Top copy on Energy, May 1979
(PM's visit to D. Energy)

Energy 1979

PRIME MINISTER

I attach notes setting out the main issues, with an indication of their possible timetable, on which I expect early collective discussion will be necessary. You may wish to have a brief discussion on some of these when you visit the Department on Friday.

I am sending copies of the note to Geoffrey Howe, Keith Joseph, Lord Carrington, Michael Heseltine, John Nott, Jim Prior, George Younger, Nicholas Edwards and Sir John Hunt.

DH.

Secretary of State for Energy
16 May 1979

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INTERNATIONAL OIL SHORTAGE

As a result of the Iran crisis the world oil situation is extremely tight. There were little or no oil exports from Iran between Christmas 1978 and the beginning of March 1979. Iranian output has since recovered but is unlikely to exceed about two thirds of its pre-crisis level - a shortfall of 2 m. barrels per day or about 6% of internationally traded oil. Some OPEC countries which had increased output while there were no Iranian exports are now cutting back to pre-crisis levels. Local shortages are beginning to appear and more serious ones can be expected next winter.

2. The member countries of the IEA at the beginning of March committed themselves to reduce demand for oil on world markets by 5% by an unspecified date. The European Council at its March meeting agreed that the Community should reduce oil consumption by 25 m. tonnes or just under 5% in 1979. Some progress has been made: but the decisions are slow to take effect and it is not clear that the full reductions will be achieved. The question of continuing demand restraints into 1980 will arise in the coming months.

3. The UK has been partly insulated from the pressures by North Sea oil, but export commitments cannot be redirected into the UK except in a full emergency, when our obligations under international oil-sharing arrangements (IEA, EEC) would come into effect. Supplies this quarter are expected to be about 2½% below demand at present prices. Most companies are now allocating supplies to regular and contract customers at or below last year's level and declining to take on new business. Customers without contracted supplies are finding it hard to get enough at prices they are at present prepared to pay. The CEGB at the request of the Government is reducing oil consumption in the six summer months by 1½ to 2 mill. tonnes and a vigorous oil saving campaign was launched by our predecessors throughout the public sector. But further measures including fiscal ones may well be needed.

4. The most serious result of the Iran crisis is that it has enabled OPEC countries to increase prices substantially. After taking account of the premia which most OPEC countries except Saudi Arabia are charging, prices at the end of April were nearly 25% higher than at the end of 1978, though in real terms only restored to 1974 levels. Since then Iran has increased prices by a further 60 cents a barrel or 3.6%. This may produce a ratchet effect and make it difficult for Saudi Arabia to hold her prices at levels lower than those of the other OPEC producers. The OPEC increases have not yet been fully reflected in the UK partly because of the strength of sterling. But further retail price increases are inevitable. Petrol prices must be expected to rise by 4p to 5p over the next few months even with no change in fuel tax.

5. Policy hitherto in both the IEA and EEC has been to try and tackle this situation by encouraging a better balance between supply and demand through demand restraint. But a number of countries are now urging the introduction of formal allocation systems or of new measures to influence prices through Government action. The UK has been cautious about these suggestions. (We doubt whether they are either practical or in our interests given our North Sea oil).

6. It has to be remembered that, though in 1980 we may produce the equivalent in tons of our domestic oil needs, we have to export a lot of our light sulphur free oil and import other producers' heavy oil to meet our product needs.

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REVIEW OF BNOC

A quick review of BNOC has been set in hand with the aim of putting recommendations to Ministers in June. The review will cover all the Corporation's activities: how far each of them is essential to secure the national interest: and the compatibility of such activities with a commercial operation. Urgent consideration is being given to a new financial structure separate from the National Oil Account (which will require legislation), and the removal of BNOC's special position on assignment of licences. The Corporation should certainly be made subject to PRT (Petroleum Revenue Tax), a change which the Chancellor could embody in the Finance Bill together with any changes in PRT that might be agreed.

2. The review of BNOC will include the future of their participation agreements with oil companies. It will also cover possible changes in the financial structure to permit private ownership and mixed finance and/or the outright disposal of assets to private buyers.

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COAL STRATEGY AND NCB FINANCES

We expect to submit in mid-June papers on policy for the coal industry, and on the financial position of the National Coal Board, which is likely to require legislation in the late autumn.

2. The changed outlook and steep price increase for oil in 1973/74 transformed the future prospects for coal and led to the adoption of a substantial programme of investment - some £500 million a year - designed to reverse the industry's previous decline. Current energy forecasts confirm the longer-term need for a larger, more efficient coal industry at which the investment programme is aimed, but suggest the possibility of exportable surpluses in the medium term. Substantial cost increases, aggravated by losses from keeping in production old and uneconomic collieries and the burden of unfructified investment costs, have eroded coal's competitive advantage. The NCB's current five year plan forecasts large losses and heavy reliance - some £375 million in 79/80 after a second coal price increase in the summer - on public expenditure throughout the period with substantial claims on the contingency reserve. No

3. A review of the industry's present planning objectives and its financial position is in hand. Decisions will then be needed on general coal strategy on measures to set the industry on the road of financial viability the future financial regime of the NCB and statutory powers of grant aid to the industry, and the handling of a number of specific problems, such as the heavily loss-making coalfields. These include South Wales, on which there is a published report which the previous Secretary of State prepared in conjunction with the Board and the mining unions, under the tripartite consultative arrangements set up by the previous Administration. The future of these arrangements also needs to be considered.

