on the most problematical areas and that the competitive position of most British companies is not adversely affected by our energy prices.

Nevertheless, as you point out, there is likely to be a strong reaction on the part of industry to the publication of the report. One way of containing it would be for me to announce the measures which the esi and BGC are taking and the boiler substitution scheme in a Parliamentary statement immediately after the NEDC's meeting on 4 March. Alternatively, I know that you would prefer to announce all the measures as a package in the budget. The advantages of this approach are that it would show our response to its best advantage, and reduce the risk of unfavourable comparisons between that response and the report's view of the problem it addresses.

You mentioned informally that you wished to take credit for £100m revenue from the eighth licensing round in your budget speech. I must reiterate that my Departmental advice is still that there is not suitable territory available at present to attract such revenue and the Oil Companies will be occupied with recent Licence awards. I camot see the £100m being obtainable in 1981/82.
I am sending copies of this letter and the earlier correspondence to the Prime Minister and the Secretary of State for Industry.

Yours ever

David

D A R HOWELL

Encs

CONFIDENTIAL

PRIME MINISTER

ENERGY PRICES

You and other colleagues will wish to have an interim report on the work of the NEDO Task Force.

2 Detailed discussions between energy consumers and suppliers have been completed. The (esi) and its customers have reached broad agreement on the facts. Less agreement has been achieved between BGC and its customers. Users of HFO and gas oil have been very critical of the oil industry for lack of competition in the oil market.

3 A first draft of the report was circulated to members of the Task Force on 19 February and considered on 20 February. The extracts from the draft which appeared in the Business Section of the "TIMES" on 20 February are inaccurate. The draft report accepts that our electricity prices for the vast majority of users are still in line with those in European countries and that gas prices were in line last summer. Nevertheless, the report has revealed some recent disparities for large electricity users and also for gas. These disparities, which to a large extent are accounted for by the strengthening of Sterling since last summer, are worrying and will certainly require action by the Government.

Heavy Fuel Oil

4 In the latter part of 1980 and very early 1981 UK Heavy Fuel Oil prices including duty were amongst the cheapest in Europe. Following the Bali decisions our oil companies raised their HFO prices by 13%, while oil prices in Europe moved much less. As you will see from the attached table, our pre-tax HFO prices are now in the middle of the range of EEC prices but again towards the top of the league post-tax. The two reasons advanced for the disparity are the HFO duty and the degree of competition in the UK oil product market. I am in touch with the Chancellor on the former and will again be pursuing the latter with the oil companies.

Electricity

5 The report confirms that for the vast majority of the esi's 185,000 industrial customers, UK electricity prices remain broadly in line with those on the Continent. But the Task Force's work has confirmed that in the case of a limited number of large and high load factor customers, notably in such industries as chemicals and steel, there now are significant disparities in prices. By far the most important cause of these disparities is the strengthening of Sterling. This has a direct impact on Continental electricity prices expressed in Sterling. The point is illustrated in the attached table covering the extreme case of the figures agreed between the esi and the Chemical Industries' Association for large high load chemical users at July 1980, 2 January 1981 and 29 January 1981 exchange rates. These show that, whereas the esi's prices were broadly in line with those in Germany at mid-1980 exchange rates, they are now markedly out of line. There are, of course, a number of other factors which account for the price disparities, notably the large nuclear and hydro component in French electricity costs (some 50% of the total).

Gas

6 The draft report confirms that BGC's gas prices were broadly in line with those in Europe in mid-1980, although the CBI representatives are still contesting this conclusion. But recently our renewal prices have moved above those in Europe, although the average price charged by BGC covering all its industrial customers (including ICI) is probably still broadly in line with those in Europe. Once again the strengthening of Sterling accounts for a significant proportion of the disparity, although the price increases decided by BGC last summer are also an important factor. Unless we take early action and/or Sterling falls significantly in the next few months these disparities will almost certainly persist.

Coal

7 Apart from the limited question of foundry coke, the Task Force has little to say about coal prices. It does, however, make the point that industry could do much to reduce its energy bills by replacing oil boilers with coal ones. Despite short payback periods (3-4 years)

industry is not making such investments now largely because of capital rationing. I have already written to the Chancellor on this subject as I believe that limited funds to encourage such boiler conversion will greatly help us both in respect of energy prices and in dealing with the miners.

Next Steps

8 I will send you and the recipients of this letter copies of the revised draft of the report of the Task Force as soon as it is ready - copies of the first draft (which will be extensively revised) have already been circulated to officials on the interdepartmental Working Group on Energy Prices.

9 I have already been in touch with the Chancellor in the Budget context about the package of measures which will be required in response to the Task Force's findings. We cannot, of course, hope to offset fully the impact of the strengthening of Sterling on comparative energy prices, which are still only causing serious problems for a limited number of companies. But we have accepted that where disparities exist and put our major companies at a competitive disadvantage we shall look sympathetically at their problems, as we did in the case of Bowaters. I will therefore be writing separately about the package which industry will require when the work of the Task Force is completed. One question to be decided is whether to announce such a package immediately after the Task Force's report is published on 4 March or, as the Chancellor of the Exchequer would prefer, in the course of his Budget Statement the following week.

10 I am sending copies of this letter of members of E, the Secretaries of State for Scotland and Wales, Sir Robert Armstrong and Mr Ibbs.

DH

Secretary of State for Energy
24 February 1981

ELECTRICITY PRICES: 2 JANUARY 1981

FOR LARGE HIGH LOAD FACTOR USERS IN THE CHEMICAL INDUSTRY

AT AVERAGE JULY 1980 EXCHANGE RATES: P/KWH

	LF	UK	FRANCE	FR GERMANY
	40	2.74	2.15	3.20
40	60	2.60	2.00	2.60
MW	80	2.53	1.85	2.30

AT 20 JANUARY 1981 EXCHANGE RATES: P/KWH

	LF	UK	FRANCE	FR GERMANY
	40	2.74	1.87	2.70
40	60	2.60	1.73	2.23
MW	80	2.53	1.61	1.94

AT AVERAGE 29 JANUARY 1981 EXCHANGE RATES: P/KWH

	LF	UK	FRANCE	FR GERMANY
	40	2.74	1.75	2.52
40	60	2.60	1.62	2.08
MW	80	2.53	1.50	1.81

HEAVY FUEL OIL PRICES OIL 57/138/1

16 FEBRUARY 1981

SOURCE : EEC REPORT-BACK TELEX

£1 tonne

	NET	DUTY	DUTY-INC	TREND IN NATIONAL CURRENCIES
BELGIUM	99.99	-	100.0	
DENMARK	97.13	26.37*	123.5*	-
GERMANY	88.72	2.96	91.7	-
FRANCE	96.25	0.07	96.3	
IRELAND	95.28	11.67	106.9	-
ITALY	90.79	0.42	91.2	
NETHERLANDS	92.25	2.74	95.0	-
UK	95.5	8.0	103.5	

*Duty in Denmark rebated to VAT-registered traders

Exchange rate : £1 = $2.2523

Nat Ind
Pt 3

✓ MS

01-211-6402

The Rt Hon Leon Brittan QC MP
Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
London SW1P 3AG

23 February 1981

Dear Leon

Your letter of 12 February to George Younger invited me to comment on the different price increases proposed by the Scottish Electricity Boards (average 11%) compared with those proposed for England and Wales (average 13%).

As you know, your letter crossed with mine of 16 February in which I expressed concern at the presentational aspects of these differences. While financial targets were set last year for the esi in England and Wales I understand none has yet been set for the Scottish Boards. Awkward questions could therefore be raised about the possible influence on prices of the financial regime (financial target and EFL) we are seeking to impose on the supply industry in England and Wales.

In the absence of financial targets for the Scottish Boards there is no basis against which I can assess their pricing proposals and I cannot usefully offer further comment.

I am copying this letter to the recipients of your letter.

Yours ever

David

D A R HOWELL

Nat Ind

PEC(81)4 ✓ MS

THE GAS LEVY BILL

It is hoped that Members will find this useful in the debate on the Second Reading on Monday, February, 16th.

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Conservative Research Department,
32 Smith Square, SW1

LMR/ST-R
13.2.81

1. The Purpose of the Bill is to impose upon the British Gas Corporation (BGC) a levy which will allow the nation as a whole to participate in the windfall which the BGC now enjoys on UK North Sea gas sold to them on contracts signed before June 1975. This gas is exempt from Petroleum Revenue Tax (PRT). The levy will be imposed not upon profits; nor upon consumers. It is to be a levy on the BGC's costs.

Clause 1 provides for the imposition of the levy in 1980/81 and in subsequent years on the cost of gas which is bought by the BGC and exempt from PRT under section 10(1) (a) of the Oil Taxation Act (1975). The levy will be applied retrospectively to April 1980, although members will note that this is only shortly before the intention to impose the levy was made public on 8th May 1980.

Clause 2 specifies the rate of the levy: 1p per therm in 1980/81; 3p per therm in 1981/82; and 5p per therm in 1982/83. (The average cost to BGC of gas purchased in the current financial year will be about 8p per therm). Further, the clause would allow the Secretary of State, with Treasury approval and subject to affirmative resolution of the House, to vary the rate from the above. This is a precaution against unexpected changes in circumstances. The need for the BGC to have a stable financial framework is fully accepted. Finally, the Clause sets out that the rate of the levy for years subsequent to 1982/3 shall be specified by order, subject to affirmative resolution of the House.

Clause 3 deals with the timing of payments of the levy and provides for interest to be paid on overdue and excess payments. It is intended that the levy should be paid quarterly, in arrears.

Clause 4 ensures that gas stored in North Sea fields after production is not subjected to the levy twice.

Clause 5 provides that the accuracy of instruments used to measure the amount of gas taken which is subject to the levy should be the responsibility of the BGC, and provides powers for this equipment and the BGC's records to be checked by Crown servants.

Clause 6 allows for the proceeds of the levy to go to the Consolidated Fund; for the expenses incurred by the Secretary of State in consequence of the provisions of the legislation to be met from money provided by Parliament; and for an account certified by the Comptroller and Auditor General to be laid before Parliament each year. laid

2. The Need for the Levy. Almost all of the gas purchased by BGC, apart from the 20% imported from Norway at world prices, is exempt from PRT because it is supplied on contracts which were signed before PRT had been envisaged. Many of these contracts were signed in the 1960s, and there have been vast increases in oil prices since that time. BGC, as the monopsony buyer, was able to negotiate prices on the early contracts which were as little as one tenth of the price of today's gas from the northern North Sea.

When this gas is sold in today's market, a considerable windfall accrues. The Labour Green Paper (Cmnd 7101, 1978) recognised that the policy (advocated therein) of long run marginal costing of fossil fuels "can give rise to large surpluses, and decisions would be needed on the use to which these surpluses should be put". (Annex 4, para. 10, p. 115). Opposition members who assume that a Labour Government would have left the surplus with BGC or given it to consumers should be reminded that, as late as 1978, the last Labour Government was leaving its options open.

A levy on BGC's costs seems to be the easiest and most efficient way of securing the windfall for the nation. Other options were examined. For example, gas presently exempt could have been brought within the scope of PRT, but this would have raised relatively little since the producers of exempt gas secure very little of the windfall. PRT could only have been useful in this respect if old

contracts with the BGC had been renegotiated to current market values.

3. Who should benefit from the Windfall?

The options are:

a) that consumers could benefit from the windfall through prices below the economic level. This was specifically discounted in the Labour Green Paper. For example, para. 8.16 acknowledges that "the (gas) industry's prices need to be related to the expected cost of future supplies .... and this implies prices higher than can be justified by the view that price increases should be limited to those made necessary by cost increases actually incurred". The present Government agrees in principle with this analysis, because this is the only way in which the waste of a valuable yet finite national resource can be avoided. Prices reflecting long run marginal costs are further the way in which all sound businesses operate.

Under Labour, gas to industry was sold at 100% of the price of the competing oil product. The Gas Corporation reviewed this policy last year and existing gas contracts are being renewed at about 75% of oil parity. Further, new contracts now revert to the 75% level after the first year, and a significant number of the BGC's customers who have signed contracts in the last three years will benefit from retrospective implementation of this policy. Oil-related industrial prices are needed to prevent a "flight from oil" as oil prices rise; to match demand to supply as far as possible; to ensure that there is adequate availability of gas users who value it most highly because they have a particular use for it which could not be met by a less valuable fuel; and to avoid wasteful and premature exhaustion of our indigenous gas reserves.

In July 1979, the Price Commission reported that domestic gas was 30% underpriced. The necessary adjustment towards full economic pricing is being phased over three years and the domestic consumer does, meanwhile, enjoy some of the windfall. The imposition of the levy will not change the previously announced pricing policy for domestic gas, which is based upon sound principles of resource management, and upon the need to inform people through accurate price signals of the likely future trend in prices. This is the only way in which they can be enabled to make rational judgements upon investment in conservation.

b) that the BGC could use the windfall for its own purposes. At the moment, the BGC is the main beneficiary of the windfall, and its effect is seen in the fact that the BGC's profits have increased from £32 million in 1976/7 to £426 million in 1979/80. The BGC was revealed to be a relatively efficient organisation in the Price Commission Report of July 1979. However, this massive increase in profits can by no means be accounted for by increased efficiency; nor by increased sales. Within a year or two, BGC's profits could approach £1 billion, not because of the Corporation's own efforts, but because of the move towards economic pricing of domestic gas and the rising price of oil. (Note that the £361 million profit announced in March 1979 was achieved despite the fact that domestic sales were then only breaking even).

Should BGC continue to retain an increasing proportion of the windfall? The Government believes not. The Corporation's investment is already self-financed, and there is no reason why this should change. The Corporation will still, having paid the levy, earn a reasonable return on its assets and the revised financial target for the industry has been framed on this basis. There remains, however, the need that the financial target should retain pressure upon the costs and efficiency of the industry.

c) that the windfall should benefit the nation. This is the option which the Government wishes to take, and is the rationale behind the present Bill. The windfall results from the fact that, because our indigenous resources meet 80% of our gas requirement, we are relieved of the need to import this or produce it from coal. It is wholly right that everyone (not just those who consume gas) should gain from this national advantage.

The Opposition will decry the concept of "a tax on gas". Three points need to be made in this context.

1. The 1978 Labour Green Paper (Annex 4, para. 2) advocated market pricing of North Sea oil, and that "the nation's participation in the surplus thereby yielded (should be) secured by taxation and other policies rather than by artificially low prices to the UK consumer". Why is gas not the same as oil in this respect? (The Green Paper bears the signature of Tony Bell).

2. Mr. Edmund Dell, then Paymaster General, told Standing Committee D (6.2.75) during the Committee Stage of the Oil Taxation Bill, that, in principle, " ...the gas supplied from the North Sea really should be as liable to PRT as oil". Pre-1975 gas was exempted for particular reasons, but the principle of taxing gas was accepted. Post-1975 gas from UKCS will be taxed under Labour's 1975 Oil Taxation Act.

3. Labour did tax gas in 1977, and in such a way that the tax burden fell directly upon consumers. The then Chancellor, Mr. Denis Healey, announced (Hansard 15.12.76, col. 1529) that, as part of the package of measures designed to cut public expenditure, (in order to comply with conditions for the provision of stand-by credit from the IMF) domestic and commercial gas prices would rise (in the event by 10%) in April 1977. The BGC was not consulted about this. The 1978 Green Paper is explicit (para. 8.16 p. 43), "The BGC was requested to increase prices from 1st April 1977 by an average of 10% as a contribution to the Government's policy of reducing the PSBR, following the agreement with the IMF in December 1976".

4. The Effect of the Gas Levy on the PSBR.

Opposition members might refer to the Government's "obsession with the PSBR". Labour's tax (see above) was specifically for this purpose of reducing the PSBR, but the present Bill will not have this effect.

At present, BGC's surplus is deposited with the National Loans Fund, where it bears interest. The effect of the levy will be to prevent this surplus building up beyond the present £300 million. However, although funds, under the Bill, would be transferred from the National Loans Fund to the Exchequer there will be no net effect upon the Government's need to borrow money.

5. The Financial Effects of the Bill. The Levy is expected to amount to £130 million in 1980-81; £420 million in 1981-82; and £750 million in 1982-83. The rise in the levy in this period is in line with the steady movement towards the economic pricing of domestic gas, and the anticipated increase in oil prices. Beyond 1983, the rate will be set at a level dictated by the situation, as it unfolds. The revenue from the levy will however, start to decline as the old gas fields become exhausted. While about 75% of gas supplied will be subject to the levy in 1980, this will decline in the next ten years to about 40%.

6. The Effects upon the BGC. The BGC accounts will show the levy as a cost, and it will be a proper charge for the purposes of Corporation Tax, which BGC will begin to pay in 1981/82.

The BGC forecasts post-levy profits of about £300 million this year, and perhaps around this level in subsequent years. In view of the levy, and the implementation of current cost accounting, the financial target for the industry has been revised to 3½% return on assets valued at current cost. This is agreed by the BGC as a reasonable target. The revised target is an arithmetic change: it does not reflect a change in the principles which underlay the target as previously announced.

BGC's investment plans will amount to about £4 billion in the next five years. The new financial régime should allow self-financing of this from profits, depreciation, and (if necessary) the £300 million NLF deposit. The Corporation's investment plans have to be approved by the Government, even

when they are self-financed. (Members will note that the gas gathering pipeline will be financed outside the public sector).

7. Attitude of the BGC.

The BGC have been consulted on the effect the Levy will have on their finances, and upon the method of timing and payment, and upon the post-levy financial target. Of course, the Corporation does not welcome the Levy, but the Government has taken pains to ensure that it will not adversely effect their future operations.

Conservative Research Department,
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Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon George Younger TD MP
Secretary of State
Scottish Office
Dover House
Whitehall
London SW1A 2AU

TL 12/2

12 February 1981

Dear George,

SCOTTISH ELECTRICITY BOARDS - TARIFF INCREASES FROM APRIL 1981

Thank you for your letter of 6 February about the Scottish Electricity Boards' intention for tariff increases from April 1981.

I note that the Chairmen of the two Boards have decided to hold their average tariff increases this year to 11 per cent. This compares with the forecast 12 per cent tariff increase assumed when the two Boards' EFLs for 1981-82 were set. David Howell will no doubt comment on the different price increases in prospect for Scotland and for England and Wales, where a 13 per cent increase has been decided. I want to comment on the reason put forward for the Boards' proposed increase of 11 per cent compared to the 12 per cent assumed in the EFL calculation.

You say that the Boards' EFLs were calculated on the basis of figures which were "about a year out of date when the EFLs were set" and that subsequent work on "up-to-date figures" has now demonstrated that the tariff increase need not be so large as had been anticipated towards the end of last year. This is surely unsatisfactory. The two Scottish Electricity Boards ought to be told that their EFL submissions should be prepared on the latest and most up-to-date assessment of their financial prospects for the year ahead. The decision to set EFLs in the autumn of 1980 cannot have been a surprise to them since this followed the same timetable adopted for the previous year's EFL.

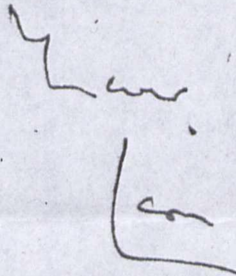
Could I ask that the Boards should be told now in the firmest terms, that the calculation of their EFL for 1982-83 should be based on up-to-date figures, and not ones which will by then be a year out of date.

You say in your letter that the 11 per cent tariff increase is as low as the two Boards can go without running the risk of breaching

their "combined" EFL for 1981-82. But the two Boards do not have a combined EFL. They are separate statutory bodies and separate EFLs have always been fixed for them. They have no authority to vire between their EFLs. They must manage their financial affairs so that each meets its published limit. I would appreciate it if this could be made clear to them.

Finally, I think that there should be an announcement of the two Boards' financial targets as soon as possible and certainly before the beginning of the next financial year. The target for the industry in England and Wales was announced over a year ago and an announcement of the Scottish Boards' targets is long overdue. Perhaps you could let me know if you see any problems with this timetable. Otherwise, I suggest that our officials should quickly prepare proposals, in full consultation with the Department of Energy.

I am sending a copy of this letter to the Prime Minister, David Howell, Keith Joseph, Francis Pym, Nicholas Edwards and Sir Robert Armstrong.



LEON BRITTAN

Wat Ind.

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
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01 211 6402

The Rt Hon Sir George Younger MP
Secretary of State for Scottish Office
Whitehall
LONDON
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10 February 1981

Dear George

ENERGY PRICES AND THE PAPER INDUSTRY

Thank you for your letter of 10 December following your meeting with representatives of the British Paper and Board Industry Federation (BPBIF).

The evidence presented to you and summarised in the brief they left with you is based on a full report which they have prepared and sent to this Department.

The figures are based on a very small sample - four companies in all - and given the very wide variations in prices for any fuel in a single country this severely limits their significance. However it is clear that UK industry faces very much higher prices for natural gas than do its North American competitors and also much higher electricity prices than those in Canada and Scandinavia.

So far as North American gas prices are concerned, this reflects tight Government regulation which has held prices well below the economic level. Although there are plans for progressive deregulation, the price of "old" indigenous gas will rise only slowly before 1985 or 1987, though imports and "new" indigenous gas will tend to pull up the price. As you know, I have been taking a number of initiatives to press the United States and Canada to move more rapidly to economic pricing principles.

Canadian and Scandinavian electricity prices are much lower than our own. This is because such a high proportion (three quarters or more) of their electricity comes from cheap hydro-electric sources. The same applied to a lesser strip-mined coal helps keep down electricity prices. There is no way we can hope to compete with such countries on electrictiy costs.

So far as comparison with our European Community partners is concerned the BPBIF presents no strong evidence to show that there is any substantial price differential. But I have told them that if they believe they can identify clear cases of price distortion elsewhere in Europe, they should work with the fuel supply industries to produce hard evidence so that the Government can act quickly. And, as you know, following January's NEDC meeting a task force including NEDO, CBI, TUC, Government and nationalised energy industry representatives has been set up to narrow down remaining differences of view on international price relativities. I understand that discussions with the BPBIF are planned.

Yours ever

David

D A R HOWELL

Mr. Sanders.

10 DOWNING STREET

From the Press Secretary

TM to see
MS 12/2

9 February, 1981

Dear Ian,

It is perfectly clear that none of us is happy with the way that fuel price increases are announced - or, for that matter, many other nationalised industry prices. But gas and electricity prices present a particular difficulty because of the consultative process.

I think it is fair to say that we have improved on last year's debacle but we still do not have the presentation under our control. The projected increases, subject to consultation, are still presented on the most disadvantageous terms by either the industry or the consumer lobby.

I wonder whether there is any possibility of trying to ensure for next year that once the Gas Corporation and Electricity Council have taken decisions - and preferably they might do it on the same day - they could immediately make their announcements, making it clear that the price increases are subject to consultation.

In my view we need to take far firmer control over presentation, if that is possible. In practice, we are working towards it. But can we make the final jump and cut the ground from under the feet of the industries and the consumer lobbies and get the price proposals announced immediately the basic decisions are taken? I don't see why we shouldn't. After all, your Department, as representative of Government, is their banker.

These points are, of course, over and above those made by the Secretary of State for Industry in his letter to your Secretary of State of February 5.

I am copying to the Chancellor of the Duchy.

Yours ever,
Bernard

B. INGHAM

Ian Gillis, Esq.,
Director of Information,
Dept. of Energy

Nat Ind.

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SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

The Rt Hon Leon Brittan QC MP
Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
LONDON
SW1P 3HE

6 February 1981

SCOTTISH ELECTRICITY BOARDS - TARIFF INCREASES FROM APRIL 1981

I have seen a copy of David Howell's letter to you of 21 January about the tariff increases recommended by the Electricity Council and I am now in a position to provide information about the Scottish Electricity Boards' intentions in this area.

