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

PRIME MINISTER

UK OIL POLICY: REFINERY AND DISPOSAL STRATEGY

I have seen a copy of David Howell's minute of 28 January to you about the report on oil refinery and disposal policy. While I do not disagree with David's conclusion, which as he says has been endorsed by colleagues, I would like to make two comments on his minute:

(i) As David Howell says in paragraph 4 of his minute, some reliable oil exporters can in today's conditions demand a straightforward monetary premium for their oil. The UK has so far taken the view that our interest in a healthy international economy, our international obligations and our interests as a major consumer of energy deny us that option.

I do not by any means suggest that we should necessarily alter our present policy of linking the price of North Sea oil to the term prices of the comparable African producers; and we must of course avoid any action which would certainly increase world oil prices in a way which would be against our economic interests. But the price obtained for North Sea oil has a direct impact on the PSBR through Government take from the North Sea and less significantly through BNOC's revenues.

/In view of

In view of the importance of maximising Government take and keeping down the PSBR, I believe it would be timely if officials from the Department of Energy, Inland Revenue, Treasury and the FCO (and perhaps BNOC) could review our North Sea pricing policy in order to check that we are not missing any legitimate and sensible opportunities here.

(ii) Paragraph 5 of David Howell's minute refers to my scepticism about the creation of substantial additional reserve production capacity. This understates my position. The creation of reserve production capacity would be very expensive and if achieved through production cutbacks, would reduce Government tax take from the North Sea in the short and medium term thereby increasing the PSBR. I have already told David Howell that I would see the very greatest difficulty in any policy of production cutbacks from 1982 because of the consequences for the PSBR, which would be in clear contradiction to our general economic and monetary strategy. The latest forecasts of Government take from the North Sea over the next few years are lower than expected, partly as a result of lower production forecasts. This makes the difficulties of production cutbacks even greater. (The table attached shows the progressive decline in the forecasts of oil production over the next few years; revised figures on North Sea tax take will be available at the time of the Budget.) As I have told David Howell and other colleagues, I see little prospect of Treasury agreement to the creation of additional reserve capacity if it involves any adverse consequences for the PSBR.

/2. I am

2. I am sending a copy of this minute to the Foreign Secretary, the Secretaries of State for Trade, Energy, Industry, Employment, Scotland, Sir Robert Armstrong and Mr. Ibbs.

(G.H.)
6 February 1981

TABLE I: NORTH SEA OIL PRODUCTION FORECASTS* m. tonnes

	JUNE 1979	OCT 1979	MARCH 1980 (MTFS)	JUNE 1980	INDUSTRY ACT (NOV. 1980)	JANUARY 1981	FEBRUARY 1981
1979	76	77	77	77	77	77	77
1980	94	95	83	81	81	80	79
1981	106	110	99	91	91	88	88
1982	125	122	110	103	103	102	101
1983	128	129	117	112	113	112	105
1984	131	131	126	119	121	118	110
1985	127	129	126	115	117	120	118

*including natural gas liquids, measured in million tonnes of oil equivalent

DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SW1H 0ET Telephone 01-215 7877

JL 17/2

From the Secretary of State

Julian West Esq
Private Secretary
Secretary of State for Energy
Thames House South
Millbank
London SW1

13 February 1981

Dear Julian,

UK OIL POLICY: REFINERY AND DISPOSAL STRATEGY

My Secretary of State has seen Tim Lankester's letter to you of 9 February following the Chancellor of the Exchequer's minute of 6 February to the Prime Minister suggesting an interdepartmental review of our North Sea pricing policy. In view of this Department's interest in the scope for using UKCS oil in resource diplomacy and the current discussions in EX Committee, he would be grateful if officials here could be kept informed of progress of this review. Perhaps the Secretariat could send copies of relevant papers and minutes to Mary Lackey in our West European and General Division and Christopher Benjamin of Projects and Exports Policy Division.

I am sending copies of this to recipients of Tim Lankester's letter.

Yours ever,

Nicholas McInnes

N McInnes
Private Secretary

jfh

cc FCO
TRADE
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Energy
copied to
Energy for to
North Sea Oil Prices

10 DOWNING STREET

From the Private Secretary

9 February 1981

UK Oil Policy: Refinery and Disposal Strategy

The Prime Minister has now considered your Secretary of State's minute of 28 January. She has also seen the Chancellor of the Exchequer's minute of 6 February.

The Prime Minister has noted the main measures that are in hand and the further possibilities that are to be looked at for improving the UK's security of supply. She has no objection to the Chancellor's proposal for an inter-departmental review of our North Sea pricing policy.