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ORGANISATION OF THE ELECTRICITY SUPPLY INDUSTRY

The last Government prepared a Bill to set up a new Electricity Corporation in place of the Electricity Council, the CEGB and the 12 Area Electricity Boards in England and Wales, and to provide for the internal structure of the industry below the main board of the Corporation to be determined in future by secondary legislation. The Bill was published but not introduced; it was however the subject of "pre-legislative hearings" by the Select Committee on Nationalised Industries last year which highlighted a number of controversial features of the proposals, but endorsed the general framework and argued the need for early legislation.

2. Decisions are required on whether or not to proceed with the reorganisation of the industry and, if so, whether on a centralised or devolved basis. A report on this including the legislative implications will be submitted as soon as possible.

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PROSPECTS FOR THE TURBO-GENERATOR INDUSTRY

An early report will be submitted on the prospects and scope for early rationalisation of the two turbine manufacturers.

2. Related to this question is the allocation by the Central Electricity Generating Board and the South of Scotland Electricity Board of the orders for the turbo-generators for the two AGR power stations at Heysham and Torness which the previous Government approved. Design contracts, which will in practice determine the ultimate destination of the manufacturing orders, are due to be placed soon and the Generating Boards are expected to consult the Government before notifying the manufacturers of their intentions. Other Departments will need to be consulted. Collective discussions by Ministers may be necessary.

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ORGANISATION OF THE NUCLEAR INDUSTRY

The present structure of the nuclear industry, based on the National Nuclear Corporation (NNC) and its operating subsidiary the Nuclear Power Company (NPC), was devised in 1973 and intended to operate as a partnership between Government and General Electric Company (GEC). The arrangement has not worked satisfactorily, and changes have been under discussion for the last 15 months. There is a consensus that GEC should cease their supervisory management of NPC, that the present two-tier structure (NNC and NPC) should be replaced by one single Company directly responsible for all its activities and that the NPC's management should be strengthened. Other more fundamental proposals about NPC's long-term role, structure and membership have been raised but left unresolved. There is an urgent need to end the uncertainties and settle on a sensible structure which will meet present and future needs. There will be early discussions with the parties mainly concerned with the aim of bringing forward proposals for limited interim changes to resolve the immediate uncertainties before the Summer Recess.

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THE ROLE OF NUCLEAR POWER

Ministers will need to give careful consideration to their attitude towards nuclear power. The recent incident at Harrisburg in the United States has prompted widespread concern about nuclear safety. However, the general safety record is good and at present there seems little prospect of our being able to satisfy, without a significant nuclear contribution, our future energy requirements, particularly as oil and gas supplies become scarcer and increasingly expensive. It will be important therefore to maintain and develop our nuclear option. But public confidence will need to be strengthened in the safety of nuclear operations.

2. Nuclear, in particular safety aspects, and general energy policy will be reviewed to arrive at a considered and balanced view. A number of specific issues will arise for decision in the coming months, though it is not possible at this stage to say whether or when they may call for collective consideration. They include policy on the further development of the fast reactor, possibly under international collaborative arrangements, and related issues; the choice of licensor for work on a PWR design for possible introduction in this country; expanded arrangements for assessing the safety and security of civil nuclear power, possibly - again - international arrangements and our position relative to various questions which arise on Euratom and the competence of the Community.

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NATIONALISED ENERGY INDUSTRIES PRICING AND FINANCIAL TARGETS

Proposals to increase domestic prices for gas and electricity by 8 - 9%, and to increase service charges in the gas industry, are being considered by the Price Commission. The proposals (together with increases in non-domestic prices, which have gone ahead) were put forward by the industries to enable them to achieve their financial targets for 1979/80 (6½% on turnover, after interest, for gas; 10% on net assets before interest for electricity (England and Wales). The Price Commission reports are due in June.

2. Ministerial decisions to overrule the findings of the Price Commission and to allow the price increases to go through may be necessary to allow the industries to achieve their financial targets, and to operate within their cash limits; there may need to be a second electricity price increase later this year because of rising costs (see paragraph 4 below) and lost revenue from the current delay to price increases.

Scope for increased efficiency? TL

3. Industrial coal prices were increased in March by 9%; domestic prices are to go up in the autumn. The NCB's cash limit set for 1979/80 assumed a further industrial coal price increase this summer. The Board now estimate that the additional revenue required is £133m. requiring an average increase of about 6%. The most likely date would be 1st July. If Ministers wish to intervene a decision would be needed by early June.

4. A further coal price increase would need to be passed on in higher electricity prices. The consequential increase would be about 2 - 3%, if there were no other factors involved, but may need to be higher (see paragraph 2 above).

5. Decisions will also be needed in the summer in the nationalised industries' financing and investment review on measures to eliminate the nationalised energy industries' bids

for additional public expenditure in the years 1980/81 - 1983/84 as a result of their forecasts of higher external financing requirements. This could involve higher prices for gas and electricity, colliery closures and reductions in investment programmes. Decisions on gas and electricity prices will need to be reflected in the setting of medium-term financial objectives for the gas and electricity industries, from 1980/81 onwards, which will determine the industries' future price levels. Energy policy, public expenditure and counter-inflation will be relevant considerations.