As you will be aware, the Scottish Boards, in common with the rest of the electricity supply industry, are experiencing falling demand at present and are in addition faced with the problem of a large excess of generating capacity. In these circumstances the Boards have concluded that it makes commercial sense for them to avoid taking any action which would aggravate the problem of falling demand. They are also strongly motivated by a desire not to add unnecessarily to the financial pressures on their consumers in this period of recession. The Chairmen have therefore decided, subject to ratification of their proposals by the Boards, to hold their average tariff increase this year to 11%, which is as low as they can go without running the risk of breaching their combined EFL for 1981/82. Because of differences in the method of forecasting fuel cost increases, industrial and domestic tariffs in Scotland have not got out of line with each other over the past year to anything like the same extent as they have in England and Wales and the Boards' intention is that the increases for all the main tariff groups, once fuel cost adjustments have worked their way through, should be broadly similar.

I should perhaps explain why it is that the Boards are now proposing an 11% average tariff increase when the EFLs for 1981/82 were set on the basis of a forecast 12% tariff increase. The EFL discussion coincided with the early stages of the Boards' process of revising load forecasts in preparation for the updating of their financial forecasts for this year's Investment and Financing Review. It was therefore necessary for the Boards to estimate their financing requirements for 1981/82 on the basis of figures prepared for last

year's IFR which were about a year out of date when the EFLs were set. Subsequent work on up to date figures had demonstrated that the tariff increase need not be so large as had been anticipated towards the end of last year.

I expect that the Boards will finalise their proposals at meetings later this month following discussions with their Consultative Councils, which are at present in hand.

I am copying this letter to the Prime Minister, Geoffrey Howe, David Howell, Keith Joseph, Francis Pym, Nicholas Edwards and Sir Robert Armstrong.

GEORGE YOUNGER

JU

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
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Secretary of State for Industry

5 February 1981

The Rt Hon D A R Howell MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
London SW1P 4QJ

Dear David,

Thank you for your letter of 21 January to Leon Brittan about the proposed electricity price increases.

2 You are aware of the indignation felt by industry about recent trends in electricity prices. I think, therefore, the electricity industry needs to present the increases now proposed with considerably more care and tact than was apparent in the Electricity Council's recent announcement of its recommendations in the press. Perhaps it would be helpful if some thought were given to the following presentational points before a firm announcement of the price increases is made.

3 It should be explained why the increase (with fuel cost adjustments) to industry in 1981/82 is expected to be higher than the increase to domestic consumers. It should also be made clear whether the increases make any concessions at all to the high load factor users, whose disadvantage in respect of electricity costs was a matter of general agreement in the January NEDC. The Task Force will of course report on this subject at the March NEDC, just prior to the price increases.

4 The industry (and to some extent the Government) should be prepared to justify those cost increases which are leading to the proposed price increases, bearing in mind that many industrial consumers are convinced that part of the reason for electricity price increases is that the electricity supply industry is covering its fixed costs in a declining market - an option which is not open to any industry facing international competition - in order to meet its external financing limit.

5 The Government should also be prepared to meet the criticism that, in a recession, it is unreasonable for nationalised industries to put up prices to meet the same financial targets as in more favourable trading circumstances when private industry is making much lower returns.

6 I am copying this letter to the recipients of yours.

Yours ever,
Keith

Nat Industries

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
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Rt Hon Leon Brittan QC MP
Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
LONDON
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21 January 1981

Dear Leon

ELECTRICITY PRICE INCREASES - APRIL 1981

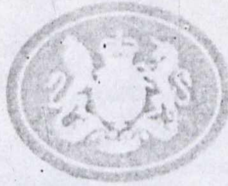
When I wrote to John Biffen on 21 November in the context of the industry's 1981/82 EFL I indicated that the Electricity Council were proceeding on the basis of an average tariff increase from 1 April 1981 of about 12%. The Council has now confirmed that it has recommended an average increase of 13% to Area Boards.

This overall average is made up of an average increase of just over 11% to quarterly billed (mostly domestic) consumers and a basic 8% for monthly billed (mainly industrial) consumers. Plus a further amount, estimated at around 7% over the year, resulting from fuel cost adjustment. This difference results from the industry's over-estimate of its 1980/81 fuel costs, to which I have referred in previous correspondence. In consequence average prices to quarterly billed (domestic) consumers have increased by some 29% in the past year. This compares with an increase of under 25% to industrial consumers whose prices are adjusted monthly in line with the movement in fuel costs.

These figures are not yet firm as they are still under consideration by the Electricity Council; but I understand they are unlikely to change significantly. Nevertheless the industry maintains that even with these increases achievement of their - £210m EFL remains difficult.

As you know Area Boards have a statutory duty to put tariff proposals to their Consultative Councils at which point they will be made public. For implementation of the revised tariffs from 1 April these consultations have to start very shortly. I

/understand...



understand - though this is still to be confirmed - that the first consultation meeting will be held on 22 January. The Council intends to issue a press statement to pre-empt damaging leaks.

I am copying this letter to the Prime Minister, Geoffrey Howe, Keith Joseph, Francis Pym, George Younger, Nicholas Edwards and Sir Robert Armstrong.

Yours ever

David

D A R Howell

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Treasury Chambers, Parliament Street, SW1P 3AG
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15 January 1981

The Rt. Hon. David Howell MP
Secretary of State for Energy

Dear David

GAS LEVY BILL

Thank you for your letter of 5 January in which you register three concerns on the points in my letter of 22 December. Taking these in turn:

(i) Since BGC's profit figures are optimistic and uncertain, I agree that their post levy target should be expressed as the rounded 3½ per cent, rather than 3.7 per cent. But it should be understood that this does not imply Treasury agreement now to any changes in the underlying profit and external financing figures which will be used in preparing the next White Paper on Public Expenditure. These will be considered again in the next Investment and Financing Review.

(ii) I note that you wish to reserve your position on the potential impact of the new oil tax on BGC. We can consider its consequences for BGC's EFL and the levy rate in the light of officials' advice on the application of the new tax to gas.

(iii) It is disappointing that you are not prepared to include in the Gas Levy Bill powers to enable the removal of BGC's cash surpluses. While the application of the levy will reduce BGC's cash surpluses for the next few years, this is not the levy's principle purpose, and there can be no certainty that a proper rate of levy would always cream off surplus cash. Nor would it seem likely, as you suggest, that the presence of the cash claw back powers in the Bill would confuse presentation of the purpose of the levy itself. The levy is directed at BGC's economic rent derived from the

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speical circumstances of the PRT exempt contracts, whereas a power over cash surpluses would have been directed at the more general question of dealing with nationlised industries which generate surpluses over time.

Nonetheless, provided that you are convinced that the application of an appropriate level of levy will, over the next few years, remove the prospect of BGC building up semi-permanent cash surpluses, I will not press for claw back powers to be included in the present Bill. However, I believe that such powers should be taken the next time there is general BGC financial legislation. Indeed, we might have to propose legislation for claw back powers before then if BGC started to amass substantial cash surpluses which could not be dealt with by the Levy powers.

I am copying this letter to the Prime Minister, members of E Committee and to Sir Robert Armstrong.

GEOFFREY HOWE

jfh

bc Mr Wolfson
Mr Hoskyns
Mr. Ingham
Mr Walters

SUBJECT

10 DOWNING STREET

From the Private Secretary

13 January 1981

Energy Prices

As you know, the Prime Minister held a meeting yesterday afternoon with your Secretary of State and the Chancellor of the Exchequer to discuss energy prices. They had before them your Secretary of State's minute of 31 December.

Mr. Howell outlined the various possibilities which he had been looking at to provide some relief to industry on energy prices (as set out in his minute). Options (i), (iii) and (iv) - which would involve certain concessions to bulk users of gas and electricity and somewhat greater flexibility in the application of electricity tariffs generally - would bring a minor but immediate easing of prices charged to some users. The other three options - involving an across the board cut in gas and electricity prices and the possible reduction of the heavy fuel oil duty - would be more radical and more expensive. In the case of the electricity bulk supply tariff option, the electricity boards were already providing some improvements in their charging policies; but he was very keen to see this option and at least some of the others pursued further. On the other hand, he was well aware of the adverse PSBR implications of pursuing the more expensive options - although in the case of the fuel oil duty, making no concession would be very hard to justify given the existence of North Sea oil.

The Chancellor said that there had been a good discussion in NEDC at the meeting held the previous week. There had been general agreement that the problems faced by British industry in regard to energy prices, compared with their competitors overseas, related almost entirely to bulk use of gas and electricity and the heavy fuel oil price (although in the last few months the latter had fallen below fuel oil prices in Europe). He was quite content for options (i), (iii) and (iv) to be pursued, and to the extent that these would have implications for the PSBR, he would be prepared to look constructively at them. Option (vi) - reducing fuel oil duty - was an option for the Budget, and he would be prepared to consider it seriously. Officials in the Treasury and your Department were already looking at this. One aspect which would have to be considered carefully was the arrangement whereby, under the Frigg contract, part of any concession would involve payment overseas to Norway and to the French companies operating the Frigg field. As for the possibilities of

/across

across the board price reductions, he did not think these would be justified.

Summing up a brief discussion, the Prime Minister said that your Department should pursue options (i), (iii) and (iv) urgently; indeed, they should be pressed to the limit of what could be justified commercially and, in the case of electricity, in terms of the constraints imposed by the Electricity Acts. Options (ii) and (v) should not be pursued further at this stage; the Treasury and your Department should continue their examination of the fuel oil duty option with a view to a decision prior to the Budget. In view of the consensus they had reached, it did not seem necessary to discuss the proposals further in E Committee.

I am sending copies of this letter to John Wiggins (HM Treasury), Ian Ellison (Department of Industry), David Wright (Cabinet Office) and also John Craig (Welsh Office).

T. P. LANKESTER

Julian West, Esq.,
Department of Energy.

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PS/CHIEF SECRETARY

cc Principal Private Secretary
PS/Financial Secretary
PS/Minister of State (C)
PS/Minister of State (L)
PS/Sir Douglas Wass
Mr Burns
Sir Kenneth Couzens
Sir Anthony Rawlinson
Mr Ryrie
Mr Middleton
Mr Bridgeman
Mr Britton
Mr Evans
Mr Monck
Mr Unwin
Mr Collinson
Mrs Gilmore
Mr Riley
Mr Turnbull
Mr Ward
Mr Denham
Mr Ridley
Mr Cardona
Mr Wright B/E
GECS

MONTHLY NOTE FOR THE PM ON THE CGBR IN DECEMBER AND 1980-81

I attach a copy of a note which the Chancellor sent to the Prime Minister on Friday night, together with the monthly note on the CGBR. The outturn in December to be published today - was disappointing and has led to an upward revision to the PSBR expected for the year.

MPB

PATRICIA BROWN
12 January 1981

PRIME MINISTER

CGBR in December and Prospects for the rest of 1980-81

I am afraid that December's figure for the CGBR brings more bad news. The number which I have learned today and will be published on Monday is £2.3 billion. This follows £2.8 billion in November and is bound to be a shock. One implication is that the money figures for banking January - to be published in February and the last working figures before the Budget - are unlikely to show a reduction in the underlying rate of monetary growth.

We are pressing the revenue departments to get all the money they can to the Consolidated Fund, and the Bank to maximise gilt sales; we have till 21 January before the banking month ends (though Monday's figure will not make the Bank's task easier). There will also be some help from the raising of the ceiling on holdings of the 19th issue of national savings certificates on 14 January.

The enclosed note sets out the main reasons why the December CGBR has turned out so much worse than expected. It also gives a new appraisal of the PSBR as a whole for the year to end March - over £13 billion - in the light of it.

I went into this with officials on Friday afternoon and evening, probing the reliability of the latest assessment.

On the revenue side, the experts in both revenue departments hold to their present forecasts for the financial year, despite the shortfalls in December.

On departmental expenditure, the latest figures confirm the problems which we already know about defence and the costs of employment/unemployment. There do not appear to be any new problems.

/Finally,

Finally, I am, of course, stepping up the effort that is already being made to rectify the deficiencies revealed by these forecasts.

9 January 1981

THE PROFILE OF THE CENTRAL GOVERNMENT BORROWING REQUIREMENT (CGBR) TO END MARCH AND THE PUBLIC SECTOR BORROWING REQUIREMENT (PSBR) FOR 1980-81: NOTE OF JANUARY 1981

A. Outturn of the CGBR in December

The provisional outturn of the CGBR in December, at £2,311 million, is seriously above the forecast of £1,450 million made at the beginning of the month. The outturn will be published on 12 January. Table 1 compares the outturn in December with the forecast made in Table 3 of last month's note.

2. A shortfall in receipts by Inland Revenue and Customs and Excise accounted for £500 million of this difference. About £400 million of the shortfall of £497 million shown next in the table had no implication for the CGBR: various receipts had not been transferred by the end of the month to the Consolidated Fund from other funds and accounts masking a shortfall in that line, which is explained below.

3. On expenditure, Supply Issues were just over £100 million above forecast. Issues for the Ministry of Defence did not fall £50 million as assumed; and the surge in expenditure under the temporary short term working compensation scheme meant that issues to finance it were some £50 million more than had been assumed. This is part of the extra finance that it is now known will be needed for the rest of the year. Local authorities continued to borrow heavily from central government in December (an indication of their total borrowing will be available shortly). In the last section of the table - other funds and accounts - a shortfall of about £100 million is masked, as described in the previous paragraph, by receipts not yet transferred to the Consolidated Fund. Two factors account for much of this. Interest liabilities of national savings rose more than had been allowed for and interest receipts from the Exchange Equalisation Account were below the path interpolated from the forecast for the year.

4. The first instalment of the refunds from the EC under the 30 May agreement, amounting to £98 million, was received as expected. The money was drawn from the EC balance at the Paymaster General's office.

5. The outturn of the CGBR in the December banking month (20 November to 10 December) at £1,890 million (£610 million after seasonal adjustment), had been £120 million below forecast. Almost all of this gain had been due to high Inland Revenue receipts in the early days of December. Thus, all the deterioration in calendar December, compared with the forecast, came after 10 December.

B. Rolling forecast for CGBR in banking - January

6. Banking January runs from 11 December to 21 January. For the period up to 31 December the CGBR was £1,770 million and the current figure for the banking month as a whole is a net repayment of £160 million, in both cases before seasonal adjustment. Banking January contains the annual peaks of receipts of mainstream corporation tax and Schedule D income tax and the quarterly peak of VAT receipts. After seasonal adjustment, therefore, the small surplus becomes a large borrowing requirement of £1,850 million.

C. Rolling forecast for CGBR in January - March and the whole year

7. With two successive months when the outturn of the CGBR has been significantly over the forecast, the latest estimate for the year as a whole, at £12,850 million, is over £2 billion higher than the CGBR forecast implicit in the Industry Act forecast of the PSBR published on 24 November. Most, though not at all of this raises the PSBR now expected.

8. Since November, Inland Revenue and Customs and Excise have each reduced their forecast of receipts for the year by £0.4 billion. In the case of Inland Revenue the subsequent shortfall in December absorbed much of this. Customs have, in effect, taken account of

monthly shortfalls between forecast and actual so far but assumed their previous forecast will be valid in coming months. The question is how far the recent shortfalls reflect a misjudgement of the trend or (especially in the case of Inland Revenue) of the timing effects of the long Christmas break.

9. On the expenditure side, the forecast of Supply Issues has increased by £0.4 billion. This allows for defence expenditure to be about £500 million above the revised cash limit and reflects the extra provision for special employment measures. The unemployment situation has also led to a reappraisal of the speed of run down of the Redundancy Fund. The mis-forecast in respect of national savings interest in December is (pending further enquiry) assumed to have affected also previous forecasts for the remaining months of the year.

10. Extra net lending from the National Loans Fund of £0.5 billion is now expected to both local authorities and public corporations, but in both cases this is expected to be a switch in the sources of their finance and not an increase in their total borrowing or the PSBR.

11. Some of these excesses were allowed for in last month's note. The latest forecasts for January to March are as follows:

	£ million
January	- 850 (net repayment)
February	1,050
March	- 400 (net repayment)

12. Table 2 sets out the CGBR outturn since A pril 1979 together with the new forecasts to the end of the financial year. The cumulative excess over last year of the CGBR rose to £2.9 billion by the end of ~~the year~~ December and is now forecast to reach £4.6 billion by the end of March.

13. The net repayment in January is smaller than previously

forecast, as a direct consequence of the latest view of the outturn for the whole year. In particular, the important changes are a reduction in Inland Revenue receipts, an increase in Supply Issues and an increase in net lending. The January surplus is below that of a year ago; receipts are forecast to be a little higher than last January whereas expenditure is considerably higher, partly because of the large payments due under Rate Support Grant Increase Orders. The latter should have an effect on what local authorities borrow. The second instalment of the EC refunds under the 30 May agreement is expected in the month and it is assumed that this will necessitate a transfer of £100 million across the exchanges from the EC.

14. The figure for February shows a slightly smaller borrowing requirement than was previously thought likely. This is due to a reduction in the forecast of net lending.

15. The forecast for March is a repayment of £400 million. This is larger than last March's repayment primarily because of the growth in petroleum revenue tax. PRT receipts of nearly £1,500 million are expected this year compared with £700 million in March last year. As last year, receipts by BNOC of advance payments for oil will bring in around £600 million which would otherwise have been received in 1981-82. Further receipts from the EC under the 30 May agreement are expected in March bringing total receipts for the year of £680 million. Of this £120 million has been assumed to be funded by a reduction in the balance on the EC account with the Paymaster General's office.

D. Forecast of the PSBR for 1980-81

16. Most of the upward revisions to the CGBR carry through to the PSBR. The forecast outturn for 1980-81 is now put at around £13¼ billion. This is some £1¾ billion higher than published in the Industry Act forecast on 24 November. Since then there has been no change in the view of total borrowing by local authorities or by public corporations although (as noted in para 10) both are now

expected to borrow more from central government than previously thought likely.

17. The new forecast outturn of £13¼ billion is above the Winter economic forecast of £12¾ billion. The larger figure reflects the consequences of the higher than expected CGBR in December. The major components of the PSBR are now forecast as follows:

	Industry Act[1)]	Latest Forecast	£ billion
CGBR	10½	12¾	
CG borrowing for own account	6	7¾	
Local authorities' borrowing requirement	2¼	2¼	
Public corporation's' borrowing requirement	3¼	3¼	
FSBR	11½	13¼	

1) Only the total for the PSBR was published.

18. Even at this stage of the year, there is a substantial margin of error around these estimates. Further updating of the forecast outturn for 1980-81 will take place before the Budget estimates are published.

TABLE 1

CENTRAL GOVERNMENT BORROWING REQUIREMENT - DECEMBER

£ million

	Forecast	Outturn	Effect on CGBR
RECEIPTS			
Consolidated Fund			
Inland Revenue	2,350	2,047	-303
Customs and Excise	1,700	1,498	-202
Other	1,350	853	-497
National Loans Fund			
Interest etc receipts	350	349	- 1
Total receipts	5,750	4,747	-1,003
EXPENDITURE			
Consolidated Fund			
Supply services and Contingencies Fund	5,600	5,716	-116
Other	300	235	+ 65
National Loans Fund			
Service of the national debt	500	439	+ 61
Net lending	100	248	-148
Total expenditure	6,500	6,638	-138
Other funds and accounts	-700	-420	+280
(of which: changes in the European Community's balance at PGO)	(-76)	(-91)	
CGBR	-1,450	-2,311	-861

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TABLE 2

CENTRAL GOVERNMENT BORROWING REQUIREMENT

£ billion

			Cumulative		
	1979-80	1980-81	1979-80	1980-81	Difference
April	1.3	0.9	1.3	0.9	-0.4
May	1.5	2.4	2.8	3.3	+0.5
June	1.0	1.3	3.8	4.6	+0.8
July	-	0.8	3.8	5.4	+1.6
August	1.1	1.6	4.9	7.0	+2.1
September	1.7	0.8	6.6	7.8	+1.2
October	0.1	0.1	6.8	8.0	+1.2
November	1.8	2.8	8.6	10.7	+2.2
December	1.6	2.3	10.2	13.1	+2.9
January	-2.5	(-0.9)	7.7	(12.2)	(+4.4)
February	0.3	(1.1)	8.1	(13.2)	(+5.1)
March	0.2	(-0.4)	8.2	(12.8)	(+4.6)

Note: Some rows may not across add because of rounding. Each column is correctly rounded.

TABLE 3

CENTRAL GOVERNMENT BORROWING REQUIREMENT

£ million

	(1) April - December	(2) January Forecast	(3) February Forecast	(4) March Forecast	(5) Whole Year	(6) Budget Forecast for whole Year.
Receipts						
Consolidated Fund						
Inland Revenue	21,480	5,050	2,850	3,750	33,150	32,860
Customs and Excise	16,181	2,550	1,750	1,800	22,300	24,000
Other	6,003	1,250	1,000	1,950	10,200	8,555
National Loans Fund						
Interest etc receipts	3,552	200	300	900	4,950	5,050
Total receipts	47,216	9,050	5,950	8,400	70,600	70,465
Expenditure						
Consolidated Fund						
Supply services	48,458	6,250	5,950	6,650	67,300	64,765
Other	2,258	350	300	300	3,200	3,460
National Loans Fund						
Service of the national debt	6,858	1,450	650	1,050	10,000	10,000
Net lending	3,111	150	250	50	3,550	2,905
Total expenditure	60,685	8,200	7,150	8,000	84,050	81,130
Other funds and accounts (of which: changes in the European Community's balance at PGO)	+410 (-100)	- (+11)	+150 (+121)	- (-149)	+600 (-117)	+1,352
CGBR	-13,059	+850	-1,050	+400	-12,850	-9,313

Note: some rows and columns may not add due to rounding

Qa 05217 CONFIDENTIAL

To: MR LANKESTER

From: J R IBBS

ENERGY PRICES

Background

1. I understand that the Prime Minister is to discuss Energy Prices with some of her colleagues on Monday. You may find the following notes helpful in that they highlight in simple terms some of the main points at issue.

2. At this week's NEDC discussion on industrial energy costs the CBI made it clear that they were not advocating a general relaxation from the principles of economic pricing of energy; their case was the more limited one that British Industry should not be disadvantaged on energy costs vis-a-vis its competitors in Europe. The papers prepared for the NEDC showed that in general while UK prices were not out of line, there were three particular areas of concern -

- electricity prices to the large consumer;
- firm gas prices in certain instances; and
- fuel oil prices during the first nine months of 1980 including the level of duty.

It was agreed at the NEDC meeting to set up a small task force with representatives from all sides to investigate claims and counterclaims and report back definitively on their substance for the March NEDC meeting

3. The Secretary of State for Energy has already implemented some measures aimed at alleviating these areas - on electricity he has asked the area boards to be more flexible within the limits already open to them, and the Bulk supply tariff is also

being reviewed by the CEGB; on gas he asked BGC to reduce the price for new contracts; market forces have made the fuel oil disparity disappear at least for the moment. Overall, energy costs are reported to be only 4 or 5% of Industry's total costs. In so far as special assistance is provided it is important that it should be concentrated where it will make a difference, i.e. on users for whom energy is a substantial proportion of total costs (some may be quite small companies and so not be regarded as large consumers).

Disparities already clearly established.

4. On the evidence produced so far the price of electricity to large consumers and the level of fuel oil duty do seem to result in British industry being disadvantaged. In the period before the NEDC report in March the CPRS suggest that the Department of Energy might, as well as ensuring that the review of the Bulk supply tariff is completed as soon as possible, clarify whether the price to large consumers of electricity could be substantially decreased without contravening the statutory requirement that the electricity supply industry shall not discriminate; prices on the continent are more tilted in favour of the large consumer - is this discrimination or just a proper way in which the market should work? On the question of fuel oil duty, doubtless the Chancellor is giving consideration to the level of this in his deliberations for the Budget.