I am sending copies of this letter to George Walden (Foreign and Commonwealth Office), Stuart Hampson (Department of Trade), John Wiggins (HM Treasury), Ian Ellison (Department of Industry). Richard Dykes (Department of Employment), Godfrey Robson (Scottish Office), David Wright (Cabinet Office) and Gerry Spence (Central Policy Review Staff).

TK

Julian West, Esq.,
Department of Energy.

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Energy A

PRIME MINISTER

UK OIL POLICY: REFINERY AND DISPOSAL STRATEGY

Officials from the relevant Departments (Energy, Treasury, Trade, Industry, Employment, Scottish Office, FCO, CPRS), with the assistance of BNOC, reported to me towards the end of last year on Oil Refinery and Disposal policy. A copy of the recommendations in their report is at Annex A. These recommendations, based on an analysis of the oil market in the light of the events of 1979, are designed to achieve maximum economic benefit for the UK from the disposal of our oil and the use of UK refineries. Though most of the analysis was done before the Iran/Iraq war, the conclusions are important and have been generally endorsed by colleagues, though with the proviso that implementation of oil disposal policy will remain an area of policy in which Ministers will continue to need to be involved on particular issues. Accordingly, I thought I should acquaint you with the main points.

The first purpose to which we must devote UKCS oil is ensuring the UK's security of supply. Direct use of UKCS oil in the UK to the full extent of our refinergy throughput would be neither practicable nor economic: the nature of our refinery investment and of our market makes it necessary and profitable to export much of our oil and import cheaper oil from the Middle East. To the extent that we remain dependent on imports, we remain vulnerable to external events and steps must be taken to enhance our security of supply. Our international commitments in a fullscale oil crisis limit our freedom of action in this respect, but in shortages less severe than those which trigger the sharing mechanisms of the International Energy Program, there is action which can be taken.

The main measures in hand are:

i. obtaining from UK refiners, on the strength of their position also as UKCS oil producers, "voluntary" undertakings to protect their UK customers in times of shortage. Substantial protection has now been obtained from most of the major UK refiners, covering over 60% of the market.

In addition, Shell UK (a further 20%) has always used its own UKCS crude to ensure a measure of security to its customers and my officials expect the company to volunteer complete protection before the end of this quarter. That leaves under 20% of the market uncovered, including 5% met by independent product imports. Such protection can never provide complete protection against some product shortages in some areas of the country, but the position is now much improved relative to 1979;

ii. developing, through suitable contractual terms, BNOC's capability to increase supplies to the UK quickly in times of shortage, by diverting cargoes from export destinations.

Given that there will be a continuing level of export of UKCS oil, we need to realise the full available value from these exports. Point (ii) above illustrates one way in which exports can command the full term market price, while yet contributing additionally - in that case by way of insurance - to the UK economy. Other reliable oil exporters can in today's conditions command a straightforward monetary premium for their oil. We have so far taken the view that our interest in a healthy international economy, our international obligations and our interests as a major consumer of energy deny us that option. Against that background we must consider whether we can devise other ways to realise the full value of our oil.

The possibilities include:

i. encouraging UK refiners to improve their refinery capability and to develop profitable export markets. That can add value to UKCS crude in the UK in most market conditions and may provide a less conspicuous way of obtaining substantial extra returns for exports in times of shortage;

ii. using oil export commitments to promote exports of other goods through package deals. There are pitfalls in associating exports of goods with exports of oil, given the limited quantities of oil which can be committed to this purpose, but EX Committee has now provided a

framework for follow up work in this area. On the basis of that, we shall be discussing both the potential and the problems of such deals;

iii. creating additional reserve production capacity and using it to achieve wider political gains. There are substantial difficulties in that approach and it would be very expensive unless financed by foreigners and involve revenue losses for HMG; but, though he is sceptical, the Chancellor has agreed that the question whether there is scope for securing benefit for the UK by this means should be re-examined when depletion policy is next reviewed.

We have to attain our objectives without attracting accusations that we are in breach of the Treaty of Rome. We also have other foreign policy interests to protect. Since the oil is largely produced by private companies, whose interests may differ from our national interests, and since there are international constraints on direct action, attainment of our objectives depends on maximising BNOC's access to oil both by the full exercise of participation options and by taking royalty in kind.

I am sending a copy of this minute to the Chancellor of the Exchequer, the Foreign Secretary, Secretary of State for Trade, Secretary of State for Industry, Secretary of State for Employment, Secretary of State for Scotland, Sir Robert Armstrong and Mr Ibbs.

JA.

SECRETARY OF STATE FOR ENERGY

28 January 1981

INTER-DEPARTMENTAL COMMITTEE ON REFINERY AND DISPOSAL POLICY.