The domestic/industrial price balance.

5. Perhaps the most striking difference in comparing UK energy prices in general with the continent is the substantial under-pricing of the domestic vis-a-vis the industrial market, particularly in respect of gas. However, the CPRS would support the Secretary of State for Energy in his judgement expressed in his minute of 7 January to the Secretary of State for Wales, that the current policy of an annual 10% real increase in domestic prices to redress this imbalance probably runs pretty close

to the limits of public acceptability. It is of course, important to ensure, so far as the balance is concerned, that the effect of this is not being offset by similar price increases to industrial users.

The U.S. energy price advantage.

6. Pricing parity with European competitors in the industrial sector would, still leave a substantial unfavourable differential for industry when compared to the USA. Whilst Europe cannot hope to match the USA's huge cost advantages that come from cheap coal resources, the slow rate of de-regulation particularly of gas prices, contributes greatly to the substantial under-pricing of products that is causing damage, for example to our textile and chemical industries. The CPRS believes that Mr Reagan's administration should be exhorted to give high priority to much more rapid deregulation of gas prices.

Energy Conservation.

7. The present cash flow pressures on the manufacturing sector mean that what funds are available are directed by industry to primary strategic investment rather that to energy conservation measures which even with a good return often appear to companies to be of secondary importance. Ministers might like to consider whether further incentives (financial or otherwise) to industry for conservation could be justified.

8. I am sending a copy of this Minute to Sir Robert Armstrong.

VR

9 January 1981

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Ref. A03951

PRIME MINISTER

Energy Prices

You are to have a discussion on 12th January with the Chancellor of the Exchequer and Mr. Howell on energy prices. This meeting will both continue the discussion you had with them and others before Christmas and will set the scene for discussion in E later in the month when Mr. Howell is due to bring forward a general paper on energy prices.

2. The basic text for the meeting is Mr. Howell's minute to you of 31st December. In this, and in the papers he has been submitting to the NEDC (notably NEDC(80) 84 on industrial energy pricing), Mr. Howell is effectively saying that much (though not all) of the case industry makes (that United Kingdom energy prices are excessive when compared with those of our competitors) has crumbled away on examination; that nevertheless there are points of difficulty for particular industries which he is doing his best, with the energy industries, to meet; and that broader measures of relief on energy prices would be very costly in PSBR terms, inefficient as a means of bringing short-term help to industries in recession, and damaging to the Government's long-term interests.

3. The basic issue is whether the Government can or should spend (or forgo) sums of money running into hundreds of millions of pounds in order to provide British industry with cheaper energy. If not, there is probably little option but to back Mr. Howell's present actions, designed to provide relief where detailed work shows that a particular industry or firm has a case, but to avoid generalised relief. If on the other hand your judgment is that colleagues would be prepared to see substantial sums spent on reducing energy prices, then the questions become how can this best be done and how quickly? These questions will be of particular significance to the Chancellor who is already deeply involved in preparing the March Budget and needs to know whether he is to contemplate action on the fuel oil duty and whether he needs to modify his assumptions about the financing of the nationalised energy industries in the year ahead.

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4. If Ministers conclude against any generalised relief, it will be the more important to consider what can be done to influence energy pricing policies in other countries with a view to improving the competitive position of British industry. Although industry's case against current United Kingdom energy prices as compared with those in Europe has, for the most part, proved weak, the case to be made against United States energy pricing is strong. Some action is already in hand through the EC but colleagues will need to decide whether, and if so, how the pressure can be kept up or intensified once Mr. Reagan has taken over. This will need to be viewed in the general context of our relations with the incoming Administration and the likelihood of mustering effective support from our European partners.

5. The case for and extent of help to industry on energy prices needs to be considered in relation to other possibilities for action by Government to ease the problems of industry. If it were thought that relief for industry's problems might come through an easing of the pressures of the exchange rate and of interest rates, or by other measures which the Chancellor may have in mind for the Budget, Ministers might think that extra general help through energy prices was not worth the longer-term costs inevitably associated with such action.

6. You may want to press Mr. Howell further on the scope for putting pressure on the nationalised energy industries to increase their efficiency. They are largely immune from the pressures of competition, but there are possibilities: for instance, would there be anything to be said for enabling companies that produce gas from the North Sea to supply large customers direct rather than through the BGC (paying the BGC an appropriate tariff for the use of BGC transmission facilities, if need be)?

7. Is there scope for the Government to do more by way of encouraging industry to reduce its energy consumption? In the field of energy conservation, there are still many worthwhile investments to be made, and too many firms do not appear to have grasped (or perhaps feel able to afford) the potential benefit to themselves from cutting their energy bills. If there is to be no generalised relief on energy prices to industry, would there be political and economic

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advantage in spending limited extra amounts of Government money on the encouragement of energy conservation measures in industry which would benefit both the firms concerned and the economy generally?

RtA

ROBERT ARMSTRONG

9th January, 1981

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MJS
8/1

01-211-6402

The Rt Hon Nicholas Edwards MP
Secretary of State for Wales
Welsh Office
Gwydyr House
Whitehall
London SW1A 2ER

7 January 1981

Dear Secretary of State,

Thank you for your letter of 15 December. The delay in sending a further reply to your November letter was in part caused by a misunderstanding, at official level. My officials expected further detailed background to some of the individual cases from the Welsh Office, whereas the Welsh Office was expecting further contact before providing additional material where needed. This reply also takes into account your three subsequent letters on individual companies.

I welcome your support for the long-term objectives and the principles underlying our present energy policy, but I must reiterate that I consider economic energy pricing as fundamental to that policy.

This means that the energy industries should charge at levels which reflect the long run cost of supply. It also means that they should take into account short and medium run market factors.

For most of UK industry, energy costs are not large, being 4-5% of total industrial costs, and, further our evidence shows that, as a whole, industrial energy prices here are not out of line with our European competitors. As I said in my previous letter it is a case of identifying and considering how we can help those energy intensive companies now in financial trouble which have a viable future once the recession is over. But the possibility of such help must be viewed within a general industrial policy framework: there are many companies in financial trouble for whom energy costs are of small concern.

Turning to your comments on the papers for 'E' Committee, we may be fortunate in our energy resources, but we are not rich in cheap resources, and we have limited reserves of oil and gas. We must not fritter away those resources. Both the US and to a lesser extent Canada have realised that they must price their oil more realistically and the Netherlands has gone to great lengths to raise her gas prices both at home and abroad to market levels. You may be right

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in saying that progress in eliminating the worst unfair competition will not be swift, but I do not think this is sufficient reason to reverse our policies and suffer the longer term consequences of fast depletion of our resources, and reduced incentive to develop alternatives.

I note that you say our coal prices are based as much on socio-economic requirements as the world market price, but this is not correct. The NCB's customers are not constrained by socio-economic considerations to take Board coal and the NCB therefore has to take account of the prices of competing fuels, including coal imports, when setting its prices. You question in particular my point that most NCB coal delivered to CEGB power stations is competitive with imported coal. The Commission's data in table E1 (Annex 3 of E(80)120) showing low prices for coal imported to Denmark, Italy and the Netherlands is suspect in quality and the latest figure given is for January 1980. Coal import prices have risen substantially over the last two years from about $40 per tonne c.i.f. Roterdam at the beginning of 1979 to over $50 per tonne in early 1980 and over $60 per tonne currently. At present, NCB steam coal prices are competitive on a delivered cost basis with imported coal except at plants close to purpose-built importing facilities, such as Thamesside power stations. The NCB also supplies coking coal to the BSC on a competitive basis; the Board and Corporation have recently concluded a new long-term contract under which NCB prices are aligned to world levels.

For electricity, the estimates of the current level of long run marginal cost of electricity supply are based on the cost of fossil fuels because at present, and indeed for some considerable time to come, the marginal unit of electricity is generated by fossil fuel fired power stations. Of course, as the nuclear programme develops this situation should change and we would expect to see the marginal cost of production fall as nuclear reaches the margin. But the esi would not even be covering its short term marginal costs if prices were based now on current estimates of the costs of nuclear generation. Such a policy would require substantial and continuing Exchequer subsidies.

You and Keith Joseph have both suggested that we might consider the possibility of increasing domestic gas prices faster if this enables us to hold down gas prices to industry. In my letter to Keith, I commented that we would have to think very carefully about urging BGC to put up domestic prices faster. Is this really what industry wants when it comes to negotiating with its workers on pay? Is it what we want? Domestic gas prices have increased by nearly 30 per cent in money terms this year alone, with the prospect of a further 25% increase next year. I think myself that this runs pretty close to the limits of public acceptability. As for intending to hold down industrial prices in general, I mentioned that it would be a departure from the pricing principles agreed with British Gas whereby they relate the price of gas (though by no means fully) to the alternative oil fuel. This approach rests on market forces, and if the Government wished BGC to move away from this it would mean a high level of intervention

in the management of a nationalised industry with Government being held directly responsible for pricing with all its attendant pressures. We would also be moving contrary to price trends all over Europe.

Energy prices are clearly considerably lower in the United States than in Europe. I believe that most representations make comparisons with Europe rather than with the US partly, as you say, because these comparisons are more relevant to many industries, but also because industry accepts that we cannot afford to price our energy at North American levels. But they do expect competitive pricing, and therefore see European prices as a correct comparison. This said, companies in sectors such as chemicals and textiles are rightly extremely concerned about the impact of competition from North America. Where this stems from underpricing we must attack as we are doing through the IEA by proposing the adoption of economic energy pricing principles, and through the EC by encouraging concerted action against the slow deregulation of US gas prices. However, North America also has natural cost advantages through its vast coal resources and hydro-electric power. We cannot match their industrial coal and electricity prices without vast continuing subsidies.

This brings me to an important point which you yourself raise on the future of energy intensive industries. We cannot automatically assume that some of our energy intensive industries in present difficulty during the recession will share in a general economic recovery. As the world economy recovers from the recession, there is likely to be an increased pressure on limited energy resources, and energy costs will remain high. You will recall that Bowaters took the commercial decision to close the Ellesmere Port plant despite offers of substantial Government assistance towards an investment programme which we thought could make the plant profitable once more. North America's natural cost advantages in coal and electricity supplies was not the only factor involved here, of course, but it was sufficiently important in the eyes of Bowaters' management for them to demand a considerable and continuing energy cost subsidy if they were to keep the plant open. Government assistance in restructuring and modernising some companies is a worthwhile use of limited resources, but we cannot open-endedly support operating costs; the penalty would have to be paid elsewhere in the economy. We clearly have to be selective in our support, and if as you say, other EC countries appear to be supporting their energy intensive industries, we need clear evidence before we consider action.

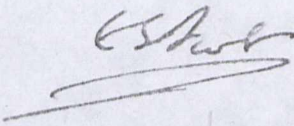
The question of offering 'bridging' help to specific companies should be raised at the forthcoming 'E' Committee meeting. Apart from the problem of finding the money, identification of the most deserving recipients does not lie within my Department's expertise, and, as I mentioned above, there are many other companies without energy cost problems in grave financial trouble. Two of Keith Joseph's proposals in his letter of 8 December are limited to actions which might be taken by the energy industries across the board. The third concerns a reduction in HFO duty at which I am also looking. But direct Government action to rescue certain

companies is a different matter.

I hope that the attached comments on the particular cases which you have raised are helpful.

I am copying this letter to recipients of yours.

Yours sincerely,



pp D A R HOWELL

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

ANNEX

Dealing first with the losses currently being incurred by the CEGB on their contract with Anglesey Aluminium, the figure I quoted of £30 million pa is indeed an estimate based on the difference between the price Anglesey Aluminium is currently paying for its power and the price that the company would have been paying if the power was being supplied at present Bulk Supply Tariff rates which reflect the present marginal costs of production. The comparison also takes into account Anglesey Aluminium's demand pattern, with a relatively high proportion of units taken at the low night rate, and does reflect the rate they would be quoted today as a major bulk user.

On your recent trip to the US, Kaiser Aluminium, the parent company, told you of its interest in the possibility of purchasing CEGB generating plant, in considering an expansion of its UK operations. To my knowledge, this has not been pursued far, but I understand that Airco are providing input for a study commissioned by the Department of Industry into the feasibility of private electricity generation.

But private generation is clearly not an option for the vast majority of companies. It is therefore important that they should discuss existing flexibilities within the esi tariff structure with their area boards. I understand, for instance, that Alcoa have not made any representations to either the South Wales Board or the Electricity Council about their prices!

On 19 December, however, the South Wales Board did receive a letter requesting a meeting following notice to Alcoa that their contract price would be revised from 1 April, 1981. I hope that this meeting proves useful. The Electricity Council have given us examples of specific assistance recently offered in Wales following discussion with companies. Reductions in nominated supply capacity have resulted in savings to two firms of £12,000 and £75,000; transfer to an alternative available published tariff produced savings of £9,500 pa; and special rates were offered for a 12 MW load to be supplied over the Christmas/New Year holiday. In general, load management terms are being extended to a greater range of industrial consumers. The local area boards are offering a positive service.

I would very much like to hear how Alcoa's gas contract negotiations develop. It would also be interesting to see the background figures to the comparative information Alcoa and Duport gave you, as it is important to compare like with like. Clearly the length of a contract, the date signed and its terms, eg interruptibility of supply, are important. Electricity prices are significantly affected by voltage, load factor, load management, pattern of daily and seasonal demand etc. In France, for instance, it is quite likely that a large, high-load factor electricity consumer could have a lower electricity bill than in the UK, because of the high proportion of nuclear and hydro-electric plant in France compared to the UK. But I am surprised that Alcoa is paying less for their electricity in the Netherlands; generally electricity

prices to large users in the Netherlands are in line with our own. Such anomalies need to be looked at in greater depth. For instance, the Iron and Steel SWP study shows that the Dutch Hoogovens steel company has a close relationship with their electricity utility, the steel company supplying large amounts of gas to the utility for electricity generation. This clearly brings down the price which Hoogovens pay for their electricity, but the reason for the low price would not be apparent without a close look at the case.

Turning to the gas price increases facing Duport, Ferodo and Moss Gears, they are in line with increases for all industrial consumers. Ferodo's firm contract renewal at 28.15p/therm compares with the figures quoted by the independent research organisation, NUS, of 27.8p in Germany and 24.2p in France for September 1980. In Germany, renewal contracts for premium uses are now reported to be close to the full gas oil equivalent price, whereas in the UK, British Gas is renewing contracts at about 75% of gas oil prices.

Gas prices on the Continent generally have been rising over the past year, with the consequences of higher gas import prices still to work through. The evidence suggests the rate of industrial real price increases since early 1979 on the Continent has been faster than in the UK in local currency terms. The impact of fast rising world energy prices is not just being felt in the UK. Duport is a particularly worrying case. I have corresponded with the Chairman, Mr Sayers, who is familiar with energy pricing realities as chairman of the CBI's Energy Policy Committee, about his concern for many of his subsidiaries who are unable to pass on rising costs. He has welcomed the Government's determination to take up cases where other countries are unfairly subsidising costs. I have already mentioned the Iron and Steel Sector Working Party report which we are examining carefully for such evidence. But the position of both private sector steel companies and BSC must be viewed in the wider context of industrial strategy. Even if we were to intervene in the nationalised industries's operations to the extent of reducing energy prices below commercial levels for certain specially singled out companies with all the problems that entails for our pricing policy, international reaction and in practical implementation, I doubt that it would be a satisfactory solution in the steel industry where the cost of energy is only one of many factors contributing to their present plight. However, if financial support by Government was considered appropriate, I hope that it would include support for energy saving investment. I note that the BSC Corporate Plan includes proposals for such action.

It is unlikely that Ferodo would find themselves in a similar position to Bowaters if they were forced to announce closure. Bowaters were indeed offered better terms by the Coal Board for their coal supplies, but this was on the basis of a commercial decision by the NCB, which clearly had a greater financial interest in keeping up their sales by retaining a large customer than would British Gas. There was no Government intervention. This of course does not mean that Government support should not be offered if Ferodo warrants it, but clearly we and the Department of Industry would need to know a great deal more about the financial state

of the company and its prospects before considering help. It is difficult to comment 3Ms and Signode without further information Perhaps you could provide this?

To return to Airco, and the contrast in new contract prices for firm gas in 1979 and 1980 they were offered by BGC, the explanation is that rising demand has made BGC's supply position very tight and they can take on very few new customers as I have explained above. The Corporation has therefore discouraged new customers' by offering supplies at the full gas oil equivalent price. As you know we have asked British Gas to review this practice, but if they do bring down prices demand will rise and they will have to ration on a more arbitrary administrative basis, which may also bring complaints from companies which will claim that they have been discriminated against in being refused a gas supply. In Europe, supplies are also tight, and Airco would not necessarily be successful in obtaining a new gas supply there. In France, only those who cannot possibly use an alternative fuel are being considered for supply, and in Germany major suppliers are very reluctant to give new contracts. Availability as well as price is an important consideration for industry, and on the Continent, particularly in France, interruption has been far more frequent than in the UK.

CONFIDENTIAL

2 PM

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

2

PRIME MINISTER

To see. You will be seeing the Chancellor and Mr Howell next Monday.

MS
6/1

PRIME MINISTER

ENERGY PRICES

I have seen a copy of David Howell's minute to you of 31 December in which he sets out his preliminary views of the possibilities of helping industry on energy prices in the recession.

2. I agree with David's general approach. It seems to me to be both positive and sensible and I welcome his proposal for a full discussion of his final recommendations in E Committee when he returns from the Gulf.

3. I am sending a copy of this minute to David Howell, Sir Keith Joseph and Sir Robert Armstrong.

(G.H.)
6 January 1981

CONFIDENTIAL

TL

TL(O/R) to see
MJS 6/1

01-211-6402

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

5 January 1981

Dear Geoffrey

GAS LEVY BILL

Thank you for your letter of 22 December. I intend to press ahead quickly with the drafting and introduction of this Bill, which will set the rate of levy on British Gas at the levels we have agreed. There are, however, three particular points in your letter that concern me.

First, I suggested rounding the post-levy target to 3½% so as to avoid giving the impression of spurious precision, against a background of a medium term outlook invariably fraught with uncertainty. I would not regard the ESI financial target as a particularly desirable precedent; an original 2 per cent return was adjusted down to 1.8 per cent as a concession to the industry, to reflect the staging of price increases subsequently agreed. Moreover, "3.7 per cent" would have no different effect in practice, compared with "3½ per cent", since BGC would not expect to reach either, on the basis of the latest forecasts and agreed pricing policies. For these reasons I would prefer to stick to a post-levy target of 3½ per cent.

Second, you express reluctance to see any adjustment to the rate of levy to deal with relatively minor effects of the new tax on North Sea revenues. I agree that we ought to try to avoid departing from a levy expressed as a round number of pence per therm. I would, however, expect BGC to ask that any impact of the new tax should be reflected in the levy, and certainly in their EFL. We will clearly need to consider these matters further in the light of forthcoming advice from our officials on the scope of the new tax. Until then, I would wish to reserve my position on adjusting the rate of the levy.

Finally, I would be most reluctant to include a "claw back" power in the present Bill for a number of reasons. First, we are setting the rate of levy and the timing of payments so as to control both the level of profits and the size of the Corporation's cash balances. I expect that the levy will be a sufficiently flexible device in these respects for many years to come, despite declining supplies of PRT-exempt gas. So I do not think that a claw back power, in addition to that already provided in Section 16 of the Gas Act 1972, is at all urgent. I would hope that the PAC could be persuaded of this.

Second, our opponents will argue that the levy is a thinly disguised profits tax for revenue raising purposes, and we shall play into their hands if we introduce a Bill which provided for removing monies from British Gas both through a levy on PRT-exempt gas (which we can justify) and, in effect, on excess profits levy (which we recommended against in our joint paper to 'E'(E(80)19). Moreover, BGC would be suspicious of our intentions in taking such a power and their present reluctant acquiescence in the Levy could be forfeited.

I am copying this letter to the Prime Minister, members of E Committee and to Sir Robert Armstrong.

Yours ever

David

D A R HOWELL

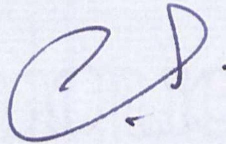
BF 9.1.81.

PRIME MINISTER

You wish to see Mr. Howell on Monday, 12 January, on energy prices.

Would you like the Chancellor to be present?

Yes MT



Arranged for 1445 at No 10.
6/1

5 January, 1981.

MISS STEPHENS

You were going to fix up a meeting for the Prime Minister with Mr. Howell on 12 January. I asked Debbie at Chequers to ask Clive to ask the Prime Minister whether the Chancellor could attend this meeting. Did you get an answer? If not, please could you follow up.

R.

2 January, 1981.

PRIME MINISTER

ENERGY PRICES

1 At your meeting with Geoffrey Howe, Keith Joseph and myself on 22 December, you asked for a note on what the Government could do now, immediately, to help industry on energy prices in this very deep recession. This minute sets out the possibilities on which I have been working. As I told you I would propose to put my recommendations to 'E' Committee very soon after I return from my trip to the Gulf in early January. However, if you think it would be helpful, I would be very willing to call on you on 3 January - the day before my departure - for an informal discussion on this note, in which I could perhaps explain more fully the background to these possibilities and the wider implications for our overall economic policy and its presentation.

2 There can be no doubt that it is vital to achieve much greater efficiency in all the nationalised industries. In the energy industries, substantial progress has already been and continues to be made. The gas and electricity industries have achieved a faster growth in labour productivity and a slower growth in employment costs per unit of output than in the rest of the economy over the last decade. In coal the pressures of the financial strategy have recently led to a big acceleration in the rate of colliery closures which had fallen to a negligible level under the previous Government. $3\frac{1}{2}$ million tonnes will be closed this year. But much remains to be done in all the industries and there can and will be no letting up in the pressures on these industries to cut their costs.

3 Private industry will reap the benefits of this work in due course. However, as you said, the pressure on industry from the world recession is immediate and demands immediate relief. And greater efficiency and lower costs in the nationalised energy industries will not affect the price of oil or gas prices to industry which, in a situation of excess demand for gas, are set by market forces. Indeed, as BGC cuts its costs its profits are further enlarged.

4. Our general policy which I am sure we must stick to is to require the nationalised energy industries to base their pricing policy on sound economic principles and to refrain from the detailed intervention by the Government which has done so much damage under previous administrations. This means letting them charge so as to reflect the cost of supply on a continuing basis: but it also means that the industries should behave sensibly and flexibly in response to both short and long term market factors. It also gives consumers a clear picture on the cost of their fuel consumption, enabling them to make rational decisions about fuel use, investment in fuel appliances and in energy conservation. Artificial under-pricing or general price control would both promote wasteful use and reduce incentives to develop new sources of energy. I have therefore been looking for possibilities which are consistent with our long term objectives. Some (Nos (i), (iii) and (iv)) could bring a minor but immediate easing of prices charged to some users. Others (ii and v) are more radical and expensive. They would involve a substantial gross cost to the PSBR - partly offset by PSBR savings through the jobs they would help to preserve. Number (vi) - the duty on heavy fuel oil - is really a question of energy tax policy rather than energy pricing policy. However, I offer some views below.

5. The possibilities are:-

ON GAS

(i) I have asked the BGC to consider two changes of pricing practice:-

(a) Their present policy is to provide interruptible gas at a discount to industrial consumers who would otherwise use heavy fuel oil. The discount on interruptible gas would however be of greater value to consumers who would otherwise use the more expensive gas oil. I have asked BGC to consider whether it is practicable to create a category of "priority interruptible" supply for such customers. This might save them 3p/therm and it would remove one of the discrepancies between pricing practice in the UK and some Continental countries.

(b) I have also asked whether the structure of firm gas renewal prices adequately reflects the discounts for bulk which would be available in an unconstrained competitive market. Bulk discounts might save large users a few p/therm.

Both these possibilities would have some immediate PSBR implications on which I am awaiting the advice of the BGC, although the ultimate net PSBR effects could well be smaller.

(ii) a more far-reaching step would be a reduction of, say, 3p/therm on the price of gas to all industrial consumers of firm gas. This would involve direct and overt intervention and be inconsistent with our pricing principles; it would create an additional demand for gas which could not be met; and it would cost the PSBR (gross) some £80 million in a full year.

No.

On Electricity

(iii) I asked the CEGB in July to undertake a comprehensive review of the Bulk Supply Tariff under which they supply electricity to the Area Boards. Some marginal benefits should be available to customers with special agreements in the Spring. The full review will be completed next year.

(iv) I have also asked the electricity boards to show as much flexibility as possible in the application of the existing tariffs. This too is now producing some small benefits for industry: as one example, a joint investigation by an Area Board and a large industrial consumer (steel) into process and other improvements will realise savings of 2% on an electricity bill of £10 million per annum.

(v) Because of the statutory position under the Electricity Acts tariff cuts would have to be across the board. A cut of the order of 5% would cost the PSBR (gross) about £250 million

X

a year; would be inconsistent with our general pricing policy; and would not be a cost effective way of helping industry. It would be hard to tailor any concession to help large users without changing the legislation against undue discrimination. This would be seen as a very hostile move against smaller industries, which we want to encourage not hurt more.

On Oil

(vi) I am examining the question of the £8 per tonne duty on Heavy Fuel Oil - the matter which Keith Joseph has also raised with me. I believe there could be a case on energy policy grounds for, say, halving this duty. This would bring it much closer to the level in other Community countries and help ensure that our fuel oil prices, which are currently below most of those elsewhere in Europe anyway, stay in a good competitive position. However, the direct and indirect cost to the PSBR would be about £200m (gross) in a full year, of which £100m would, under the Frigg contract, be payment overseas to Norway and to the French companies operating the Frigg field. We are looking urgently at possible ways of getting round this disadvantage.

6 I have not mentioned coal in the list of measures. There is now acute pressure on coal price increases. Although the industry is facing some severe short term problems it is making good progress towards an economic and efficient long term future.

7 Finally, a general point. If we want to bring short term immediate help to certain industries in this very deep recession, as I understand we do, then to attempt this by general intervention to reduce energy prices is bound to be highly inefficient, very costly and the most damaging form of help when it comes to our long term interests. Finding more efficient ways of helping those industries and firms which face immediate difficulties but have good long term prospects goes beyond my Departmental responsibilities. But collectively we should be looking for them urgently.

8 I am copying this to Geoffrey Howe, Keith Joseph and Sir Robert Armstrong.

pp Secretary of State for Energy
31 December 1980

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

2.

Prime Minister
The Chancellor is not yet convinced that Mr Howell has established the facts on relative energy prices.
MP 29/xii

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

29 December 1980

The Rt. Hon. David Howell, MP
Secretary of State for Energy

Dear David

INDUSTRIAL ENERGY PRICES

I have just seen a copy of your letter of 8 December to Keith Joseph in which you comment on his letter of 27 November on industrial energy prices. (Do not appear to have a copy)

While I do not necessarily dissent from the approach in your letter, I do not think we can yet be quite sure that we have got to the bottom of industries' complaints about the level of energy prices in this country compared to those in other Community countries. I recognise that industry is bound to put the best light on its case and the facts are often obscure both because of the inevitable difficulties of international comparison and the complexities of the markets for each fuel in the countries concerned. I also know of the efforts which you and your Department have put in over the last few months to investigate and discuss with industry their complaints. But I think that you would agree that industries' complaints have not lessened.

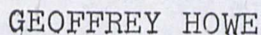
I therefore welcome your proposal for a further discussion on energy prices in E in the New Year. Could I suggest that before your paper is circulated to E, there should be a renewed effort to make sure that we have got the facts right on energy pricing in this country and abroad. Your paper could then provide an authoritative summary, which might provide the basis for some public document. It might also be helpful if the Committee were to consider what more might be done to get the Government's case on energy pricing across to industry and to the public generally.

/The meeting

CONFIDENTIAL

The meeting of the National Economic Development Council on 7 January will provide a further opportunity for the CBI to renew their campaign and the TUC could well give them some support. My officials have already passed on to yours my request for an appraisal of the papers on energy pricing from NEDO, the CBI and the CIA. Could I also suggest that it would be helpful if we had in our brief for the Council a summary of the Government's policy responses to date, those which we might contemplate and those which are clearly ruled out.

I am sending a copy of this letter to the Prime Minister, the other members of E Committee, George Younger, Nicholas Edwards as well as to Sir Robert Armstrong and Robin Ibbs.


GEOFFREY HOWE

CONFIDENTIAL

10 DOWNING STREET

From the Private Secretary

22 December 1980

Dear Tim,

As you know, the Prime Minister held a meeting this afternoon to discuss the nationalised industries. The following were present, in addition to the Chancellor of the Exchequer: the Secretaries of State for Industry and Energy, Mr. Ryrie, Sir Donald Maitland, Mr. Croft, Sir Robert Armstrong and Mr. Ibbs.

Nationalised Industry Financing

The Prime Minister said that she was becoming increasingly concerned at the financing burden of the nationalised industries. This was proving a huge drain on the PSBR and the prospects did not seem to be getting any better. After 20 months in office, the Government had achieved far too little in terms of improved efficiency and reduced financing requirements. The Government was now being severely criticised for not having achieved more. It was essential that sponsor Departments should drive harder at the industries to get them to achieve better efficiency. In addition, she wanted the various proposals which had been put forward for removing certain types of financing from the PSBR to be carried forward urgently. She understood that the Treasury had been considering the options, including removing the Government guarantee from certain types of borrowing and sale and lease-back arrangements, for several months. She wanted a report from the Treasury by 6 January on where the review of options had got to, what further work needed to be done, and - if possible - with some specific proposals for decision.

The Chancellor and Mr. Ryrie explained the well-known objections to removing from the PSBR financing which was guaranteed by the Government. The Treasury were trying to identify areas where the giving of guarantees could be avoided so that the relevant financing could be taken out of the PSBR. One example already identified was the gas-gathering pipeline; there were other possibilities in British Rail, the NCB and British Telecoms. In all of these areas, there were likely to be difficulties - including the need for legislation. But the Treasury would continue to pursue the various options urgently, and would prepare a progress report for the Prime Minister as requested. Sir Keith Joseph added that in the case of British Telecoms, there were a number of hopeful options; he intended to write to the chairman of the Corporation about them shortly since he would have to go along with whatever the Government decided to do.

/ Energy Prices

CONFIDENTIAL

Energy Prices

The Prime Minister said that she was also most concerned about the high energy prices which private sector industry were having to bear. There was nothing the Government could do to bring down the exchange rate, which was also causing increasing problems for certain industries, without undermining the monetary strategy; but she felt that more could be done to make cheaper energy available to industry. High energy prices were partly caused by inefficiency in the coal industry and electricity industry; and as she had said already, the Government must press the industries harder to bring about improvements. But many industrialists, particularly bulk energy users, felt they were being unfairly treated compared with their competitors abroad.

The Secretary of State for Energy said that his Department had been conducting an intensive review of energy pricing, and he would be bringing forward proposals for collective consideration in early January. Certain small changes had already taken place: for example, BGC were now adopting a policy for charging slightly lower prices for new contracts and the electricity industry was showing somewhat greater flexibility in its prices for bulk users. In addition, the Electricity Council had been conducting a review of the bulk supply tariff since the autumn, and this work would be completed by early January as well. Contrary to what many in industry were saying, small and medium size electricity users were not being charged higher prices than their competitors abroad; it was only the bulk users who were at a disadvantage. He had freely recognised this, and that was why the bulk supply tariff review was being undertaken. Ministers would have to consider the option of reducing bulk supply tariffs, though this would be at a cost to the PSBR. But there would be some industries who would be unable to survive even with competitive tariffs. As for heavy fuel prices, these were now the lowest in Europe - and he would let the Prime Minister have chapter and verse. The current pricing regime for gas feed-stocks was very advantageous to British industry. As regards the proposals he would be coming forward with in January, these would include the option of reducing or abolishing the tax on heavy oil and also limiting the increase in gas prices to industrial users; but again, Ministers would have to weigh up the advantages to industry against the losses to the PSBR. In short, Ministers would have to decide whether to make relatively minor changes which would be presentationall helpful, or much larger reductions in energy prices which would cost substantial amounts of money. He would include in his paper to colleagues various possible packages within the latter category.

The Prime Minister said that, against the difficult prospects which manufacturing industry were facing, it would be desirable to make some substantial concessions on energy prices; and in looking at the PSBR consequences, it was important to take into account the PSBR consequences of industries going out of business if concessions were not made.

Mr. Howell said that he would let the Prime Minister have a paper by 4 January; and I would be grateful if his office could let me have the information on heavy fuel prices by tomorrow (Tuesday) close of play.

/ Other points

CONFIDENTIAL

Other points

The following further points were raised:

(i). Sir Keith Joseph said that BSC's Corporate Plan was optimistic about the Corporation's market prospects. It did not include the "lower case" option, which would involve closing Llanwern and Port Talbot. Although more expensive in the short term, it was possible that the "lower case" would be more likely to make BSC competitive again; and his Department would be looking at this closely.

(ii) The Prime Minister questioned the need for the NCB to use Hobart House as their headquarters: wasn't there a strong case on employment and other grounds for having their headquarters outside London? Mr. Howell said that their present lease was on favourable terms, but he would look into the matter and let the Prime Minister have a report.

(iii) The Prime Minster said that she was concerned that more progress had not been made by British Shipbuilders in selling off the ship repair companies. She had been impressed by the arguments put forward by Mr. Christopher Bailey on this matter; she would like a report from Sir Keith Joseph as soon as possible.

I am sending copies of this letter to Ian Ellison (Department of Industry), Julian West (Department of Energy), Sir Robert Armstrong and Robin Ibbs.

[signature]

A.J. Wiggins, Esq.,
HM Treasury.

CONFIDENTIAL

Nat. Ind.

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

22nd December 1980

The Rt. Hon. David Howell, MP.,
Secretary of State for Energy

Dear David

GAS LEVY

Thank you for your letter of 12 December.

Subject to the points below, I am broadly content with the approach you propose.

(i) I accept that we should not revise BGC's financial target at this early stage of the target period other than to take account of the SSAP 16 adjustments. But I accept that some account must be taken of BGC's lower forecasts of profitability in assessing the rate of levy to be applied.

(ii) On the revised financial target, I am content with the proposals set out in the table in your letter. But I see no reason to round the 3.7 per cent target down to 3½ per cent. There is nothing absurd about a target of 3.7 per cent - after all, that for electricity is 1.8 per cent, not rounded to 2 per cent, and I propose that you should set the target calculated to the nearest decimal point which is derived from the profit forecast and the chosen rate of levy.

(iii) As to the rate of levy, I recognise that on BGC's current profit forecasts your proposed 1p/3p/5p levy would result in profit levels consistent with those suggested in the Chief Secretary's letter of 15 August. These profit levels are, I think, about the highest that can be presented with a reasonable prospect of avoiding embarrassing criticism. If BGC ask to be allowed to keep higher profits through a lower rate of levy, I am sure that their request must be refused. I am also somewhat concerned at the level of profits which would arise if BGC's latest

/pessimism

pessimism about future profits is overstated and the outturn shows their achieving the restated financial target. This would, of course, be highly desirable for the PSBR, but could be difficult presentationally; depending on public reaction we might be forced to review the rate of the levy. But I am content to leave this for the present and consider it if there is real presentational difficulty.

(iv) I recognise that your proposals take no account of the possible impact on the price BGC pay for their gas of the new tax on North Sea revenues. I know your officials are in touch with Inland Revenue about this and we may have to reconsider the position when they report to us. But I ought to point out now that I would be reluctant to see adjustments to your proposed levy rate to deal with relatively minor effects of the new tax on BGC, particularly as the numbers you suggest for the levy are rounded.

(v) I am content with the proposal that the levy should be collected quarterly in arrears.

Subject to these points, I am content for you to propose legislation on the lines you suggest. I also wish to ask you to consider, as my officials have already mentioned to yours, that the legislation should provide additional powers for the Secretary of State to remove BGC's cash surpluses, along the lines of the provision intended for BNOC in the Petroleum and Continental Shelf Bill. I suggest this for the following reasons.

The levy is not primarily intended to remove BGC's cash surpluses, but to reduce their profit. And it bears only on profits from PRT exempt contracts. We cannot therefore be certain that the levy will remove BGC's cash surpluses for the foreseeable future. An explicit power would give us this assurance. It is relevant here that the PAC in their recent 20th Report proposed that industries should make additional payments to the Exchequer when they were in a position of cash surplus. There are already indications that Exchequer and Audit Department are interested in this point in connection with BGC. A decision to take powers in the Gas Levy Bill to claw back surplus cash would help forestall criticism. I should be grateful for your urgent views.

I am copying this letter to the Prime Minister, members of E Committee and to Sir Robert Armstrong.

GEOFFREY HOWE

3PPS Nat Inds

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Oddi wrth Ysgrifennydd Gwladol Cymru

THE RT HON NICHOLAS EDWARDS MP

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01-233 6106 (Direct Line)

From The Secretary of State for Wales

CONFIDENTIAL

15 December 1980

Dear David

My concern over the long term future of BP Chemicals' operations in South Wales - with 3,700 being employed at Baglan Bay and Barry - prompts me to comment on your minute of 9 December to the Prime Minister, a copy of which I have seen.

I would not dissent from the statement of objectives set out in your minute but do believe that in "making as much ethane as possible available to the British chemical industry at the most advantageous terms" we need to have very much in mind the position of present operators and their need for continued supply of appropriate feedstock. As I understand matters, the proposal to pipe ethane to Grangemouth would provide a degree of underpinning for BP Chemicals' operations as a whole and thus represent as much of an insurance as is possible for the South Wales plants in the context of this important project. But I would ask you to bear in mind my concern over the long-term viability of the Baglan Bay and Barry plants and my need to know of any developments that could significantly affect their future.

I am copying this letter to the Prime Minister, members of E Committee, George Younger, Norman St John Stevas, Angus Maude and Sir Robert Armstrong.

Yours ever

Nick

The Rt Hon David Howell Esq MP
Secretary of State for Energy
House of Commons
LONDON
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cc Mr Ingrid

Nat Ind

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The Rt Hon Nicholas Edwards MP

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From The Secretary of State for Wales

15 December 1980

Dear David

I am seriously concerned at the lack of a detailed response to my letter of 18 November on industrial energy pricing, and at the lack of progress in tackling the urgent issues it raised.

Time is not on our side and more important it is not on the side of the industries that are affected, as the case of Ferodo Limited illustrates.

Mr F G Carter, Chief Executive of Ferodo Limited, has sent me a copy of his letter to you of 25 November. Ferodo's Caernarfon Plant is one of the four major employers in North West Wales. Its gas pricing problems have an importance similar to those of Duport and other companies whose difficulties you are currently investigating.

I would particularly draw attention to Mr Carter's final comment. It would be a tragedy if more jobs were to go whilst we are looking for a solution.

Keith Joseph has put a number of important proposals in his letter of 27 November. If they could be implemented quickly, viable industries might be safeguarded long enough for the problems caused by foreign energy subsidies to be tackled at source.

It seems to me imperative that firm proposals should be put to 'E' Committee very soon. In view of the fact that Keith Joseph and Peter Walker have copied their letters on the subject more widely than I did my original letter, I am now copying this letter to the Prime Minister, the other members of 'E' Committee, George Younger, Sir Robert Armstrong and Robin Ibbs and enclosing copies of the earlier correspondence.

Yours ever

Nick

The Rt Hon David Howell Esq MP
Secretary of State for Energy
Department of Energy
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LONDON
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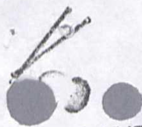

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From The Secretary of State for Wales

The Rt Hon Nicholas Edwards MP

Mr Edwards

18 November 1980

Dear David

ENERGY PRICING

I had to leave the meeting of E Committee on 5 November before the brief discussion of your memoranda on energy prices. I am glad to hear that there is to be a further discussion on a future occasion and I know that you are anxious that that should not be long delayed. To avoid the need to raise a whole lot of detailed points in E I hope you will forgive me for setting out in this letter some of the questions that worry me and I should be extremely grateful if you could let me have your comments on them.

We face mounting criticisms from industry who do not understand why monopoly nationalised industries should be required to increase their profits at the expense of the private sector when profitability is disastrously low. During my recent United States visit, I found that energy pricing was one of the most important single obstacles we face in attracting inward investment. I am also acutely aware that the existence of a number of major companies is now in doubt because of uncompetitive energy pricing.

I fully understand and indeed support the long term objectives and the underlying principles of the present energy policy. But I do have serious reservations about aspects of the policy and I question some of the assumptions and conclusions in your papers. First, however desirable the objective may be, we have to consider what our competitors are doing and at a time of severe recession it may be perverse for a country rich in energy resources to move much faster than its principal competitors eg I understand that of the four OECD countries with indigenous oil resources only one (the United Kingdom) charges OPEC prices to industry. I agree with the efforts that are to be made internationally to eliminate the grosser forms of unfair competition, but it would be foolish to assume that progress will be very fast and in the meantime I do not believe that we can ignore the substantial evidence that many leading companies are facing greater increases in their energy bills than are their principal competitors. Your paper emphasises the need

/to conserve ....

The Rt Hon David Howell MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank LONDON SW1P 4QJ

to conserve energy but we also have to consider industry so that it is still there to use energy when the present recession ends.

Your paper admits that economic pricing is a complex and inexact concept. You say that it requires pricing our oil at world levels and pricing our other fuels at levels which cover their costs, but there are many cases where the purity of the principle has had to be tempered by other considerations. In the case of coal (and therefore of electricity) it can be said that our pricing policy is based as much on socio-economic requirements as it is on a world market price (for reasons which of course as Secretary of State for Wales I have special reason to appreciate). Our gas pricing policy has been substantially affected by a political judgement as to the speed with which we can increase domestic gas prices, with the result that we have put up the price of gas for industry more rapidly than we have the price of gas for the domestic consumer. When it comes to electricity I have to confess that after having read the detailed explanation on the system of long run marginal cost policy several times I do not fully understand it, and perhaps I am therefore mistaken in my suspicion that a policy that is based on the cost of fossil fuels takes insufficient account of the benefits to be obtained from the gradual introduction of nuclear plants and the present under-utilisation of existing capacity. However, I welcome your conclusions that some reductions may be possible for individual users.

I question a number of specific statements in your paper. It does not seem to me that the evidence that you yourself supply, for example in Table E1 (page 3/13) about Steam Coal Prices in the countries dependent upon imported coal, Denmark, Italy and Norway, bears out the contention that NCB coal delivered to the power stations is likely to be competitive with the delivered price of imported coal. What BSC has told me about coking coal confirms my doubts. It surely is not right to say that coking coal for BSC is now competitive with imports. It is only competitive as a part of a package deal with BSC that involves selling steel; in other words BSC are prepared to pay more than the world price for coking coal in order to get rid of their own product.

It is stated (3.11) that most representations from industry relate to the comparison between UK prices and European prices. It may be that this is the comparison that is relevant to most industrialists but many of the biggest energy users are equally or more concerned about their lack of competitiveness with countries elsewhere in the world. For a firm like Alcoa whose Swansea plant is now threatened

/with closure .....

with closure and the loss of 1,400 jobs it is their inability to compete with the United States that is relevant. I get the impression that a series of comparisons based on averages disguises the scale of the problem and its devastating consequences for individual heavy energy users for whom the critical factor is not the average European or US price comparisons but the actual price disadvantage that they face at the present time against their particular competitors. It is little consolation to a company in this position that somewhere in Europe some organisation seeking a new contract is being quoted higher rates. We must face up to these issues squarely. It seems to me that too often your paper seeks to dispute or discount the arguments of industry rather than to clearly quantify the relevant individual price comparisons. I suspect that industry is partly responsible because it has not found it easy to provide specific evidence but I believe it would be a mistake to dismiss the strongly held belief of most industrialists on that account. We must take further urgent measures to establish the actual facts.

Some of the information presented in the memoranda does not appear to give a complete picture. For example, on the information that I have I doubt that it is fully accurate that the Anglesey Aluminium contract is losing the CEGB £30m a year. The Anglesey Aluminium situation arises from the fact that the CEGB have failed disastrously to build Dungeness B on time or on budget so that a contract based on the original estimate of Dungeness B costs has proved much too optimistic. However the £30m figure must, I believe, be based on a comparison between the contract price related to the original anticipated cost of Dungeness B and current bulk tariff rates. Surely a fairer comparison would be with the unit with the lowest unit production costs, not the average reflected in the bulk tariff price, or at least with the rate they would have been quoted as a major bulk user.

More important than these detailed doubts and queries is the fact that I do not accept the conclusion that more flexible industrial energy pricing would not make a significant difference to decisions by particular companies, or that a general reduction in industrial energy prices would do little to help industry across the board. I am disturbed by how many companies there are who do believe that energy pricing is a significant factor in their performance. For some it is the significant factor. Alcoa informed me that their energy costs in Indiana are a quarter of those in Swansea and that their energy bill of £12m is comparable to their wage bill. While we cannot hope to make energy in Swansea fully competitive with that in Indiana, we might achieve savings which could make all the difference between closure and survival. My officials are in touch with the Wales Gas Board and will be keeping in close contact with your department on this urgent issue. Airco who are considering establishing a plant in the tungsten industry were quoted gas prices of 21p a therm in 1979 and 40p a therm in 1980. The project

/which would ....

which would have produced 300 jobs is now unlikely to go ahead in the United Kingdom for that reason. Duport, whose steel mill in West Wales is also threatened with closure, tell me that until recently energy represented 11% of costs but today it is between 15 and 17% and that it is expected shortly to be 20%. They say their European competitors pay 1.4p to 1.7p per kilowatt compared with 2.5p in the United Kingdom. You will know that there is a major question mark over the future of the steel division of this company. 3 M's (UK) Ltd informed the Welsh Office that the cost of energy is 10-13% higher at Gorseinon than in several of their European branches. Signode report energy costs at Swansea significantly higher than in West Germany. BSC say European prices give continental steel producers an £8 a tonne price advantage. All this evidence coming from a very small geographical area represents disturbing proof that taken as a whole we face a very major problem indeed.

I therefore believe:-

1) that it is right and proper to probe and question some of the assumptions and conclusions in your paper.

2) Before taking ourselves out of high cost energy processes eg paper, glass, steel, should we not ask ourselves what the long term consequences would be and why our European competitors are not doing so.

3) We should not dismiss without further debate the possibility of increasing domestic gas prices faster if that is the price for lower gas prices for industry.

4) We should assist companies with temporary difficulties.

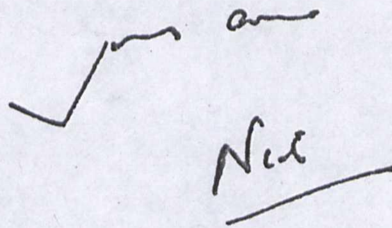
5) We should work energetically to persuade other countries to move faster towards economic pricing.

6) We should give every incentive to initiatives by the private sector such as that by Kaiser to produce their own electricity competitively. I very much welcomed Keith Joseph's interest in this area.