VIII CONCLUSIONS

The objectives of refinery and disposal policy should be those set out in *para 2 above. The detailed policy recommendations set out below are designed to achieve these objectives.

Policy towards UK refiners

(i) Security of supply to UK refiners has been substantially improved by measures taken to 'ring fence' UKCS crude and to protect UK refineries' supplies against 'equal misery' sharing cuts imposed by multi-national parents. These measures, which could be liable to challenge under the EC Treaty if they become generally known, should be kept confidential. We should be alive to opportunities to extend this process, but careful not to exert pressure in circumstances where a legal challenge could put at risk the gains already made.

(ii) UK refiners should be encouraged to develop profitable export markets for products, while bearing in mind the need to retain sufficient flexibility to support their UK customers in times of shortage.

(iii) UK refiners should be encouraged to invest in upgrading their refineries; both to make them more energy-efficient and to provide additional capacity.

(iv) The Government should not seek to determine the proportion of UKCS crude run in UK refineries but should leave this to the companies to determine in the light of their circumstances.

BNOC

(v) The Corporation's policy of exercising participation options save in exceptional circumstances should be endorsed. BNOC's access to crude is one of the most powerful tools for increasing UK security of supply.

(vi) In the 1979 shortage BNOC was able to increase substantially and quickly supplies to UK users. It should seek to maintain this ability. Trading in products could offer a less conspicuous route to achieve this.

*see appendix.

(vii) The Corporation should continue its policy of selling direct to the UK refining affiliates (rather than trading affiliates) of the international majors. The Corporation should co ordinate its discussions about such sales with the Department of Energy so that the opportunities for leverage which they may offer can be considered by the Government.

(viii) While the Corporation's main customers will remain in the UK, it will have to continue to export significant quantities of crude oil and limited products; both for commercial reasons and to ensure that additional oil could be made available for the UK in times of crisis.

(ix) The Corporation should in planning for the future, retain sufficient flexibility to allow it to respond to requests for supply in circumstances where Ministers decide that there may be wider political or economic gains to the UK in so doing.

(x) The Corporation should, while keeping the Government informed, continue to develop its contacts with OPEC countries, with the aim of developing commercial links - starting, if appropriate, with crude exchanges.

General

(xi) The existing policy of taking royalty in kind should be continued. It increases the volume of oil under UK control and its saleback to refiners offers valuable leverage.

(xii) The guidelines on destinations of crude exports and duration of contracts should be maintained, subject to (xiii) below.

(xiii) Proposals for resource diplomacy deals in which substantial and tangible benefits for the UK are offered in return for supplies of crude, should be considered case by case on their merits. Ministers should be consulted at an early stage, particularly if deliveries to a non guideline country are proposed and in this case, full weight should be given to the foreign policy advantages of the export destination guideline.

(xiv) The creation of substantial additional reserve production capacity and its use to achieve wider political gains should be considered in the context of any production cutbacks from 1982 onwards imposed as part of a depletion policy.

APPENDIX

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INTER-DEPARTMENTAL COMMITTEE ON REFINERY AND DISPOSAL POLICY

II OBJECTIVES AND PAST POLICY

2 The general objective of maximising the benefits of refinery and disposal policy to the UK economy as a whole can be broken into the following sub-objectives:-

(i) To maximise the contribution to gross national product.

(ii) To maximise the Government's take under the taxation provisions for UKCS crude.

(iii) To advance the continued development of a vigorous UK refinery industry.

(iv) To maintain secure supplies of crude oil and oil products in an emergency.

(v) To enable us to use our position as an oil producer to advance our international trade industrial and foreign policy objectives.

These sub-objectives may conflict and a balance must be sought between them which best advances the interests of the UK. Policy will also have to be formulated in the light of our international obligations and take account of the wider energy policy objectives we share with our EC and IEA partners.

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PRIME MINISTER

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The Government's Energy Policy

It is hoped that Members will find this brief useful in the Supply Day Debate on 21st January 1981.

Contents

Conservative Research Department,
32 Smith Square, London, SW1.

LMR/ST-R
20.1.81.

The Government's Energy Policy.

1. Introduction.

The era of cheap energy is over. Future prosperity for the industrialised nations depends upon accommodation of that stark fact. Delusion, procrastination, failure to face the implications of the very fundamental change which has occurred since 1973, will only store up problems for the future.

The accommodation of rising energy prices requires that millions of individuals and individual businesses become more energy efficient. Maintenance of future supplies, as oil and gas become scarcer, requires massive investment in alternatives. These developments cannot be brought about efficiently and effectively by centralised bureaucratic planning. Rather, the role of Government should be to ensure that the consumers of energy are correctly informed about expected future movements of energy prices. Undistorted price signals are essential if individuals are to invest in energy conservation and energy innovation, secure in the expectation of a return on their investment.