/I recognise ...

I recognise that you are already taking action under some of these headings in order to meet the demands that industrialists are making. I would just like to emphasise the extreme urgency of these decisions and the need to react imaginatively and quickly when we have the possibility of seeing individual companies through the present critical period. Of course we will have to bear very carefully in mind the overall implications for public spending and public borrowing. But I believe that for a relatively small outlay it should be possible to significantly assist major sectors of British industry.

/ I am sending copies of this letter to Sir Keith Joseph, Jim Prior and George Younger.



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01-211-6402

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

12 December 1980

At E(80)8th we agreed to impose a levy on the British Gas Corporation in respect of gas purchased from the UKCS under contracts not subject to Petroleum Revenue Tax. I was invited to give further consideration to the issues involved in consultation with you. On 8 August I wrote to you enclosing a paper, prepared by my officials in consultation with yours, which suggested that the levy be set at a level which would allow BGC to retain profits of about £200m in 1980/81, £400m in 1981/82, and £500m in 1982/83.

John Biffen replied on 15 August accepting the general approach but suggesting that the profit levels mentioned above might still provoke criticism; he proposed the somewhat lower figures of £250m, £300m, and £350m respectively in the three years, or £900m overall.

BGC's position has, as you know, deteriorated since our August paper was prepared (we considered the 1981/82 situation in the context of setting the Corporation's External Financing Limit). The main reasons for the adverse changes are: the effects of the current recession which in the short-term has reduced forecast gas sales to industry, despite the underlying unsatisfied demand; and faster rising gas costs, resulting in part from higher forecast oil prices, which British Gas do not in the present circumstances feel able to recover fully by raising prices further to industrial users.

Clearly, we will need to take some account of the changes in the Corporation's circumstances since the earlier calculations were made. It has always been recognised that their current financial target of a 9 per cent average return on revalued assets would need to be modified following the inflation accounting standard (SSAP 16) and the levy once imposed. One possible means of dealing with the changed circumstances would be to reduce the financial target on account of both these arithmetical factors and the worsened trading outlook. It would, however, be difficult to justify a substantive revision to a 3-year target on new trading forecasts half-way through the first year after its being set. There will no doubt be other facts and forecasts over the next year, and if we were to change the target, I would prefer to wait till we are further down the path when forecasts are more realistic. Moreover, I see

some advantage in leaving the Corporation with a target that could only be achieved by exceptionally vigorous efforts (to the advantage of the PSBR) and they themselves do not demur. I would therefore propose not to change the financial target on account of the worsened trading outlook, though in setting the rate of the levy we shall need to take account of the most recent (October) forecasts so as to leave the Corporation with average profits of £300m over the three-year period in line with John Biffen's suggestion.

Our public stance would be that the Corporation's financial target is unchanged in substance though an arithmetical adjustment to the original 9 per cent target has been made on account of the levy and the SSAP 16 changes; that British Gas would need to work particularly hard to reach this target, given changes in trading conditions; but that we would on latest forecasts expect post-levy profits to be perhaps nearer the bottom end of the range £300m-£500m on average over the 3-year period. I would wish to announce a revised financial target for the Corporation at the time the Gas Levy Bill is introduced which would need to be before British Gas announces its domestic tariff increases for 1981 in mid-January. Without such a revised target BGC would feel on uncertain statutory ground in justifying the price increases consistent with our declared policy.

The details of the rate of levy I propose and the consequences for the original financial target (based on January forecasts) and for forecast profits (based on the October forecasts) are as follows:

		80/81	81/82	82/83	Average
i)	Proposed levy pence/therm	1.0	3.0	5.0	
ii)	Proposed levy £m	135	425	758	
iii)	SSAP 16 changes to profits £m	-130	-140	-155	
iv)	January 1980 profit forecast £m	654	1028	1511	
v)	January 1980 profit less levy and SSAP 16 £m	389	463	598	
vi)	Return on assets, from v)	3.5%	3.5%	4.0%	3.7%
vii)	October 1980 profit forecast £m	541	879	1241	
viii)	October 1980 profit less levy and SSAP 16 £m	276	314	328	306
ix)	Return assets, from viii)	2.5%	2.4%	2.3%	2.4%

On the basis of the above figures the post-levy target would be an average return on revalued assets over the 3-year period of 3.7% (line vi) which I suggest we round to 3½%. However, on latest forecasts, the expected outturn would be about 2½% (line ix).

I should make a number of points in connection with these figures:

i) The post-levy profits are calculated on the basis of current forecasts of sales of PRT-exempt gas. No account has been taken of the possible impact on the price BGC pay for their gas of the new petroleum production tax that you announced last week. I think we must proceed with the Gas Levy Bill on the basis that the precise rate of the levy may need to be adjusted, depending on the impact (if any) of the new tax.

ii) Whilst the general arguments for the imposition of the levy should be capable of straightforward explanation, it will be difficult to justify the rate set for each particular year if we try to be too precise to a decimal point. It seems desirable therefore to pitch the rate in round numbers of pence per therm which could more readily be defended by general arguments than could fractions of a penny.

iii) I propose that the levy should normally be paid quarterly in arrears. Your officials are familiar with the broad cash flow consequences of this procedure which will result in the Corporation's cash balances deposited with the National Loans Fund declining from about £300m at present to about £150m over the three-year period.

As agreed, my officials have discussed informally a levy at the rate described above with their opposite numbers in British Gas. The Corporation will not consider the post-levy target formally until I put to them our specific proposals. There is nevertheless a reasonable prospect that the Corporation would just about go along with the approach mentioned above, and a 3½% financial target. A higher rate of levy, which would force British Gas to borrow from the NLF, would almost certainly provoke their public opposition both to the levy and to the resultant financial target. This could be damaging both in terms of presenting the levy itself and in respect of the other important matters under way including handling next year's domestic tariff increases; meeting this year's and next year's EFL; and the disposal of the Corporation's oil assets. In all these matters their co-operation will be important to achieving our policy objectives.

I hope therefore that you can agree to my introducing a Bill which would set the levy along the lines proposed above at 1p, 3p and 5p per therm for the successive years of the three-year period of BGC's financial target.

I am copying this letter to the other members of E Committee and to Sir Robert Armstrong.

Yours ever
David

D A R HOWELL

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

The Rt Hon David Howell MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
LONDON
SW1P 4QJ

10 December 1980

Dear David,

ENERGY PRICES AND THE PAPER INDUSTRY

I met today with representatives of the British Paper and Board Industry Federation on the problems of their industry in the UK particularly as it affects Scottish Mills.

One of the points on which the Federation members' laid great emphasis was the disadvantage to UK mills of our current energy pricing structure. The Federation handed me the attached brief giving further information which had been drawn from their members in an attempt to bring out international energy price comparisons on a strictly "like for like" basis by making enquiry of owners who have mills both in the UK and elsewhere.

This is the kind of evidence which we need following our discussion at E last month and seems to me more precise than anything I have seen before. The evidence is quite startling at face value. Given the grave difficulties faced by the paper industry in this country at the moment I am sure that we will wish to give every consideration to the concrete evidence which the British Paper and Board Federation have presented and to any action we can take to ensure that there is a fair basis of international competition.

I should certainly be interested to have your reactions. In the meantime I am copying this letter to the Prime Minister and the other members of E Committee.

Yours ever,

George

FCS/80/173

SECRETARY OF STATE FOR ENERGY

Industrial Energy Prices

1. Keith Joseph's letter to you of 27 November proposes a number of specific measures to alleviate the difficulties which British industry attribues to the current level of certain energy prices.

2. In examining ways in which these measures might be implemented I hope that you will take the international implications of any revision of our energy pricing arrangements into account. In discussions in the Community, the IEA and elsewhere we have argued strongly that realistic energy pricing is the key to promoting the rational and efficient use of energy and encouraging energy conservation. Our public commitments on energy matters at Summit meetings have reflected this line. Any action which could be interpreted as a departure from these principles of economic pricing would obviously have implications for our position in such discussions.

3. It will also be important to ensure that action to reduce certain energy prices to UK industry does not undermine our approach to the US, either bilaterally or in concert with our Community partners, over the level of US energy prices - an issue on which certain sectors of UK industry feel very strongly, and on which officials are currently working.

4. Care will have to be taken to see that measures such as the suggested rebate of heavy fuel oil tax to industrial consumers, are consistent with the terms of the Treaty of Rome, in particular those articles dealing with state aids and competition. A rebate of duty on heavy fuel oil for the manufacturing sector would presumably constitute a state aid, be notifiable, and require Commission approval

/before

before it could be granted. In addition, the Norwegians might well regard with suspicion a scheme whose purpose was to avoid paying them the higher price for Frigg gas which straightforward abolition of the tax would entitle them to. Any such scheme would need to be legally water-tight.

5. None of these points in itself rules out the possibility of action on the lines proposed by Keith Joseph. But I should like our officials to consult closely over the detailed preparation of any changes in the existing pattern of UK energy prices; and I endorse Keith Joseph's wish to have a full discussion of the subject in E Committee.

6. Copies of this minute go the Prime Minister and Members of E Committee, George Younger, Nicholas Edwards, Robert Armstrong and Mr J R Ibbs, Cabinet Office.

C

(CARRINGTON)

Foreign and Commonwealth Office

10 December 1980

JU

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DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

Secretary of State for Industry

27 November 1980

The Rt Hon David Howell MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank SW1

Dear David.

INDUSTRIAL ENERGY PRICES

1 The Departments of Energy and Industry have received a mass of representations from industry about the relative level of energy prices in this country and overseas. Much of the evidence is inevitably patchy including the CBI memorandum which, as you have pointed out in your minute to the Prime Minister of 21 November, is disappointing. But I am sure you will agree that some of the evidence is balanced and convincing, notably the contributions from the chemical and steel industries. I think there is now common ground between the two Departments on the three areas where our prices put industry at a competitive disadvantage: electricity prices fr high load factor (hlf) users, (firm) gas prices, and heavy fuel oil prices. I would now like to propose an approach to removing these sources of grievance, which, as far as possible, has a neutral effect on the Exchequer.

Electricity

2 There now seems to be general agreement that British hlf users fare less well than their overseas competitors. The initiative, which you proposed in E Committee, to encourage the electricity industry to shade prices to large users in difficulty, although welcome in itself, cannot close the substantial gap between the tariffs paid here and on the Continent by hlf users (with load factors of 0.6 and above). This is illustrated in the attached chart produced by the Chemical Industries Association. I believe that the solution lies in reforming the structure of the bulk supply tariff (BST) so that hlf users pay only the costs of the most efficient generating capacity which supplies the base load and to load the costs of supplying peak demand on to those users whose demand patterns give rise to these peaks, which is where they logically belong. My suggestion involves a re-interpretation of the BST on the basis of the economic pricing principles, which you rightly advocate as the basis for energy pricing. I do not propose a departure from such principles which, apart from any effect on resource allocation, would run

/foul ...

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foul of the electricity supply industry's statutory obligations not to favour particular consumers unduly.

3 Some hlf users have indicated that they would need a price reduction of 40% to restore their international competitiveness. I doubt whether a reduction of this size would be consistent with economic pricing principles. It seems possible, however, that a reduction of 20% for those users with load factors in excess of 60% might well be consistent with economic pricing and I invite you to consider pressing for such a reduction. The Department of Industry is not in a position to make detailed calculations of the cost of such a proposal but I understand that a reduction of this order, equivalent to around 0. 5 pence per unit, might imply a loss of revenue to the electricity supply industry which amounts to around £80 million in a full year and that it should be possible to recoup this from other users by a price increase of approximately 2%. Clearly, precise figures would have to be calculated but it should be possible to demonstrate that hlf users' competitive disadvantage can be substantially reduced at no net cost to the Exchequer. Other parts of industry would, I realise, have to pay more, along with commercial and domestic users, but there is an economic case for altering the tariff to their disadvantage and they are in a better position to cope with higher charges; electricity accounts for a small proportion of their costs and their unexploited opportunities for energy conservation are probably considerable.

Gas

4 The position on gas is more uncertain. Although the Dutch have renegotiated nearly all their supply contracts, the phasing of the resulting price increases seems so gradual as to leave much of British industry paying substantially more than many of their competitors, notwithstanding the Ruhrgas policy of renewing contracts at 30-35 pence per therm and BGC's most welcome relaxation of the link with gas oil prices.

5 The domestic market is, I fear the logical place to look for a means of financing the cost of further concessions on industrial gas prices. At present domestic consumers appear to be undercharged by around 10 pence per therm (the marginal cost of supply in 1980/81 is 34 pence per therm, whereas the average price charged is 24 pence per therm). Last year we took a courageous step in announcing successive annual increases in charges paid by domestic consumers of 10% in real terms. This was needed to correct the growing imbalance between the industrial and domestic sectors. We took our decision at a time when our freedom of action was constrained by rising inflation but now, when inflation is coming under control, I think we should envisage a more rapid adjustment in domestic gas prices. If, for example, domestic prices were raised more rapidly than planned to their economic level of 34 pence per therm rather than the planned 31 pence per therm in 1981/82, BGC

/would ...

would earn additional revenue in the next financial year of £250 million. This would be sufficient to reduce firm gas prices to 25 pence per therm and interruptible gas prices to 22 pence per therm over the coming year, bringing industry's gas costs into line with the marginal cost of supply and with prices paid by Continental competitors and at the same time protecting Goeffrey Howe's need for revenue from the gas industry. We would need to discuss staging. I accept that we would exacerbate the current shortage of gas by acting in this way and would have to consider how else gas could be allocated.

Heavy Fuel Oil

6 There is convincing evidence that British industry pays more than its competitors for HFO. A substantial part of the differential is due to the 8% duty. Earlier this year I wrote to Geoffrey Howe proposing its abolition. An inter-departmental committee is currently considering the implications of abolition but I think it appropriate to raise the matter here in the context of energy pricing policy. The duty is strongly resented by industry; it is twice as high as any major competitor's duty on oil and it has lost whatever relevance it once had as a means of protecting coal and the balance of payments. The major stumbling block to its abolition is the escalation clause in the Frigg contract, which, as you know, raises the PSBR cost of abolition beyond the likely benefit to industry. I now propose that we side-step this difficulty by rebating the duty to manufacturing industry. This would entail some administrative costs but it could leave the Frigg contract undisturbed and would focus the benefits where they are needed. I would expect that the Exchequer cost of rebating the duty to industry would be in the region of £100 million in 1981/82. I realise that this is the only element in my proposals which might increase the PSBR and would therefore have to be offset in some way. An increase in the duty on petrol is the obvious source of additional revenue; an additional 2 pence per gallon could offset the cost of rebating HFO duty to manufacturing industry.

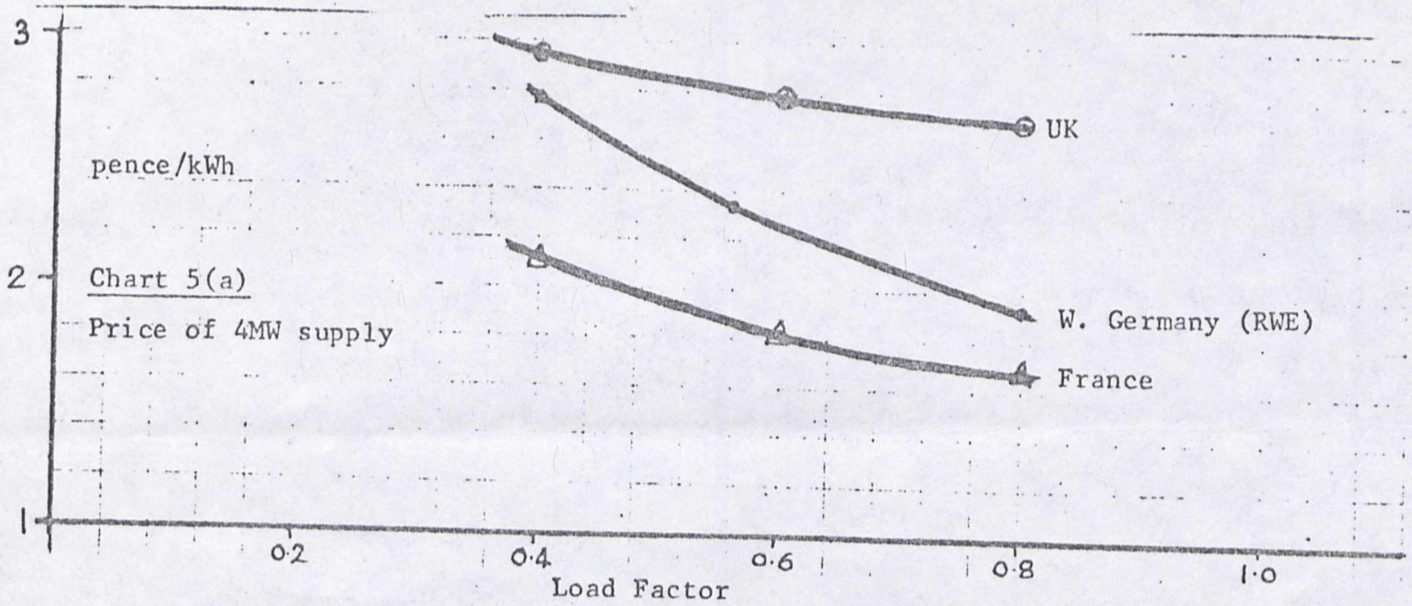
7 I hope we can discuss these specific ideas in E Committee.

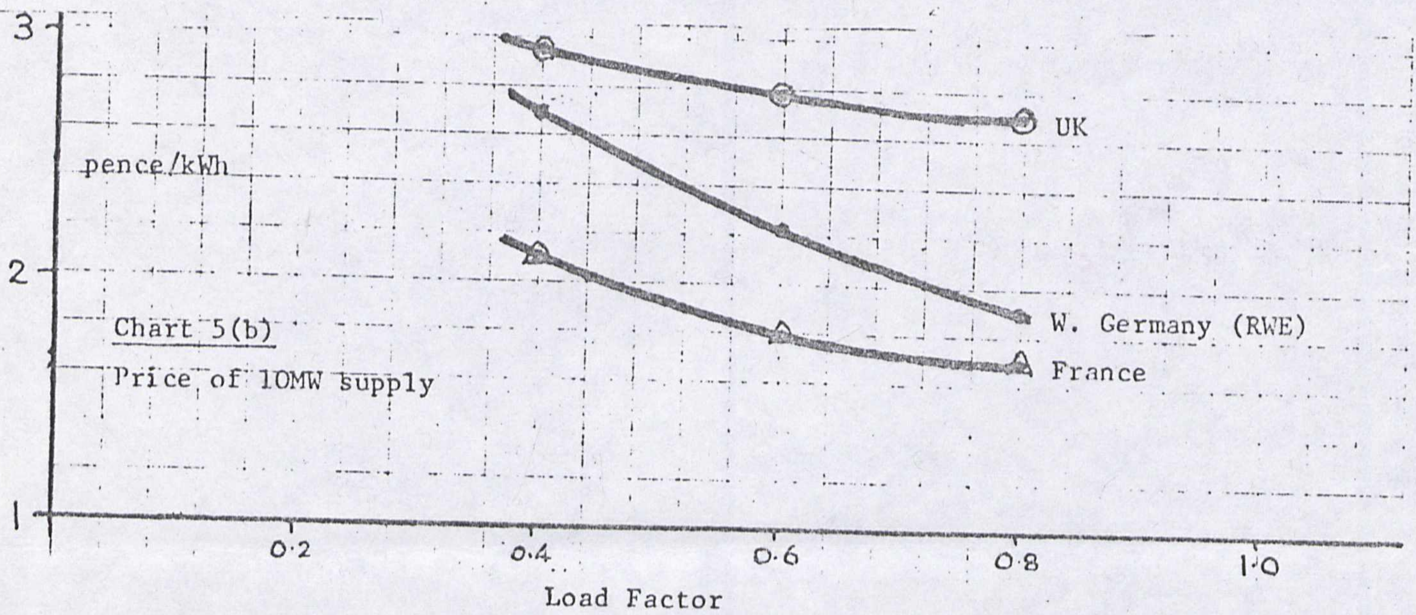
8 I am copying this letter to the Prime Minister, the other members of E Committee, George Younger and Nicholas Edwards as well as to Sir Robert Armstrong and Robin Ibbs.

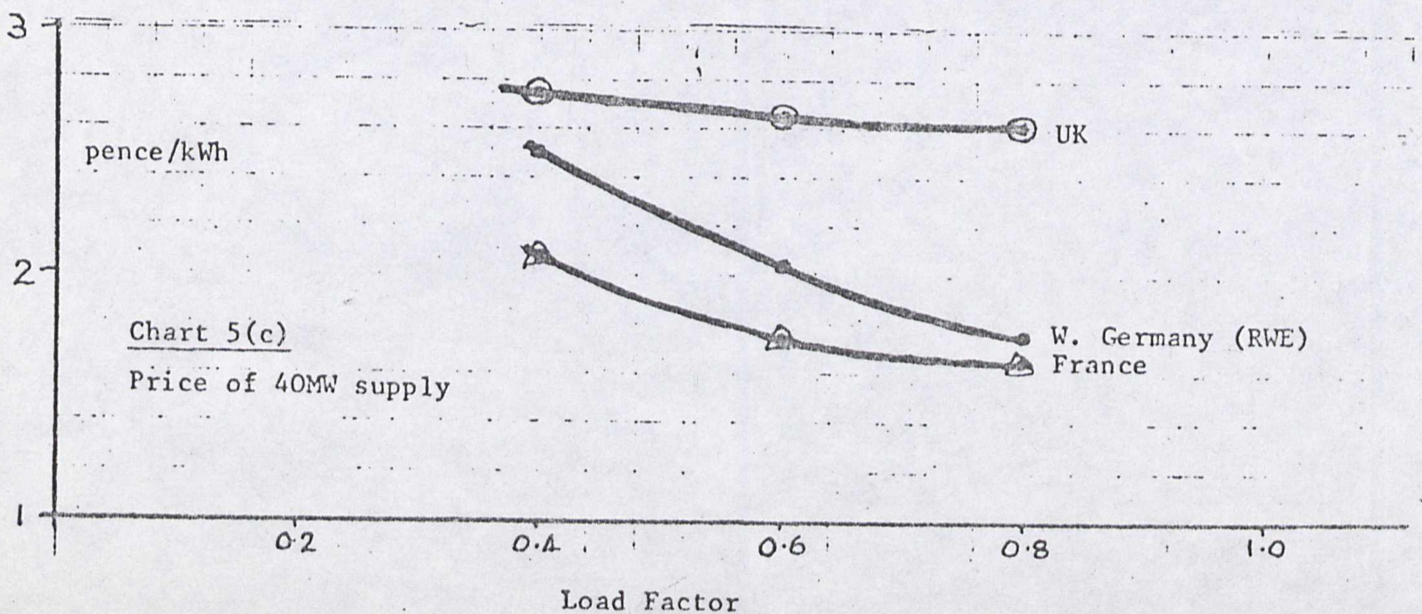
Keith

CHART 5

Average Tariff Prices of Electricity in Year 1980/81 in UK, W. Germany and France







PRIME MINISTER

ENERGY PRICES: CBI REPORT

1 I have now received copies of an interim report of the CBI's Industrial Energy Consumers' Group. I enclose copies of this report and of Sir Terence Beckett's covering letter and of my reply.

2 It is evident from Terence Beckett's letter that he intends to publish the report probably at the beginning of next week, although it could well leak in part or in whole over the weekend. I should mention that Norman Lamont has agreed to write an article explaining the Government's position on energy prices in the Sunday Telegraph this weekend.

3 The CBI report is disappointing. British industry generally undoubtedly faces serious problems at present. Some large energy intensive companies with a long term future have particular difficulties which their competitors in Europe and North America are not facing. I had hoped that the CBI, who can call on the resources of the whole of British industry, would provide me with up-to-date and detailed information on comparative international costs, so that we can see where the problems lie. Indeed I urged Terence Beckett to do so when he recently came to see me. In the event the CBI have produced a short interim report, based on a samply of only some 25 companies, which contains more assertions than facts. The Chemical Industries Association have produced superior data which my officials and the electricity supply industry are studying urgently.

4 I have therefore repeated my request to Terence Beckett to provide the detailed figures underlying the report so that we can get at the facts. While urging us to reduce public expenditure the CBI cannot really expect us to adopt policies, some of which could cost hundreds of millions of pounds to be found from taxpayers, on the basis of general and sometimes dubious assertions. While a full analysis of the CBI's paper and proposals must await their detailed information, I invite your attention to one or two points now.

First, heavy fuel oil prices in July 1980, which is the date used by the CBI, were depressed on the Continent. On the basis of unpublished EEC data, heavy fuel oil prices in France, Belgium and Luxembourg are now higher post tax than in the UK. Secondly, the chart on gas prices is misleading. It includes a random mixture of old, renewed and new contracts without distinction. It does not even include some very low prices in the UK. The German figure around 33p could suggest that German new/renewed rates are going above the BGC's renewal rate of around 30p a therm.

5 We cannot, however, wait for the CBI to complete their work. I am pressing ahead with the package of measures which with E's agreement on 5 October I have already announced and which have met with a positive response. It is particularly important to stimulate international action, notably now that there is a new Administration in the USA, and to maintain our pressure for increased efficiency in the nationalised industries.

6 I am sending copies of this minute and enclosures to the other members of E, Sir Robert Armstrong and Mr Ibbs.

Secretary of State for Energy
21 November 1980

Confederation of British Industry
Centre Point
103 New Oxford Street
London WC1A 1DU
Telephone 01-379 7400
Telex 21332
Telegrams Cobustry London WC1

From
Sir Terence Beckett CBE
Director-General

The Rt Hon David Howell MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
LONDON SW1P 4QJ

18 November 1980

Dear Secretary of State,

MEMORANDUM OF THE INDUSTRIAL ENERGY CONSUMERS' GROUP
ON COMPARATIVE ENERGY PRICES

As promised at our discussion on 31 October, I now enclose two copies of the report which has been prepared by the Industrial Energy Consumers' Group which we set up recently, as you know. As I mentioned to you at our meeting, we have not been able to get as large a sample as I would have wished, but this survey is designed to supplement rather than replace other data you have received for individual companies and trade associations.

I would emphasise that this is a report by the Industrial Energy Consumers' Group, but it has been seen by our Energy Policy Committee, who agreed with the intention to send it to you.

We were anxious to make this information available to you as soon as possible, with a view to assisting in the Government's consideration of the difficulties being experienced by the energy intensive industries arising from the level of UK energy prices. This is an initial report from the Industrial Energy Consumers' Group, and we shall continue to monitor the situation with the industrial consumers and indeed the energy suppliers and producers. I undertook to pass this information to you before releasing it to the Press, and I would therefore be grateful if you could let me have any reactions quickly. I would certainly like to be able to release the material to the Press within a week from now.

I am also sending a copy of this letter and the paper to Sir Keith Joseph.

Yours sincerely,

T Beckett

SECRETARY OF STATE'S OFFICE
TO Mr GUINNESS
FOR ADVICE (AND DRAFT REPLY IF APPROPRIATE)
PLEASE BY: ASAP.
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Mr TUCKER
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Mrs BROWN
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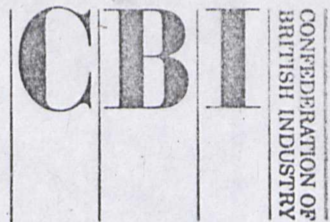
Secretary
Denis Jackson



T612 80

17 November 1980

UK ENERGY PRICES: MEMORANDUM FROM THE CBI INDUSTRIAL ENERGY CONSUMERS' GROUP

The concern of the industrial energy consumer

1 During recent months there has been mounting concern among many industrial sectors with regard to the rate of increase of UK energy prices and even greater concern that energy prices in the UK are higher than those enjoyed by our major international competitors. For the energy intensive industries, the level of energy prices is a major factor in international competitiveness and at a time when industry's costs are under extreme pressure on all sides, the additional burden of high energy costs can seriously threaten the viability of certain sectors of industry.

2 Various sectoral organisations and individual companies have already mounted strong representations to the relevant Government departments identifying the particular problems being experienced. Through the Industrial Energy Consumers' Group, the CBI has been examining the areas of common concern to the industrial consumer. A substantial amount of information on comparable international energy prices was contained in the various reports and studies produced by the individual sectors of industry. However, notwithstanding this information nor the possibility of a more detailed long term study, the Consumers' Group undertook a specific exercise of identifying price levels, particularly in EEC countries, actually being paid on three specified dates, by selected multi-national companies, with comparable operations and plants in the UK and abroad. The study was not intended to be comprehensive and the limitations of such an approach were fully acknowledged. However, when the enclosed bar charts for heavy fuel oil and firm gas prices, derived from this study, are considered alongside the information contained in the individual submissions from the various sectoral organisations, the scale of the problem is evident.

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Oil

3 Fuel oil prices in the UK over the last six to twelve months have been notably higher than in the majority of other EEC countries. The most recent figures in the enclosed bar chart for July 1980 indicate UK prices as being up to 20% higher than our major continental competitors. The high rate of excise duty levied in the UK is a significant factor in this disparity. The table below summarises the current rates of duty levied on heavy fuel oil in various EEC countries.

	duty (£/tonne)
United Kingdom	8.00
Germany	3.51
France	0.08
Netherlands	3.63
Belgium	0.00
Italy	0.50

4 However, excluding tax and duties, oil product prices were higher in July 1980 in the UK than in other EEC countries. A number of factors relating to the oil industry's marketing policy, the structure of the oil market and indeed the distribution systems in the various countries have to be considered when trying to identify the reasons for this disparity. Although the industrial consumer can acknowledge that these factors have to be taken into account, the end result, at specific times, is a higher price in the UK than on the continent.

Gas

5 The enclosed bar chart for firm gas prices indicates the wide price variations that exist within a country irrespective of the inter-country comparisons. However, the UK prices particularly for the large users have been substantially higher with differences of up to 40% when compared to France and Germany. This is in part a reflection of the more rigid and rapid application of an oil-market relating policy in the UK, which has aligned firm gas prices

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to gas oil whereas on the continent, where such a market relating policy has existed, firm gas prices have been aligned to heavy fuel oil prices. Although continental prices are likely to rise as a result of the higher prices now being sought by the gas exporting countries, it is by no means certain that this price differential will narrow, let alone be eroded, unless corrective action is taken to ease the proposed rate of UK gas price increases. It is important to note that by relating gas prices to those of fuel oil inclusive of duty there is an inevitable price disadvantage to the UK gas consumer as compared to his continental counterpart resulting from the higher UK oil product prices.

6 Irrespective of international comparisons, the industrial consumer is particularly concerned at the sheer rate of increase of gas prices in the UK which in the last year has averaged 30-40% and in certain instances has been as high as 70%. To an energy intensive industry, increases of this nature can be crippling. The industrial consumer is also aggrieved at the overall relationship between UK prices to the domestic and industrial consumers. As a result of successive Governments' intervention, the price of gas to the domestic consumer has been held down such that in the last financial year practically the entire profit of the British Gas Corporation was generated from its industrial and commercial business. At a time when the British Gas Corporation is being required by the Government to achieve a substantial financial return the industrial consumer sees the situation as being little short of an indirect tax on industry.

Electricity

7 Comparisons of electricity prices are only valid on the basis of comparable maximum demands and load factors. The information derived from the specific multi-national study was not sufficiently detailed in this respect to enable a bar chart for electricity prices to be drawn up similar to those on oil and gas prices. Nevertheless, from information contained in individual sectoral studies and indeed from published sources, it is clear that electricity prices to the small/medium sized UK industrial consumers are, at low load factors, roughly comparable with those in most other EEC countries. However, for the large user where electricity is an integral part of the process and indeed for

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those users operating at high load factors, significant disparities exist to the disadvantage of the UK consumers. It is evident that where disparities exist they are particularly marked in comparison with France and Germany. There is therefore considerable scope for further discussion between the users and the electricity supply industry on detailed tariff considerations and, in the more immediate future to establish whether particular load characteristics could be more realistically reflected in the price, as appears to be the case on the continent.

Coal

8 The question of coal prices has not been raised to the same extent as prices for the other fuels mainly because the usage of coal in general industry is restricted to a relatively small number of sectors, albeit some of whom use significant quantities, and for this reason a bar chart on prices has not been presented. Although indigenous EEC coal tends to be priced at a level similar to the UK, prices for imported coal used in Europe are seen to be between 13% and 30% lower than UK prices. It has to be noted that because of contractual agreements with the NCB, the additional inland distribution and transportation costs associated with the use of imported coal, do not make recourse to such coal a viable option for most general industrial coal users. In the medium/long term coal is likely to substantially increase its share of the general industry fuel market and the present questions regarding the price of UK produced coal via-a-vis imported coal and the level of subsidies for the coal industries in the various EEC countries are likely to grow in importance. However on a more general point the industrial consumer is obviously concerned at the impact of coal price increases on the cost of electricity generation and would not like to see UK electricity prices adversely affected because of uncompetitively priced UK coal.

Assessment and conclusions

9 From the foregoing comparisons it is clear that significant disparities exist between the level of UK oil, gas and electricity prices when compared to various other EEC countries. If comparisons are made with certain non-EEC countries, USA and Canada for example, then the disadvantage becomes particularly marked. A recent study by the chemical industry, which accounts for approx 15% of UK industrial energy consumption, compared the UK chemical industry "energy bill" with the size of the bills which would apply in France and Germany and quantified

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the differentials as being approx £200m to the disadvantage of the UK.

10 The industrial consumer finds it ironical that a country in such a favoured position with regard to indigenous energy supplies, far from using these natural resources to the benefit of its industry is actually penalising its industry by the high level of energy prices.

11 The significance of energy costs to industry should not be minimised as there are a considerable number of key industrial sectors where energy represents a substantial proportion of manufacturing costs. In the cement industry energy costs are up to 50% of manufacturing costs, in non-ferrous metals up to 40%, paper and board up to 30%, glass up to 26%, clay and ceramics up to 40%, textiles up to 15%, chemicals an average of 6% but up to 40%. There are many other such examples and it has to be recognised that in addition to being significant contributors to manufacturing GDP in their own right, such industries in turn are suppliers of raw materials to a wide range of manufacturing industry. Even for an industry with a relatively small direct energy component in its costs, there is the knock-on effect of high energy prices in terms of the indirect energy component in the cost of bought in materials. Therefore the concern regarding the impact of energy prices is widespread as indicated by the representation of industrial sectors on the Industrial Energy Consumers' Group who account for over 40% of manufacturing GDP and just under 40% of manufacturing employment.

12 The argument is often put forward that high energy prices act as an inducement to energy conservation. However, the incentive already exists for increased efforts to increase the efficient use of energy but the implementation of conservation measures, requiring substantial investments and often showing returns over a relatively long period of time, will not be enhanced by a high price energy policy at a time of a tight squeeze on profit margins.

Recommendations

13 Against this background of the importance and significance of energy costs, particularly to the energy intensive sectors of industry, the Industrial Energy Consumers' Group stresses the severe impact of rapidly rising energy prices on manufacturing industry, which exacerbated by a high exchange rate, threatens

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international competitiveness. As a matter of priority the Group recommends that:

i) The Government includes international competitiveness of British industry as a major factor in its energy policy.

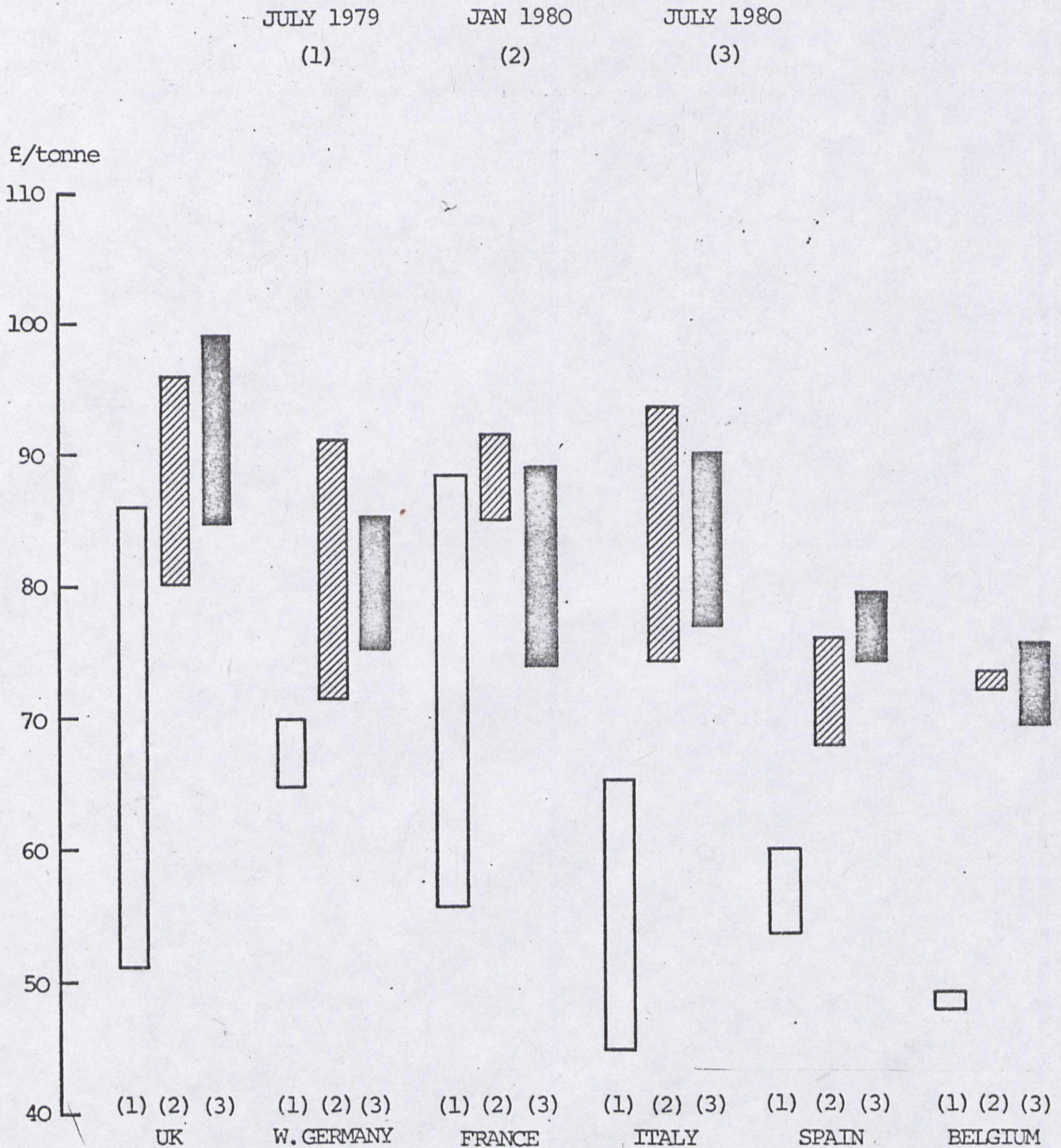
ii) The excise duty on fuel oil should be abolished immediately.

iii) The Government should be urged to recognise the impact on prices of onerous financial targets for the nationalised fuel and power industries and to take steps to alleviate this burden.

iv) The Government should urgently review the situation with the British Gas Corporation to ease the rate of price increases to the industrial gas consumer and with a view to making prices competitive with other EEC countries.

v) Further detailed discussions should be held between the electricity supply industry and the large industrial electricity users to ensure that the particular load characteristics of these industries are fully reflected in their price, as appears to be the case on the continent.

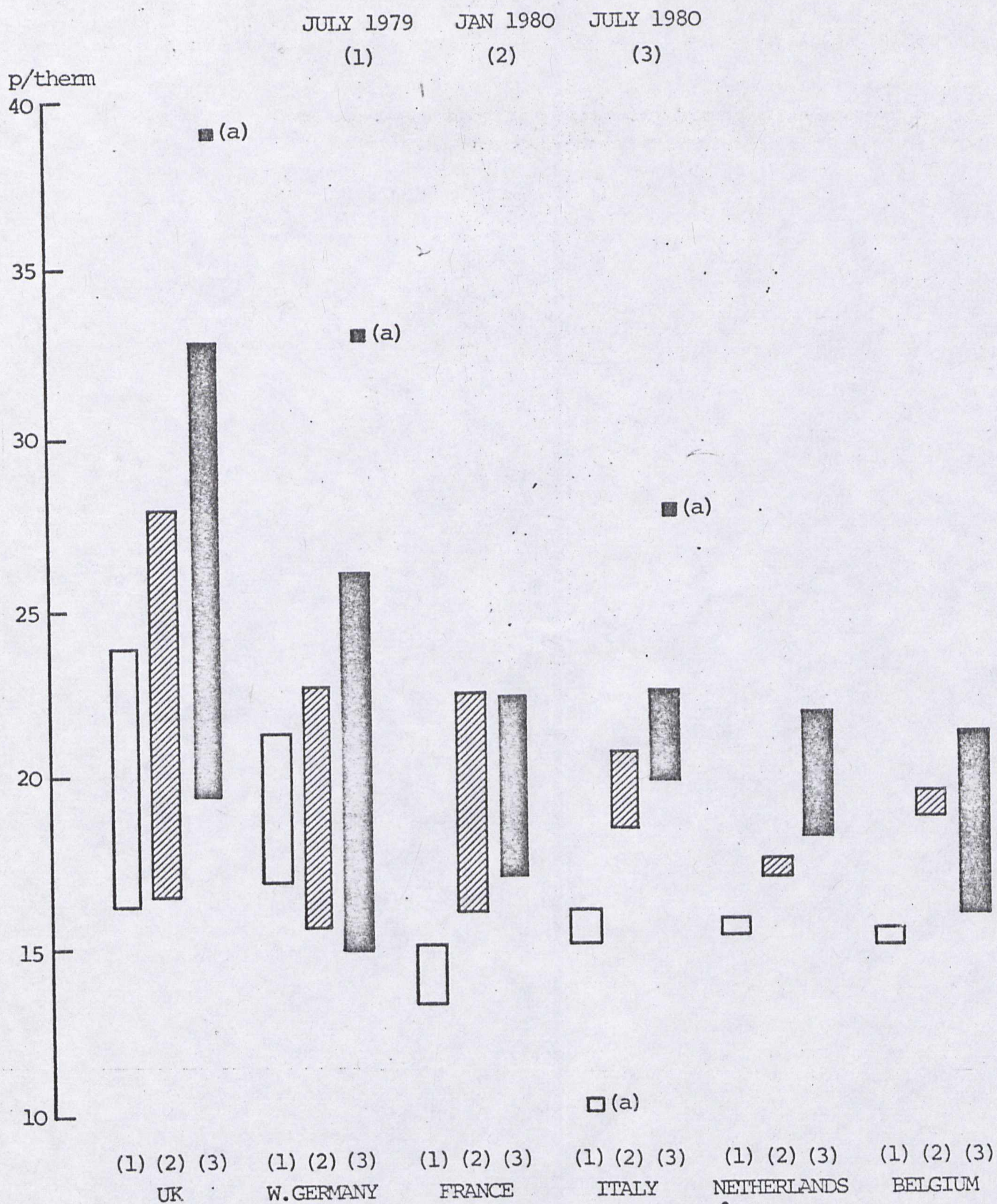
vi) The Government should ensure that the price of electricity is not adversely affected by uncompetitively priced UK coal.



NOTE: National currencies converted to sterling equivalents at the three respective dates. Some companies did not submit figures for each of the specified dates. Therefore the bar charts do not necessarily reflect a price trend within a country.

Prices exclude recoverable taxes.

FIRM GAS PRICES IN VARIOUS EEC COUNTRIES



NOTE: National currencies converted to sterling equivalents at the three respective dates. Some companies did not submit figures for each of the specified dates. Therefore, the bar charts do not necessarily reflect a price trend within a country.

(a) Isolated figures falling outside the main range of samples.

01-211-6402

Sir Terence Beckett CBE
Director-General
CBI
Centre Point
103 New Oxford Street
London WC1A 1DV

21 November 1980

Dear Sir Terence

MEMORANDUM OF INDUSTRIAL ENERGY CONSUMERS' GROUP ON ENERGY PRICING

Thank you for your letter of 18 November covering a copy of the report prepared by the CBI's Industrial Energy Consumers' Group.

As I told you when you came to see me on 31 October I am very conscious of all the problems with which British industry is currently having to grapple. Norman Lamont has given me a full account of the debate at the CBI Conference at Brighton. I therefore welcome the fact that the CBI has been working on the question of energy prices and will continue with this work.

I shall certainly study the report most carefully and may well wish to make substantive comments later. I readily accept that the report is only an initial report and that you have not been able to get as large a sample as you would have wished - I believe you mentioned that the sample covered some 25 companies. I also understand the difficulties in getting fully comparable data. In order to take this matter forward I should be grateful if you could now let me have the detailed data from these companies, which underlie the points made in this report. There is no need to let us have the names of the companies, although it would be helpful to know from what industries they came. As we have received only a limited amount of detailed data, it would be particularly valuable to have the full data from the large companies covered in your sample. I hope that my staff and yours can then get together as we proposed in August to go into the question of case-by-case international comparisons in depth so that together we can try to establish what the facts really are. As you know, the Government and the energy industries have already

taken a number of steps in the energy field to help deal with the problems facing industry, and the proposals in your paper need therefore to be considered against a clear mutual understanding of the real underlying difficulties.

Yours sincerely

David Howell

D A R HOWELL

CONFIDENTIAL

01-211-6402

Rt Hon John Biffen MP
Chief Secretary
HM Treasury
Parliament Street
London SW1

21 November 1980

Dear John

ELECTRICITY SUPPLY INDUSTRY (ENGLAND AND WALES) EFL 1981/82

We had a word about the position of the electricity industry. As you know, the EFL of -£210m which I put to them was way ahead of what they had said they could manage. Nevertheless, I made it clear that I looked to them to use their best endeavours to achieve this EFL without an average tariff increase from 1 April 1981 of more than about 12%.

Following our discussion I saw Tombs and again emphasized that I was looking for a commitment on the basis of best endeavours. The Electricity Council agreed yesterday that, while present assumptions on 1981/82 trading suggest an external financing requirement of about - £70m, they will use their best endeavours to meet the EFL of - £210m. They are proceeding on the basis of an average tariff increase from 1 April 1981 of about 12%. They consider that against this background, and with faster than expected movement towards economic pricing in 1980/81, some relaxation of the industry's current financial target is justified. I have told them that I agree that we now need to take a careful look together on the implications of these factors for the target.

A key element in securing the industry's agreement to use their best endeavours to achieve the EFL was my readiness to write formally to Tombs to confirm that the Government accept that since nationalised industries are trading organizations with large flows of expenditure and revenue, EFL's cannot be immutable; that I recognise that the industry face difficulties in achieving the 1981/82 EFL; and that I shall of course be ready to discuss the situation as it develops. Your officials were consulted.

We and the Council will be seeking to avoid speculation about the likely size of tariff increases next Spring.

I am copying this letter to the Prime Minister and to the Secretary of State for Scotland.