Some Governments have attempted to hold down artificially the price of their indigenous oil and gas. The consequences have been serious, and the folly of the policy is now widely accepted within the international community. The Carter administration started a process of phased price decontrol of US indigenous oil and gas, and this very welcome move is already beginning to stimulate indigenous production, thereby taking pressure off the market for OPEC oil. The Venice Summit concluded with agreement on the need for all Governments to ensure the market pricing of fuel, and the UK Government continues at the international level to press for adherence to this principle, since it is one key to stability in energy markets.

Equally, stability depends upon oil producers and oil importers appreciating their mutual interest in avoiding abrupt increases in oil prices (which stimulate world wide recession) and also in ensuring that OPEC reserves are not squandered without regard for the future. The OPEC Long Term Strategy Committee has identified the importance for OPEC of stability in the oil market, and a number of member countries have made a concerted effort to cushion oil importers from the effects of the Iran-Iraq war. The Secretary of State for Energy has been able, because of our unusual position as a major oil producer and oil consumer, to play an important part in fostering this growing understanding. The consuming countries are increasingly appreciating the need for them to contribute to the solution of the oil crisis. A leader article in the "Washington Post" recently commented, "Brooding about cartels and sticking pins in images of OPEC will not help. There is only one way to stabilise the price of oil, and that is to reduce the consumption of it, steadily and rapidly".

2. Energy prices and industrial competitiveness.

British industry has been vociferous recently in claiming that it pays more for energy than competitors abroad. Certainly, there is unfair competition from North American companies which have access to artificially cheap oil and gas, and the Government is pressing vigorously for an end to this situation. (Apart from the destabilising effect upon the oil market, this practice also inflicts serious damage on free world trade).

There is now growing agreement between the Government and representatives of industry that average UK energy prices are not seriously out of line with those charged in Europe. Some of our energy-intensive industries do face problems in competing overseas, though these of course go deeper than the cost of energy alone. The Government has always made it clear that it is willing to look at these, and welcomes the opportunity provided by the NEDC task force (set up after the recent

NEDC meeting) to work with industry to quantify the energy-related problems of this industrial sector.

There is the very real danger that Government inspired action to reduce energy prices to industry would create a new set of very serious problems in the economy. The constraints of this sort, and the actions which the Government has been able to take in this area, are set out in the appendix to this brief. Two points, however, need to be made here. First, as the exchange rate rises the price of goods in Britain expressed in foreign currencies increases automatically. Energy prices are affected with everything else, but this problem is not an energy problem - it is an exchange rate effect. Exchange rates are market determined, and even if the Government could intervene to reduce them, serious problems would result (eg. imports would increase in price, and inflation would be boosted. Both would prejudice competitiveness in world markets).

Secondly, international comparisons of energy costs to industry have two components; both price and energy efficiency must be compared. Britain has historically not been particularly efficient, and recently has fallen further behind. Since 1974, the energy consumed per unit of output by manufacturing industry has hardly changed in the UK. The Germans achieved a 17% improvement between 1974 and 1978, while the Americans achieved 14% and the French 9%. Japanese industrial efficiency improved by 10% in the period 1976-8.

3. Energy prices and domestic consumers.

In the year to November 1980, domestic coal increased in price by 25%, gas by 23%, electricity by 32% and oil and other fuel and light by 21%. The all-items RPI increased by 15.3% in the same period.

Domestic gas prices are set to rise in real terms at 10% per annum in this and the next two financial years. This will bring prices in line with long run replacement costs, as recommended by the Price Commission (July 1979). In the financial year 1978/9, domestic gas did not contribute to BGC's profits, and the burden of earning a return upon the Corporation's assets rested entirely on industrial users. The BGC's new pricing policy will steadily restore domestic sales to profitability. Even after these three years' adjustment, UK domestic gas will very probably be the cheapest in Europe and the cheapest domestic fuel in the UK.

The Government is concerned that rising costs (including the cost of coal) to the electricity supply industry should not be passed on to consumers when they could instead by absorbed by increased efficiency. The Monopolies and Mergers Commission will report on the efficiency of the industry in March of this year. Scrutiny of this kind is essential since many near monopoly nationalised industries escape the pressure of the market place to moderate prices.

Opposition members may well argue in the debate that the nationalised industries should be able to borrow outside the PSBR, and that this would remove pressure on consumers to finance investment. They could usefully be referred to the Labour White Paper on the Nationalised Industries (Cmnd 7131, 1978) which lucidly sets out the difficulties with this.