Yours ever

David

D A R HOWELL

Nat Ind

10 DOWNING STREET

NOTE FOR THE FILE

I was asked way back in October to set up a further meeting on energy. I was told by Tim to contact the Department of Energy and they would tell me when they were ready for their next meeting. They have never come back to me despite various enquiries from this end.
This is still pending.

CS.

No news from Energy yet. Leave it for the moment
CS.
24/11

17 November, 1980

Nat Ind

CONFIDENTIAL

MF.

Qa 05176

To: MR LANKESTER

From: J R IBBS

Industrial Energy Pricing

1. In E(80)128 the Secretary of State for Energy seeks colleagues' approval to his encouraging the Electricity Council and Area Boards to show what flexibility they can in bringing prices down closer to short-run marginal costs on a provisional basis for large users in temporary difficulties.

2. The CPRS agrees that the plight of the large users of electricity does seem to demand special examination. For them electricity costs usually constitute a large proportion of their overall costs and they have been the most vociferous in their complaints about prices relative to international competition. At the same time viewed from the commercial interests of the electricity supply industry, it can ill-afford in present circumstances to lose income if large users disappear.

3. The CPRS does, however, have reservations about the selective assistance scheme for companies in difficulties proposed by Mr Howell both on the grounds of -

(i) principle - how does one defend giving temporary assistance to one particular consumer and not his competitor who may well be able to point to energy conservation investment, higher productivity, lower wage settlements or other efficiency gains as the reasons for his better performance. When there is in general spare capacity throughout industry it seems perverse to support the inefficient. There may be exceptional cases where Area Boards shade the terms in their own commercial interests, but it seems doubtful whether the Government should explicitly encourage it.

(ii) practicality - who is going to decide on whether a particular consumer deserves temporary assistance; officials or area boards and on what basis? Will not the withdrawal of assistance in due course itself cause difficulties?

4. As an alternative, the CPRS suggests that the review of the Bulk Supply Tariff that is currently being undertaken be accelerated because to be useful in the present context a quick answer is needed. Consideration should then specifically be given to providing scope for some reduction in charge to all large users by offering a more flexible range of terms.

5. I am sending a copy of this minute to Sir Robert Armstrong.

JRI

4 November 1980

CONFIDENTIAL

Ref. A03441

PRIME MINISTER

Industrial Energy Pricing

(E(80) 120 and 128)

BACKGROUND

You raised a number of questions, summarised in Mr. Lankester's letter of 20th October (not copied to members of E other than the Chancellor of the Exchequer), on the Secretary of State for Energy's long paper, E(80) 120. The Secretary of State replied to these in his minute to you of 31st October. E(80) 128 is that minute with minor drafting changes to make it suitable as a Committee paper.

2. The papers are long, but the key general points are:-

(i) Economic pricing is central to energy policy - encouraging oil substitution, more efficient energy use and conservation of resources.

(ii) The level of energy prices has a crucial impact on the PSBR. Of course greater efficiency is important, especially for coal and electricity prices, but nevertheless the cost of price concessions to help industrial consumers can be very high (c.f. the experience of the last Conservative Administration in 1973-74).

(iii) On average fuel accounts for 5-6 per cent of industrial costs - for that and PSBR reasons any assistance should be highly selective if it is to be cost-effective.

(iv) While international energy costs, in the EC rather than the USA, are now moving more into line with our own, there is still scope for action in international fora to attack disparities.

HANDLING

3. In practice a number of questions on energy pricing will probably have been discussed under the previous item on the agenda - the nationalised industries' EFLs, E(80) 125. Subject to that, after the Secretary of State for Energy has introduced his paper the Chancellor of the Exchequer and the Secretaries of State for Industry, Scotland, Wales and Northern Ireland will want to comment.

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4. Given that time will probably be short, you may wish to suggest that Ministers should follow up any detailed points they may have on papers separately with the Secretary of State for Energy. You might then base the discussion on the proposals listed in paragraph 12 of E(80) 128, which subsume those in the earlier paper E(80) 120.

5. In particular, and always bearing in mind the interaction with the objective of reducing the nationalised industries' EFLs, the Committee will wish to decide whether they are satisfied with the limited action proposed for gas, electricity and oil prices; and with what is said on international action.

6. You will also wish to confirm whether you are in agreement with the proposal in paragraph 14 of E(80) 120 for a statement on energy prices.

CONCLUSIONS

7. In the light of the discussion you will wish to record conclusions on the recommendations summarised in paragraph 12(a)-(f) of E(80) 128 and on the proposal for a statement on energy prices in paragraph 14 of E(80) 120.

RA

ROBERT ARMSTRONG

4th November, 1980

A Bryant

Nat. Ind

01 211 6402

Rt Hon John Biffen MP
Chief Secretary to the Treasury
HM Treasury
Parliament Street
LONDON
SW1

R 3/11

3 November 1980

Dear John

ELECTRICITY (ENGLAND AND WALES); EXTERNAL FINANCING LIMIT 1980/81

Thank you for your letter of 27 October.

I agree that the 1980/81 position described in my letter of 13 October is welcome news. There will be an opportunity to consider the general position at E Committee in December in the light of end-November fuel stocks. As I said, however, there is a reasonable prospect that the reduced estimate of fuel cost in 1980/81 will offset the effect of the drop in demand, and the decision on fuel stocks which we took in August. As for the Financial Times articles at the beginning of this month, I like you thought that they were unfortunate, but they were not followed up, and I prefer to leave matters as they are.

As you know, we have been pressing the NCB to keep within their EFLs for this year and next. John Moore will see Ezra shortly for a monitoring meeting to discuss with him what steps the Board are taking and I will write to you again then.

I am copying this letter to the recipients of yours.

Yours ever

David

D A R HOWELL

File

10 DOWNING STREET

From the Private Secretary

3 November 1980

Dear Julian,

The Prime Minister was grateful for your Secretary of State's minute of 31 October on industrial energy pricing. She considers this to be a much more convincing analysis of the pricing issue, and she is content for the minute, together with Mr. Howell's earlier paper - E(80)120 - to be taken in E Committee this coming Wednesday.

In advance of that meeting, you may wish to be aware of the Prime Minister's comments on some individual points in the minute.

The Prime Minister believes the crucial, and most difficult, issue which has to be tackled is the industries' inefficiency and cost-plus mentality. On this point, she has queried the assertion in paragraph 2 that for the coal industries "a decent return on assets offers the best hope of escaping from the cost-plus mentality which can otherwise bedevil them": it seems to her that the coal industries' approach is cost-plus.

In addition, on paragraph 3, she does not regard the current EFL for the NCB as an "extremely tight financial discipline"; she agrees that it is vital that these industries should be set performance indicators which put pressure on them to improve efficiency rather than put up their prices in order to achieve their financial targets; and on the question of the 15 GW nuclear programme, she has commented that we need an organisation that is capable of seeing that the investment is cost-efficient and completed on time. On the question of competition, she has commented that the lifting of restrictions on private electricity generation ought to be more widely known and we ought to do something to encourage private sector investment.

On the question of the CEGB/NCB agreement, the Prime Minister has commented that the CEGB should be aiming to negotiate for a price equivalent to the international coal price. Lastly, in regard to paragraph 14, she doubts the assertion that "we would disastrously delay the vast process of re-tooling and new investment" if energy prices do not go up further. In her view, prices are already high enough to encourage this.

/I am sending

CONFIDENTIAL

I am sending copies of this letter to Peter Jenkins (HM Treasury), Ian Ellison (Department of Industry) and David Wright (Cabinet Office).

Tim Lankester.

Julian West, Esq.,
Department of Energy.

PRIME MINISTER

INDUSTRIAL ENERGY PRICING

1 Prior to taking further action on my paper on Energy Prices (E(80)120), I thought it would be helpful if I minuted you on the points which you raised on industrial energy pricing and which are set out in your Private Secretary's letter of 20 October.

2 No-one questions that the recent doubling of world oil prices and the consequent enormous upward pressure on all other energy prices is an uncomfortable and harsh process to which to have to adjust as the whole world is trying to do. Here in Britain we have every reason to let these prices work through - both in allowing oil and gas to be traded at market values and requiring the coal and electricity industries to pay their way by the earliest possible date. Market prices for oil and gas are the only alternative to detailed state control of the price - and therefore the returns and investment - in these limited, internationally-traded resources and would make sense even if they did not have major beneficial implications for the PSBR. Similarly, electricity and coal industries that make a decent return on assets offer the best hope of escaping from the cost-plus mentality which can otherwise bedevil them - and has bedevilled them - and will allow them to make essential cost-saving investments from their own resources. The pace at which fuel prices move towards the levels required to achieve these objectives should, of course, be carefully considered. It cannot be dictated solely by the apparent consequences for the PSBR because these can be offset or negated by the costs of adjustment which can result in lower public sector revenues and increased expenditures if the strains on industry are too great. Nevertheless, the broad strategic direction must be correct.

EFFICIENCY IN THE NATIONALISED INDUSTRIES

3 Of course, none of this provides an iota of excuse for our energy supply industries to be inefficient and live "fat". On the contrary, the pressure on their efficiency should be ever tighter so that the maximum benefits can be ploughed back into further expansion. I

agree with you that this applies especially to the nationalised energy industries from whom we, as shareholder, are entitled to expect the most vigorous performance on costs, whether their prices are market-driven (gas) or cost-driven (coal and electricity). I have made this clear from the start to these huge concerns and backed words with actions in the following ways;

(a) setting extremely tight financial disciplines for each of the energy nationalised industries. For example, the financial strategy set earlier in the year for the NCB has undoubtedly strengthened the Board's resolve in accelerating the closing of uneconomic pits from the rate proposed by the Board last year of 1½m tonnes pa to their current target of 2½m tonnes pa; this year they plan to achieve 3m tonnes and I hope there will be further improvements in future years. The elimination of high cost pits not only helps the financial position of the NCB, but also that of the CEGB which takes two-thirds of the NCB's production; coal and other fuels account for some two-thirds of the CEGB's total costs. The same tight discipline has sharply accelerated the CEGB's plans for power station closures and manpower reductions;

(b) performance indicators. It is vital that we ensure monopoly state industries do not meet financial and profit targets merely by putting up prices. I shall therefore be setting performance indicators for the gas and electricity industries in the near future and will consider a performance aim for the NCB early in the New Year when we have reviewed their financial strategy targets as it is important not to set them inconsistent targets;

(c) requiring priority for investment programmes which cut costs. For example the 15 GW nuclear programme is designed to reduce the cost of the electricity, while low cost high-productivity pits such as Selby will have a similar impact on coal costs, especially when coupled with the faster closure of uneconomic pits;

(d) independent assessment and investigation. We have recently taken powers to have the cost and efficiency of nationalised industries examined by the Monopolies and Mergers Commission. The CEGB has been under rapid investigation under these powers, and the results will be available shortly;

(e) coal import facilities. At my request the CEGB is actively studying the possibility of new coal import facilities, which would further increase the pressure on UK prices;

(f) competition. We will be lifting restrictions on private generation to encourage long term competition in the electricity market; We must let this be more widely known & do something to encourage such investment.

(g) Board appointments. We are strengthening the Boards of the nationalised industries, particularly the NCB and CEGB, by bringing in outside directors from the private sector with a more commercial background and outlook.

4 I agree with you that it is particularly important to improve efficiency and productivity in the coal industry because of its effects on electricity prices. Many of the policies I have outlined above are designed precisely to do this. We must also keep up the pressure on other nationalised industries. In this context you might be interested in seeing the attached note on some of the steps being taken by the CEGB to improve efficiency. (ANNEX)

5 But it is necessary to bear in mind the timescale in which these measures will have their full effect. Efficiency cannot be increased fast enough to make any significant difference to energy costs, and thus to the prospects of energy-intensive industries, during the immediate recession period. While we will be unrelenting with measures to improve efficiency in the nationalised industries, I believe we will need to consider their relationship with Government and the sanctions which can be used to substitute for market competition.

6 As regards efficiency in the coal industry, you were concerned about the CEGB/NCB agreement. As the CEGB mentioned at the meeting which we arranged with David Wolfson on 24 October, the NCB's prices to the CEGB were rising faster than the rate of inflation prior to that agreement. The first step was therefore to bring down the rate of price increase to no more than the rate of inflation. The CEGB are now pressing the NCB to raise prices at a rate below that of inflation - an outcome which would be highly desirable but which the NCB will find it very difficult to achieve.

WHAT OTHER COUNTRIES ARE DOING

7 It is still true to say that average UK electricity and gas prices are broadly comparable with those on the Continent. (I deal with the North American position in paragraph 8 below). Most of the representations we have received are not about average prices, but rather about electricity prices for large and energy-intensive users and the price of new or renewed firm gas contracts. While we do not have full data - despite repeated requests the CBI have still not given us their data, although I hope they will when Terence Beckett comes to see me today - I accept that at least in some cases our competitors in Europe may have a price advantage over us in respect of some electricity and gas contracts.

8 There are three possible causes of these disparities. First in the case of electricity (which in general is not internationally traded) some countries' costs are much lower than ours as a result of a large nuclear programme (France), abundant hydro power (Canada, Norway and to a lesser extent, France and the USA) or abundant open-cast coal (USA). This we must accept. Secondly, in the case of gas, all members of the EC other than ourselves have decided to load costs more on to domestic prices and less on to industrial prices. Even when the price increases to our domestic gas customers already agreed are fully implemented they will be much more favourably treated than their European counterparts. Thirdly, there are undoubtedly cases of unfair competitive practices both in the USA and in the EC. This calls for a robust response and for eighteen months we have been applying increasing pressure to the USA, in the IEA and elsewhere.

We must intensify this. As a result of the efforts of Peter Walker and his colleagues, the European Commission have taken the Dutch to the Court for subsidising their glasshouse industry. I suspect that this case is by no means unique and that there are other cases of subsidisation to large users. But in order to take effective action we need hard facts about subsidisation. Our industry has often failed to provide this. Much of the work will inevitably have to be done by our industries themselves. But my Department has been in touch with the other Departments concerned about identifying cases where unfair competition is damaging our industries.

9 I share your concern about the slow rate of deregulating gas prices in the USA. We must press the new Administration to accelerate this process. But this will not be easy to achieve. We must therefore use all the weapons we have at hand. First, I agree with the recommendation in the report by officials (paragraph 7.3) that the decisions on a more rapid move to economic pricing at the various Summits must be tightened up. Secondly, we must press our Community partners to ensure that the Commission tackles the Americans on this issue; (I raised this matter with Davignon when he was here last week and he is keen to act). Thirdly, my officials are working with other Departments on what additional pressure can be brought to bear on the Americans, including the imposition of countervailing duties in appropriate cases.

MARGINAL COST PRICES IN THE ELECTRICITY INDUSTRY

10 Turning to the points you raised on this issue, David Wolfson will no doubt have told you that we arranged for him to discuss this with Frank Tombs and Fred Bonner (Deputy Chairman of CEGB) on 24 October. The Council said then that since short run marginal cost (SRMC) respresents a large part of the total cost of producing electricity, selling it without covering fixed costs would not help companies who want a large and continuing reduction (eg Bowaters who were seeking 50%). Nor would selling at SRMC to companies in difficulty have any significant effect in generating extra revenues or increasing sales. Most companies want cheaper electricity, not more at present. However, I have asked Keith Joseph whether we can get his people to draw up a list of companies in particular

difficulties on electricity costs (eg in steel or ceramics) to see what can be done.

11 There are legal problems which prevent Area Boards openly giving particular customers preferential treatment (which would in any case be greatly resented by small industrial and commercial users). But some Boards can and do cut prices a little to customers in temporary difficulty and they should be encouraged to do so. Area Boards also help their customers to programme their electricity demand to obtain the maximum benefit from the Bulk Supply Tariff.

OUR LINE FOR THE FUTURE

12 I am fully aware of the present predicament of that part of British manufacturing industry which gets hurt, rather than boosted, by high energy prices and of the need to give what help for adjustment we can in energy and other fields without over-turning our whole medium term financial strategy. I believe the approach outlined in my E paper and this minute will make some contribution to easing these industries' difficulties. In summary this was:

(a) an intensification of our efforts to improve efficiency and productivity in the energy nationalised industries, notably the coal industry;

(b) endorsement of the BGC's proposals to charge only some 75% of the equivalent of gas oil prices for renewed firm gas contracts (currently on 28p-30p) - a price that is well below the prices now being charged by the largest German gas utility (cost to PSBR £100m);

(c) pressure on BGC to reduce their price for new firm gas contracts from 40-42p to the price of renewed contracts for firm gas (cost to PSBR £10m);

(d) encouraging the Electricity Council and Area Boards to show what flexibility they can in bringing prices down closer to SRMC on a temporary basis for large users in temporary difficulties, and to help their customers obtain the maximum

benefit under the existing Bulk Supply Tariff;

(e) tougher international action along the lines set out in paragraphs 6-8 above;

(f) pressing the three large oil suppliers to reduce their product prices.

13 I believe the above represents a positive response to the needs of industry. But our line has to take into account our economic strategy, on which the Chancellor has recently submitted papers to the Cabinet, as well as the position on EFLs which we discussed last Wednesday. We must also accept the harsh fact that a number of cases which have been drawn to our attention concern labour-intensive and energy-intensive industries which would be in difficulties in any case (segments of our steel, textiles and paper industries) regardless of the present recession, high interest rates, high exchange rate and increased energy prices. Many of the companies could do more to help themselves, eg Bowaters should have approached Manweb and not vice versa. Some of the complainants have not applied existing energy conservation technology to their operations. I am especially concerned when I learn of the massive reorganisation and new manning going into Japanese industry, so as to cut sharply energy use and costs, and when I compare it with our own more dilatory approach - with certain creditable exceptions.

14 Finally there are three further equally important reasons why it is deeply in our interest to allow economic forces to work as far as possible in energy pricing. First, if we did not, we would disastrously delay the vast process of re-tooling and new investment in industry required to increase energy efficiency and cut energy use. Second we would delay the investment in new alternatives which almost every other country is pursuing - and those that do not will be the orphans of the 90's. Third, high energy prices, however painful for some, bring enormous opportunities for new industries in a major energy producing economy like ours. The more our business community seizes these opportunities, by investing more in our energy industries, offshore and onshore, as well as in energy

No - the prices are already high enough to encourage this

equipment industries and all their suppliers, the stronger we will be relative to others. Already 36½% of all industrial investment is in energy and energy-related industries in Britain. This is job creation, not job destruction, and what is more, job and wealth creation in precisely the areas where world demand is going to expand most vigorously.

15 I am sending copies of this minute to Geoffrey Howe, Keith Joseph and to Sir Robert Armstrong.

DH.

Secretary of State for Energy
31 October 1980

CONQUEROR
LONDON

COSTS AND EFFICIENCY IN THE CEGB

1 The CEGB has for many years published a series of performance indicators (including some international comparisons). These have recently been extended and the 1979/80 figures are attached.

2 The CEGB has the objective of trying to keep unit costs of electricity constant in real terms; this notwithstanding that fuel, which accounts for over 60% of its costs, has been rising faster than the general rate of inflation. The measure of the Board's considerable success in this can be seen in Figure 1 attached.

3 The Board is also making special efforts to contain its fuel bills. The agreement with the NCB (aiming to get coal price increases below the inflation level) is a case in point. Further improvements are being sought by holding oil burn to a minimum and securing high availability and thermal efficiency from 500 and 660 MW coal fired sets.

4 The Board's 40% expenditure on items other than fuel is roughly divided between capital fixed charges (20%) and salaries, plant repairs and maintenance, research and administration. In the current financial year these latter items total some £100m (out of total net expenditure of over £6,500m). Half that £100m will be concentrated on maintaining nuclear plant, high merit coal fired plant and the transmission system. The Board is striving for the right balance between cutting repair and maintenance work to the minimum to produce immediate cash savings and ensuring that enough maintenance work is done to get the plant performance necessary to achieve the Board's cost per unit target this year without imperilling performance and costs in subsequent years.

5 More specifically the Board is taking a number of actions to meet its EFL and financial target not by price rises (which could further depress demand) but by redoubled cost cutting efforts and pruning out marginal capital expenditure. The main features have been:

i close scrutiny of the Board's programmes. For instance, in the 1980 Programme aggregate capital expenditure for the quinquennium has risen by £700m at March 1980 prices compared with earlier budgeted figures.

ii Tight restraints on manpower, including a ban on recruitment during January to March 1980, ensured that the number of men in post at 31 March 1980 was no higher than a year earlier. Recruitment of staff from outside the CEGB is being restricted. To achieve this, despite the need to build up manpower to commission stations under construction, the budget submissions from operating units have been reduced by 1000 men, at a salary saving of £10m. Manpower in various Headquarters formations is to be reduced by 5% by 1982.

iii cuts in purchases of materials, goods and services (a reduction of £34m was achieved in 1979/80).

iv accelerated closure of older and less efficient plant. The Board has announced plans to decommission 3.4 GW of capacity in 1981/82. Some 3000 to 4000 jobs will go as a result.

v introduction of more stringent appraisal rules for optional investment; a 3-year pay back is now required.

vi placing oil-fired units on a two-shift regime. This is a complex and difficult operation. The Board is also reviewing system security to establish whether there are commercial benefits from a degree of voltage reduction before bringing high cost peaking plant into operation at times of peak demand.

vii reduction in travel costs and postponement of work on improving office accommodation coupled with severe attention to good housekeeping.

6 The investigation into CEGB's efficiency and costs currently being carried out by the Monopolies and Mergers Commission will provide a valuable cross-check on the Board's efficiency.