4. North Sea oil and the economy.

Should we take Michael Edwardes' advice and leave North Sea oil in the ground, in order to provide British industry with a weak home currency? In view of the trouble which even the strong German economy is suffering in the face of its rising oil import bill, the answer is clearly 'no'. Without our own oil, about £10 billion at today's prices would be added to our trade deficit.

North Sea oil is expensive to produce, and the nation devotes more resources now to paying for oil than it did in the years before the 1973 crisis. Yet, our competitors in Europe are much worse off, because they have faced massive increases in the cost of oil imports in recent years. The Governor of the Bank of England, Mr. Gordon Richardson, made this point in an important speech

on 20th November 1980. Disagreeing with those who advocate or prophecy as inevitable a contraction in the non-oil manufacturing sector, Mr. Richardson emphasised that the need was rather for adaptation within this sector to the changed world economy.

By the mid-1980s, North Sea oil will probably be contributing about 5% to GDP. Obviously, the existence of this valuable national asset is an important factor in the rising value of Sterling, but a hard currency need not damage competitiveness. Certainly, there is pressure on selling prices abroad and competition from cheap imports, but industry also benefits from cheaper raw materials. Less directly, the strong pound reduces retail price increases, and therefore takes pressure off wage demands and wage costs. Adaptation involves industry in the need to control wage costs through sensible pay bargaining and improved labour productivity, and in improving non-price factors in competitiveness, such as quality, reliability and punctuality in delivery. The Government does not underestimate the difficulties which industry faces in making these adjustments rapidly and at a time of recession. Yet, they are the key to future prosperity.

North Sea oil brings great benefit to the economy through the associated revenues. These were £2.2 billion in 1979/80 and will be about £4 billion this year. 1981/82 revenues expressed in 1980/81 prices are estimated at £4½-5 billion, with a £900 million contribution from the changes in the tax regime announced by the Chancellor of the Exchequer on 24.11.80. There has been a reduction in the expected revenue in 1980/81, before the new tax, compared with earlier forecasts. Such forecasts are necessarily subject to error because they depend upon a number of highly unpredictable figures such as the world oil price and the level of North Sea production. To the extent that revenues are reduced by investment in the North Sea which is offset against PRT, this bodes well for the future.

The Opposition will doubtless return to the theme that North Sea revenues should be used to invigorate industry and create jobs. In fact, revenues in the UK have never been hypothecated to particular purposes. Money from the Exchequer does go into British industry, and North Sea revenues are obviously important in this. Some guide to the magnitudes involved is indicated in the following statistics. External financing limits for the nationalised industries in 1980/81 (as announced on 16.11.79 but updated to include subsequent changes) will exceed £3 billion. The Public Expenditure White Paper (Cmnd 7841) indicates the following relevant expenditures in 1979 survey prices: regional and general industrial assistance, almost £1 billion; scientific and technological assistance, about £300 million; employment and training, over £1 billion. In addition, the White Paper estimates that relief from Corporation Tax because of stock relief and capital allowances was perhaps £5.5 billion in '79/80 In short, North Sea revenues are already more than exceeded by aid to industry and employment.

Investment in manufacturing industry in 1979, augmented by leasing, reached its highest level since 1970 (British Business, 2.1.81.). Investment intentions indicate a likely fall from this high level in 1980 and 1981, but this does not seem to be through lack of funds. Rather, it is because profits are expected to be inadequate to provide a reasonable return. The solution is not, therefore, to put taxpayers' money into unproductive investment, but for industry to improve profitability (through increased efficiency and productivity, greater non-price competitiveness, sensible constraint on wage costs etc).

5. Policy on North Sea Oil.

The development of the UK North Sea Oil reserves has probably been achieved faster than in any other oil province in history. Yet, when the Government took office, the rate of exploration for new oil and gas was falling drastically because of industry's concern about the oil policies of the Labour Government. Confidence has now returned, and the North Sea is one of the most commercially attractive oil provinces in the Western World. This was demonstrated in the record number of applications for exploration licences in the latest (7th) round. 42 'own choice'

blocks have been licensed and about 70 licences on designated territory will be awarded soon. The nation shares the benefits of North Sea oil through the revenues which are raised and the jobs which are created. However, a more direct opportunity for participation by small savers will arise with the launching of the proposed oil revenue bonds linked to the performance of BNOC's North Sea fields. Beyond this, a Bill will be introduced in Parliament which will contain powers for the Government to sell to the public equity shares in BNOC's oil producing business.

It is necessary, in the national interest, to extend for as long as possible, the UK period of self-sufficiency. Government depletion policy will be flexible, executed mainly through phasing the development of fields discovered after 1975 and not, therefore, covered by the 'Varley assurances' of December 1974.

6. Gas.

One of the factors often omitted from the arguments about the price of gas (see sections 2 and 3 and the appendix) is the fact that demand for it potentially exceeds supply. During 1978/9 for example, although BGC was able to fulfill contractual obligations, it was for some months unable to meet new industrial demand, and was forced to interrupt some suppliers for unusually long periods within the terms of interruptible contracts. One reason for this was high demand in the cold winter, exacerbated by the underpricing of domestic supply. More important, however, was the fact that competing oil products were becoming rapidly more expensive.

Already, 20% of UK gas is imported from Norway at world prices. The Government has asked the BGC to look again at the incentives which, as the near monopoly purchaser, it gives to producers of UK gas in the North Sea. Beyond that, proposals have been announced for an ambitious project to collect associated gas from the North Sea oil fields which would otherwise have been flared. The gas made accessible by the pipeline will extend the life of UK reserves by 7-12 years at present rates of consumption.

Following the favourable BGC - Mobil report on the project published in June 1980, the Government formed an organising group comprising Mobil, BP, BGC and a financial advisor. Their report in October made recommendations on two key issues. First, on organisation and finance, the group recommended that it should work towards an interim pipeline company. The Government agreed and the process of consultation with interested parties is underway. The Government aim is for a substantial element of private finance for the £2 billion project.

The second key issue is the disposal of gas brought ashore. Natural (dry) gas for the BGC will be separated from the stream at St. Fergus. The residue will contain ethane and a number of other natural gas liquids. The interim plan is to remove the ethane at St. Fergus, and pipe it south to Grangemouth, Mossmorran and Teeside, while the other components will be taken to Nigg Bay. However, these preliminary arrangements will not preclude ethane supply to Nigg Bay; nor will they preclude other natural gas liquids from being supplied along the Southern route. Final arrangements will be arrived at on the basis of commercial negotiations on price and penalties should customers be unable to take gases allocated to them.

BNOC will, through its own holdings in certain fields and its participation agreements with other operators, have control over about half of the natural gas liquids collected. This will allow them to determine the general shape of the market. The object will be to maximise national economic benefit, recognising the importance of natural gas liquids as a basis for UK petrochemical production. BNOC itself will not be involved in investment in petrochemical plant.

Work on the project is right up to schedule, and it will lead, in the second half of this decade, to a massive reduction in gas flaring and an invaluable source of petrochemical feedstock.

7. Coal.

After a major review of the coal industry, the Government's Coal Industry Bill

provided for investment at 1979 prices of around £600 million per annum from 1980/ to 1983/4 (ie. £800 million in today's money). It also provided a framework within which the industry would break even, after receiving social grants, by 1983/4. Social grants were made more flexible in order to facilitate the redeployment of manpower, and additional money was provided for the widows of victims of pneumoconiosis.

These measures constitute a significant commitment to coal, in a time of increasing economic stringency. Despite the recession, it is very much to the credit of the industry that it is matching and maintaining the financial strategy agreed with the Government. Productivity is near record levels, but the industry is handicapped by a 'high-cost tail', resulting from the operation of some uneconomic pits. Closure of these pits is a matter for the industry, which has a long-established review procedure which involves the unions. The Government has made the grants available for labour redeployment as flexible as possible in order to help the industry concentrate manpower resources and investment where they can be most productive.

Imports of coal in the UK totalled 7.6 million tonnes in the year to September 1980. This represents about 6% of total UK production. Within total imports, those from Germany represented 1%; from Belgium represented 0.5%; and from France were negligible. This indicates that UK home sales are not significantly damaged by imports of more heavily subsidised European coal. Imports in total have only marginal impact, and these mainly come from Australia, the US and Poland.

Ultimately, oil, gas and chemical feedstock derived from coal will be important in the economy. British technology has been developed by the BGC and NCB, and the key to further demonstration and commercial operation will be the cost of coal. Probably the first cost-effective use for coal in this field will be as a direct replacement for heavy fuel oil, leaving the latter to be further refined for higher value applications.

8. Electricity.

Contracts for components for the new advanced gas cooled reactors to be built at Heysham and Torness have recently been placed by the supply industries. These will provide a much-needed boost for Britain's power plant engineering industry. The plan is to order reactors at a steady rate of one each year from 1982. This clear declaration of intent, and the recent reorganisation of the National Nuclear Corporation, should greatly improve morale in the industry.

Subject to safety scrutiny and the public inquiry, the next order will be for a pressurised water reactor to be built at Sizewell in Suffolk. This reactor will be licensed under the strict UK régime which has to date been extraordinarily successful in achieving safety for workers and for the general public from our nuclear power stations.