180
160
Average earnings of employees in the UK
140
Average price of fossil fuel per GJ
120
100
Total costs per kW h
80
60
40
20
0
Index
1958-59 1961-62 1964-65 1967-68 1970-71 1973-74 1976-77 1979-80

Figure 1: CEGB costs, average price of fossil fuel and average earnings, all adjusted for changes in the Retail Price Index (1958-59 = 100)

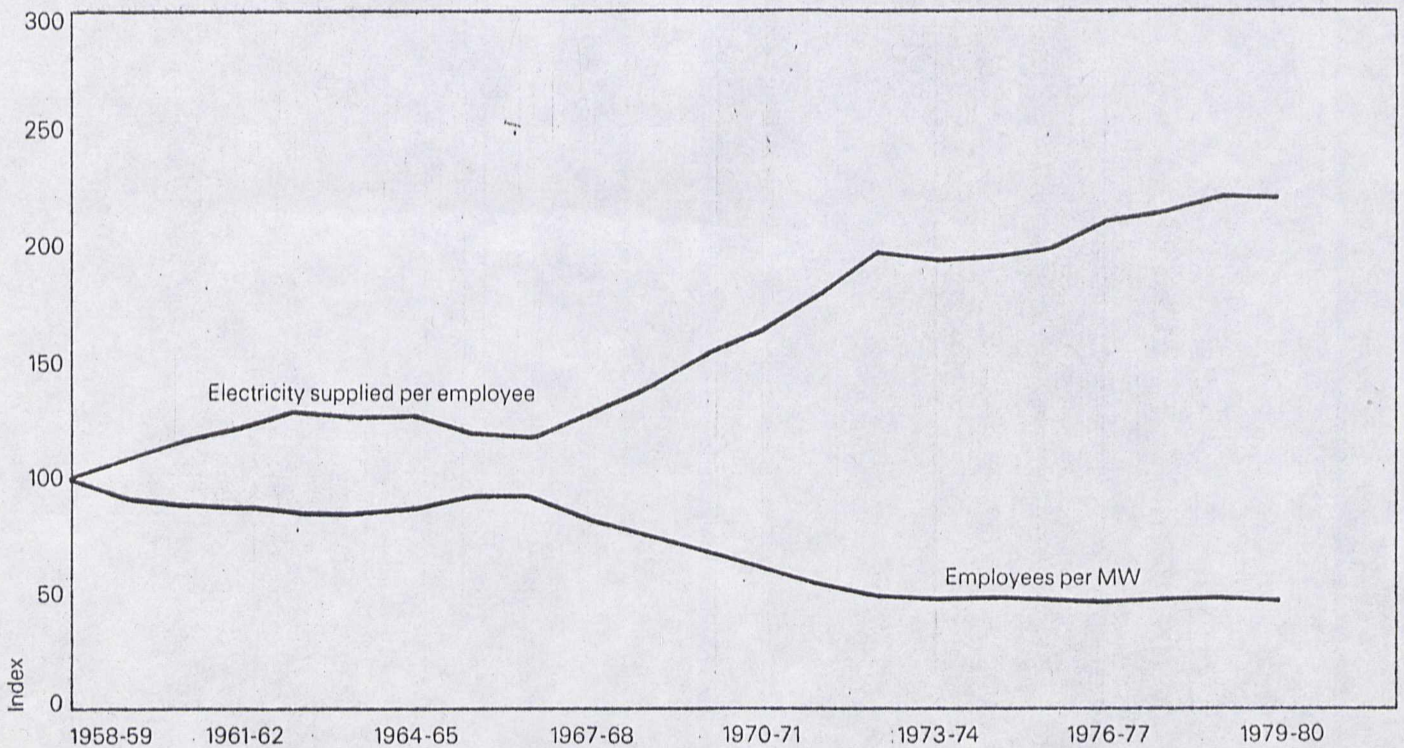


Figure 2: Manpower productivity indices (1958-59 = 100)

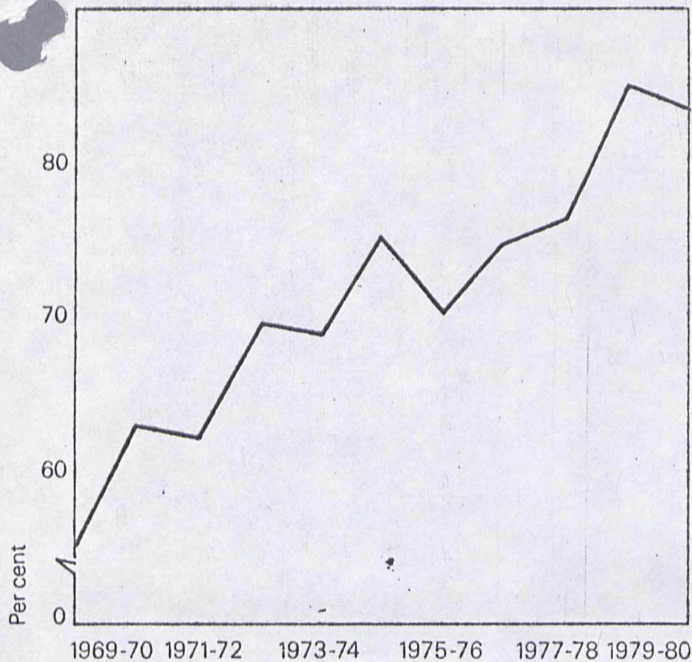
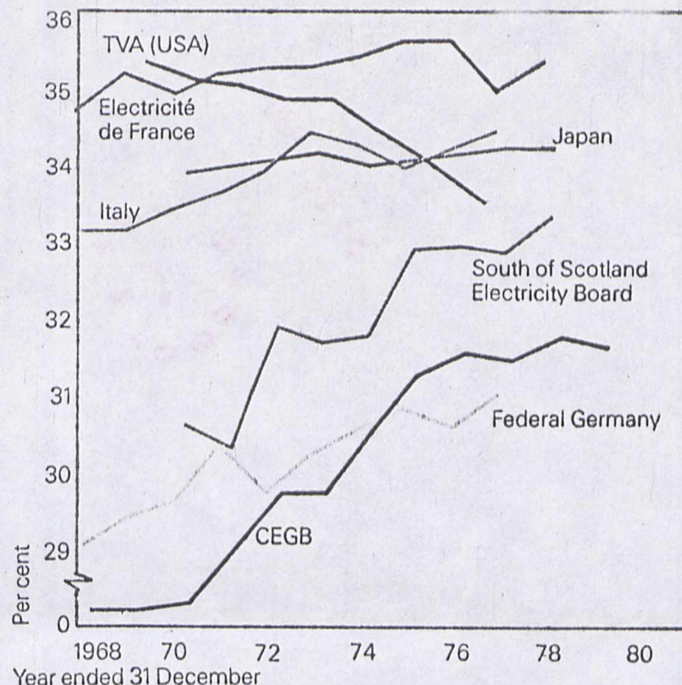


Figure 3: Mean availability of CEGB conventional 500-600MW single shaft generating units at time of daily peak for weekdays for the winter period (December, January & February)



Values plotted at date of end of financial year: 31 December for Electricité de France, Italy, and West Germany, 31 March for CEGB, Japan and SSEB and 30 June for TVA until 1976, thereafter 30 September.

Figure 4: Trends in conventional system thermal efficiency for the CEGB and other utilities

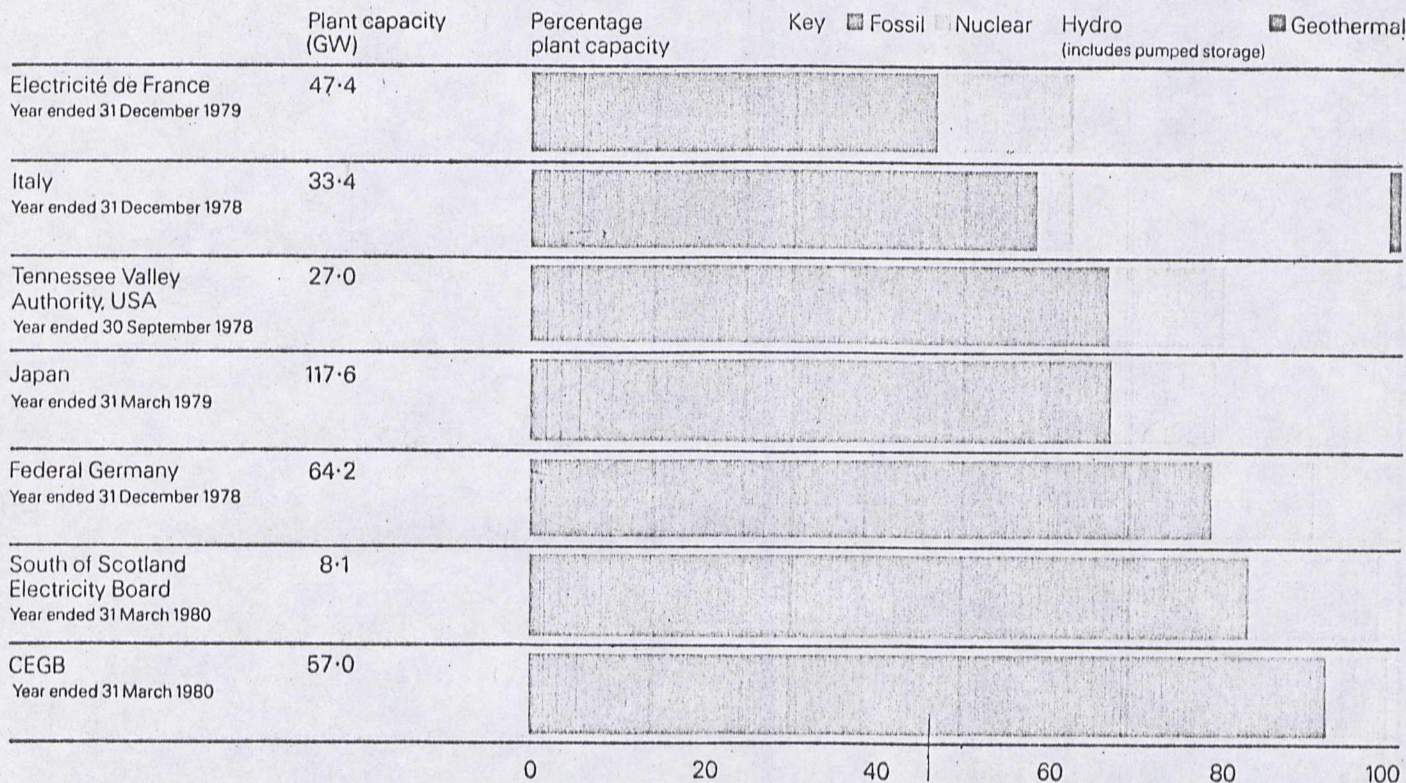


Figure 5: Plant capacity for various utilities classified by energy source

CONFIDENTIAL

Not Ind

01-211-6402

Rt Hon John Biffen MP
Chief Secretary
HM Treasury
Parliament Street
London SW1

31 October 1980

Dear John

BGC: 1981/82 EXTERNAL FINANCING REQUIREMENT

It was agreed at E Committee last week that we should consider further the measures necessary to achieve the EFLs for 1981/82 listed in column 2 of Annex A to E(80)121. The figure for BGC is -£399m (outturn) although this was based on a domestic price rise of 27% in April 1981, together with a slightly less relaxed approach to industrial pricing. Without these, and with a more realistic inflation-based domestic increase of 15% in April followed by 10% in October BGC forecast their external financing requirement would be -£284m.

2 I have discussed with BGC ways in which they could meet an external financing requirement of -£399m. They made the following points:-

(a) their forecasts have already been revised substantially upwards from -£99m and they will be very hard pressed to meet them. In particular their trading position can be significantly affected by the level of economic activity, the weather and the exchange rate; factors over which they have no control;

(b) their forecasts assume that the Government does not decide to implement the radical solution proposed by the Monopolies and Mergers Commission for their appliance retailing activity. Turnover in this area and the related area of installation and contracting is forecast to be £478m in 1981/82 against operating costs of £471m. BGC advise me that the revenue losses which would result from implementing the radical option would not in the short term be matched by similar cost savings. As a result the radical option could initially significantly reduce their forecast cash flow. I do not accept that this factor need have any impact in 1981/82;

(c) this year's April domestic price increase was based on the inflation rate prevailing when the increase was announced (ie the December 1979 rate) followed by 10% in October. They are forecasting that the rate of inflation in December this year will be 17% and that it would be quite consistent with the domestic pricing policy to announce a 17% April increase in January followed by 10% in October. If in the event inflation were lower than 17% in December then the April increase could be correspondingly lower and some, if not all, of the lost revenue would be recovered by the impact of this lower rate of inflation on their costs. They feel therefore that it would be quite acceptable to count on the £30m that the 17% April increase would bring;

(d) they also plan not to relax their industrial pricing policy any further than they have already done in response to market forces (this has accounted for £100m of the deterioration in their forecasts). This means that their contract renewal prices for firm gas would continue to be about 75% of the current industrial gas oil price and should be significantly below German and possibly other Continental gas prices. This slight change from their previous assessment of what the market would require seems acceptable to me and would generate £20m. They have stressed that any further move away from their industrial pricing policy would reduce their cash flow.

(e) bringing forward the 5% increase in their non-domestic tariff to April would generate £5m. Since it would be significantly less than the domestic tariff increase this would seem to be unobjectionable particularly as after the October domestic increase the two tariffs would be largely the same.

3 All these changes would bring their external financing requirement to -£339m. We must accept that BGC will be hard pressed to meet these revised forecasts and the scope for significant cost savings in 1981/82 is limited. In arriving at the -£284 external financing forecast they are already assuming an upturn in economic activity in the second half of next year as a basis for their sales forecasts. They have also cut their capital investment by £120m and their wages and other costs by £75m.

4 Although they would need to examine the question in more detail, they felt that the remaining £60m could be met by a combination of cutting manpower by 5,000, reducing profitable investment, and various other small savings. The manpower cut would be split roughly 50/50 between contractors and BGC employees. In cutting profitable investment they would be eliminating proposals which had a 25% forecast rate of return.

5 I have however serious doubts about accepting their proposal to assume a 17% domestic increase in April. Currently inflation is running at below that rate and will be still lower in April, and I would see very grave difficulties in explaining why BGC should increase their domestic prices in April by more than the rate of inflation. I am therefore not inclined to accept their proposal.

6 Their proposals for raising a further £60m largely by manpower and investment cuts could also cause us problems. Half of the manpower cuts will be in contractors' labour which is more expensive than their own labour. Such a move would add to any problems facing the construction industry. I am not therefore inclined to recommend this.

7 As for their proposal to cut investment further I see difficulties here also. This investment is profitable and we will see the effects of cutting it out later in reduced cost savings and efficiency. I think BGC have already cut enough capital investment, much of which they assure me is profitable. To accept further reductions would not only have an impact on their efficiency but also reduces opportunities for private sector industry. I do not therefore recommend this either. It would also go directly against our aim of trying to minimise cuts in highly profitable investment projects.

8 Thus the external financing requirement which I think BGC can achieve on the basis of the present forecasts is -£309m.

9 BGC have however said that they could not commit themselves to meeting an EFL set at this level without having a revised 3 year financial target. Their reason is that because we have announced our intention to impose a levy on their purchases of PRT exempt gas they cannot assert that the profits being generated by the Corporation are needed to meet their statutory duties. As a result they feel that their prices both domestic and non-domestic are open to challenge in the courts. They have asked therefore for a post-levy target and have suggested that this should be set at a level which will allow them to retain all of the £739m pretax and interest profits they are forecasting for next year.

10 I do not accept this, although we must take note of the possible challenge to their prices. I propose therefore to press ahead quickly with the levy now that we have received their revised forecasts for the three years up to 1982/83. I aim to write to Geoffrey Howe shortly with proposals. I would hope that we could then announce how much the levy was to be and a revised target for BGC in advance of publishing the legislation. I would also aim to have the legislation enacted as far as possible by the time BGC had to implement their domestic price increases.

I am copying this to the members of E Committee, the Attorney General in the light of BGC's comments on their statutory position and Sir Robert Armstrong.

Yours ever,

David

D A R HOWELL

Nat Ind

Prime Minister
To note that the Howell is no longer seeking an increase in the EFL for electricity.

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon David Howell MP
Secretary of State
Department of Energy
Thames House South
Millbank
London SW1P 4QJ

27 October 1980

Dear David,

ELECTRICITY INDUSTRY (ENGLAND AND WALES):
EXTERNAL FINANCING LIMITS 1980-81 AND 1981-82

Thank you for your letter of 13 October informing me that you are not now seeking an increase in the EFL for the electricity supply industry in England and Wales to take account of the decision on fuel stocks taken by E Committee in August.

This is welcome news. It makes doubly unfortunate the damaging report in the Financial Times of Wednesday 8 October that the Government had accepted that the industry may exceed its cash limit this year by as much as £80m. There was a further reference to this the following day in the Financial Times leader on Tombs' resignation which referred to "... a further setback in the Government's increasingly unsuccessful struggle to impose unrealistic cash limits on the nationalised industries." Could I suggest that now an increase in the industry's cash limit is not in prospect, you might make a public statement, eg through an inspired PQ, that the Government has discussed the EFL with the industry and that there are no plans to increase it?

I note from your letter that the NCB have said that the CEGB will have to take their full 75m tonnes of coal under the "understanding" between the two industries if the NCB are to have any prospect of keeping within their EFL this year. I assume from what you say about the electricity supply industry's EFL that it is indeed their intention to lift 75m tonnes. I also assume that if the electricity supply industry lift 75m tonnes, the NCB will be able to keep within their EFL, provided the Board takes the corrective action which your Department has already urged on them. I should be glad if you can confirm that this action is being taken, and that a breach in the NCB's EFL is no longer in prospect.

I am sending a copy of this letter to the Prime Minister, the other members of E Committee and the Secretary of State for Scotland so that they can be aware that an increase in the electricity supply industry's EFL for 1980-81 is no longer in prospect. A copy also goes to Sir Robert Armstrong.

Yours
John Biffen

JOHN BIFFEN

FROM THE MINISTER FOR INDUSTRY AND EDUCATION

Nat Ind

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU
TELEPHONE: 01-233 3000

The Rt Hon John Biffen MP
Chief Secretary
HM Treasury
Parliament Street
LONDON
SW1P 3AG

21. October 1980

CONFIDENTIAL

SCOTTISH ELECTRICITY BOARDS: EXTERNAL FINANCING LIMITS 1981/82

1. It occurred to me, on seeing a copy of David Howell's letter of 13 October about EFLs for the electricity supply industry in England and Wales, that you might find it helpful to have the overall picture for the industry in Great Britain before tomorrow's meeting of E Committee. I am therefore writing in George Younger's absence to explain the position of the Scottish Electricity Boards.

2. The Scottish Boards put forward for the IFR the following proposals for their external financing requirements for 1981/82:-

SSEB	NSHEB	TOTAL
£m	£m	£m
65	27	92

These, in common with all the other figures in this letter relating to the Boards' financing requirements, are at 1980 survey prices.

3. In advance of their major revision of forecasts for next year's capital investment review, work on which has only recently begun, the Boards have made no adjustment to the load forecasts submitted in April, which are based on the assumption that GDP will fall by 2% in 1980 and rise by 0.5% in 1981. The other main assumptions underlying the Boards' current forecasts are as follows:-

(a) coal price increases totalling 20% in 1981/82

(b) a year on year increase in inflation of 12% at March 1982

(c) an increase in salaries and wages in 1981/82 of 10% (originally set at 15% but revised recently in the light of the decision by the Electricity Council to reduce its forecast of salary increases to 10%).

(d) An average interest rate on new borrowings of 11¾%.

These assumptions do not appear to be significantly out of line with those made by the Electricity Council.

4. The Scottish Boards have not as yet taken any decisions about the level of tariff increase to be applied next year although they have indicated that their recent, and continuing, experience of falling sales suggests that it would not be commercially sensible for this to be higher than the going rate of inflation. The IFR external financing requirements quoted in paragraph 2 above are consistent with a forecast tariff increase of 15% and other assumptions as in paragraph 3, with the exception of the salary increase assumption which would be 15%. In the course of your bilateral with George Younger on 2 October you agreed that part of the £18m (8% of the Boards' capital investment programmes) saving on the IFR figure then required could be achieved by reducing the salary increase forecast to 10%, and some minor cuts in the Boards' capital investment programmes were offered and accepted. Thus the adjusted IFR figures are now as follows:-

SSEB £m	NSHEB £m	TOTAL £m
58	23	81

5. If it were necessary to find the remainder of the £18m saving from increased revenues, the 15% tariff increase suggested for illustrative purposes would have to be increased to 18%. While I sympathise with the Boards' desire to have no real increase in tariffs next year, I accept that we could not avoid giving serious consideration to a tariff increase above the expected rate of inflation if, as originally anticipated, the increase required in England and Wales were to be of the order of 18½%. The use of tariff increases to achieve savings in excess of £18m would, however, be very difficult for us to accept and would be most strenuously resisted by the Boards.

6. The tariff situation is complicated by the consideration which has very recently been given by the Electricity Council to adopting a tariff increase assumption for England and Wales of 12%. If this tariff regime were adopted, the tariff increase to be applied in Scotland would have to be of the same order. Assuming a tariff increase of 12%, and a reduction in the coal price assumption to match the Electricity Council's lower fuel price increase assumption, the Scottish Boards' external financing requirements for 1981/82 would be as follows:-

SSEB £m	NSHEB £m	TOTAL £m
61.6	23.0	84.6

Thus the savings of £11m already offered would in that event have to be reduced by £3.6m.

7. The accumulation of restrictions on the Boards' capital investment programmes over recent years, added to their own efforts to achieve savings, is now regarded by the Boards as having reached the level at which reliability of output, security of supply and improvements in efficiency are at real risk. There is no scope for further savings on capital programmes to be achieved other than by means of delaying the Torness AGR construction programme. For the reasons set out in David Howell's letter

to you of 13 October, we would regard this course of action as being wholly unacceptable.

8. Although the Scottish Boards have substantial excess generating capacity at present, their position is not comparable to that of CEGB as regards scope for closures in that most of their fossil-fired plant is relatively large and modern. Staff numbers at Inverkip and Carolina Port are being reduced in recognition of the likelihood that these stations will in future be used only intermittently and the possibility of Inverkip being mothballed in due course is at present under consideration with SSEB. Even if an early decision to mothball the station was taken, however, additional expenditure would have to be incurred in the short term and no savings would accrue in 1981/82.

9. Given the current difficult circumstances of the Scottish Electricity Boards, I would echo David Howell's view that the electricity supply industry should, if at all possible, be spared the necessity of achieving further savings.

10. I am copying this letter to David Howell and other members of E Committee.

ALEX FLETCHER

10 DOWNING STREET

1. MR. WHITMORE

2. MISS STEPHENS

I hope you agree that we should have another meeting on the energy redraft before it is circulated to E Committee. If so, could Caroline please set it up?

20 October 1980

CONFIDENTIAL

10 DOWNING STREET

From the Private Secretary

20 October 1980

As you know, the Prime Minister held a meeting this afternoon to discuss the Memorandum (E(80)120) on energy pricing which your Secretary of State had circulated to E Committee. Besides Mr. Howell, the following were present: Mr. Lamont, Mr. Moore, Sir Donald Maitland, Mr. Guinness, Mr. Hoskyns and Mr. Wolfson.

The Prime Minister said she was unhappy with the paper. In particular, she made the following points:

(a) It adopted far too much of a cost plus approach, and there was not nearly enough in it on the possibilities and necessity of improving efficiency in the energy industries.

(b) There seemed to be little appreciation that, by putting up energy prices, this would put private sector companies out of business; and that, taking into account the aggregate effects, the PSBR could well be increased rather than diminished.

(c) The need for the industries to develop truly marginal cost pricing, particularly at a time of recession, did not seem to be properly discussed. The industries' approach seemed much too narrow, ignoring the effect on their finances of losing customers through prices they were unable to afford. From the Government's point of view, it was crucial that they should take a wider view; otherwise, more and more industries would be put at risk.

(d) The legality or otherwise of short-run marginal cost pricing in the electricity industry ought to be cleared up forthwith.

(e) The analysis of the coal and electricity industries was incompatible with the NCB's reported approach to their pay negotiations. On a rational view of the facts, there was no justification for the offer which they were planning to make.

/ (f) The paper

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(f) The paper seemed to indicate that European energy prices were, in many cases, lower than in the UK. Yet, she had been defending our own prices on the basis that they were at approximately the same level. The latest figures very much weakened the Government's defence of current energy pricing policies.

(g) It now seemed that US gas prices would not be approaching world prices until 1985 (or even possibly 1987). It was essential, in these circumstances, that we should consider adopting countervailing duties to offset the lower costs which energy-intensive industries in the US enjoy.

(h) She was appalled by the CEGB/NCB contract: the CEGB were being far too generous by, in effect, allowing the NCB an automatic price rise each year in line with inflation.

A number of points were made in response, and it was agreed that Mr. Howell would circulate a revised draft, taking into account the Prime Minister's comments. I am sure it would be helpful if the new draft could be discussed with the Prime Minister before it is sent round to E Committee; and we will be in touch to arrange a date.

I am sending a copy of this letter to Peter Jenkins (H.M. Treasury) and David Wright (Cabinet Office).

J. D. West, Esq.,
Department of Energy.

CONFIDENTIAL

CONFIDENTIAL

Nationalised Industries

File

cc: HMT
CO

bc: Mr. Hoskyns
Mr. Wolfson
Mr. Whitmore

10 DOWNING STREET

From the Private Secretary

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Copied to Master set.

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CS

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CONFIDENTIAL

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I. P. LANKESTER

J. D. West, Esq.,
Department of Energy.

PART 2 ends:-

CST to S/S Energy 2.10.80

PART 3 begins:-

E(80)120 17.10.80