Safety remains paramount. Beyond that, the motivation for the nuclear programme is economic. The supply industries wish to purchase new nuclear plant because they believe that this will secure for them a net effective cost which is negative. This is because the new plant will replace uneconomic capacity and thereby achieve significant reductions in running costs. It is certainly the case that French consumers can expect to benefit from relatively cheap electricity from the French nuclear programme. However, it is incumbent upon all those involved in the construction of the outstanding AGR power stations to demonstrate that the problems of poor management and construction delays which have beset the UK industry are now resolved.

The Government's plans have been criticised as a "crash programme". Yet the proposed rate is only half that foreseen in Labour's 1978 Green Paper (Cmnd 7101). Critics will also condemn the PWR as unsafe, but this is to prejudge the NII scrutiny of the Sizewell proposal, and the public inquiry.

Conservation and help with fuel bills.

Energy use has fallen to a far greater extent in the past year than is accounted for

merely by the effect of the recession. The Government's policy of allowing the fuel industries to price oil and gas at market prices, and electricity at prices determined by the long run marginal cost,is clearly paying off in this respect.

In the domestic area, publicity on benefits and methods of conservation has increased by 30% in real terms and has been backed by research to find additional steps which may be cost-effective. The Homes Insulation Scheme was extended in August 1980 to give extra help to elderly people on low incomes, at a cost of £4.2 million, and an extensive advertising campaign began in October to encourage take-up. Allocation to the scheme in 1980/81, was £16.7 million in total. This has been increased to £27 million in 1981/2.

The Department of Energy has also increased expenditure on energy conservation demonstration projects, as an important step between research and the commercial use of conservation technology. However, once a project offers the prospect of a commercial return, further investment is rightly the responsibility of the private sector.

Besides providing special help to the elderly with the cost of home insulation, the Government has been concerned to reduce the burden of fuel bills on those least able to cope with rising fuel prices - the old, the sick and disabled, and poor families with children. Help of this kind will cost £200 million this year, and that represents a real increase (deflating for the rise in the price of fuel and light) on Labour's 1978 expenditure (£127 million)even though this latter amount included their electricity discount scheme.

There has been continuing Government concern to ensure that the code of practice on gas and electricity disconnections adequately protects those in real need. As a result of Government discussions with the industries, hardship criteria for the availability of prepayment meters have been removed. These meters will be more widely available and the Government have asked the industries to publicise this fact. The code will also now take account of the particular plight of the sick and the disabled.

The gas and electricity industries now sell fuel stamps through sub-post offices; selling them through main post offices is subject to the British Telecommunications Bill receiving Royal Assent. These Government initiatives are in addition to another important change; the gas and electricity industries now accept each other's stamps.

Appendix - Notes on industrial fuel prices.

Q1: Have not different trade associations shown convincingly that British energy prices are higher than in Europe?

A: The Government has received a large number of representations from different organisations and these have been studied carefully. They do not establish that our energy prices in general are out of line with those in Europe. There are undoubtedly particular firms or industries who have problems. The Government is certainly prepared to look at this especially in the light of the very severe short-term pressures on many businesses, but it is by no means clear that moving away from a sensible pricing policy generally would be the most effective way of assisting these special cases. The recent NEDC meeting was very productive in narrowing down the areas where problems and differences are thought to exist. In fact there was a considerable measure of agreement between industry and the Government at the NEDC meeting. The Government will be taking full part, along with the CBI and TUC, in a further study sought by the Council.

Q2: Why does not the Government reduce energy prices to help British industry?

A: The Government does not control in detail the industrial pricing policy of the fuel industries. Oil is in the private sector anyway. Gas and electricity set their own industrial price policies. On the basis of these the Government fixes tight cash limits which the industries are expected to meet.

But they do so not by departing from their declared pricing policies but by cutting costs. That is the purpose of EFLs, to reduce costs and increase efficiency. Gas prices to industry are not, repeat not, affected by external financial requirements. They are determined by BGC's own pricing policy. Similarly, electricity prices reflect the pricing policy of the supply industry. To meet their EFL's these industries are expected to reduce costs, not raise prices beyond the levels required by their own policies (broadly market-related in the case of gas, and long-run cost related in the case of electricity).

Q3: But why does the Government not step in then, and demand lower prices anyway. After all, this is a very difficult time for industry in the recession?

A: Attractive as that might be in the short-term, it would lead to waste and long-term shortages. It would also be extremely expensive - 10% reduction in electricity and gas prices would add about £700m to the PSBR. And energy costs represent only about 5% on average of British industrial costs, so that even large price reductions would bring little benefit to industry. What we are looking for is evidence of particular industrial sectors which really need help, either from their energy suppliers or from the appropriate government department. There may be some scope for dealing with particular problem areas which are identified by the combined working group set up by the NEDC.

Q4: Why should firms believe that they are all paying more? Why should their figures be wrong?

A: Comparing energy prices is extremely difficult. It is most important to compare like with like; that means, for example, taking into account contract conditions, degrees of interruptibility to supplies, the exact type of gas. In some countries there may also be a range of different prices being charged. For example, there are about 400 utilities supplying gas in Germany, with many different price structures and in France (and to some extent in the UK also) electricity tariffs vary according to the region of the country). On gas prices, many reports have compared renewal prices - that is, the prices at which existing contracts are renewed. This can be misleading. In the UK gas contracts in the past have usually been renewed annually for each company when its contract falls due. In most European countries prices rise in a series of steps and for all companies at once. This means that in order to reach the same annual average, British renewal prices always makes British prices appear higher. The best comparison is with average prices - what British industry is actually paying at any one moment. Of course, the average does not help the firm paying the big

renewal price increase; but it makes even those paying less very worried that in the future they will be penalised. But, while all prices will rise there is no reason why the UK should not in general continue to be moderately favourably placed.

Q5: What is British industry actually paying for gas? And how does it compare with other countries?

A: In September/October the overall average industrial sales price actually being paid in the UK was about 20 pence/therm or 23½ pence excluding the old, low-price contracts. Over 85% of all sales were under 26 pence/therm. At the same time contracts for firm gas were being priced at 28-30 pence a therm, and for interruptible gas about 22-24 pence. The latest EEC figures available for average prices are for 1 January, 1980. They showed industrial prices averaging around 24 pence/therm in Germany (Dusseldorf) and 20 pence/therm in France (Paris), compared with 16 pence/therm here (or 18.5 pence excluding some big, old, low-priced contracts).

More recent comparisons are difficult to make. However, the Chemical Industries Association has estimated that in 1980 the average price for gas for fuel use in the chemical industry will be 17.9 pence per therm in Germany and 18.9 pence per therm in France. In the UK the average price paid for the year as a whole is not expected to be higher than this. Another indication is the estimate made by an independent research organisation, who calculated average renewal prices in September, 1980, to be 27.8 pence in Germany and 24.2 pence in France. Given that renewal prices and average prices are much closer in Europe, this gives a guide to the trend of prices. At the same time in the UK, the average price was 23½ pence per therm.

Q6: Are other countries increasing their gas prices as quickly as we are?

A: Yes. Sources of cheap gas are drying up throughout Europe. Holland, supplying 40% of EEC consumption, has raised its export prices about 60% over the last year, aiming at low-sulphur fuel oil prices.

This is a border price and distribution costs have to be added to it. (In the UK distribution costs are about half as much again).

In France, gas prices to industry have risen by over 60% in 1980. Interruptions have been much more widespread than in the UK and new, firm supplies are almost impossible to obtain.

In Germany, Ruhrgas is charging some customers fully gas/oil related prices. Gas oil prices in Germany are currently around 35 pence per therm.

Q7: Is it not the case that Continental gas contracts are all for a firm supply, whereas here they may be either firm or interruptible?

A: No. There are contracts for both firms and interruptible gas in Germany. In France, 40% of gas sales are on an interruptible basis, and there is no limit to the period of interruption. Because of the loss of Algerian gas, French customers have had much more extensive interruption than here.

Q8: What about energy-intensive industries - should not they receive some special help?

A: Of course, energy prices are a much more important factor for energy-intensive industries. Some chemical companies buy their gas for feedstock on very low-price "old" contracts, a benefit which is worth hundreds of millions of Pounds to them. Some foreign companies have actually complained to their governments about these low prices to British industry.

But our energy supplies are not particularly cheap. Energy-intensive industries can be at an energy cost disadvantage, compared with countries which have cheap hydro-electric power or more nuclear power.

Unfortunately, rising energy prices affect the energy-intensive industries like everyone else, and subsidising energy for large users could only be at the expense of other consumers.

Where a company is in serious difficulties, of course, the Government will look carefully at what can be done to help. However, the Government has asked the electricity supply industry actively to ensure that its customers are benefitting from the best available type of contract.

Q9: What is the position on heavy fuel oil? Does the duty put our prices above other countries'?

A: Our fuel oil prices tend to be more stable than in other parts of Europe. So when "spot" prices are falling, we may creep ahead. Some people complain about the tax on heavy fuel oil. But as the table shows, the tax is not enough at the moment to push our prices out of line. In any case some other oil products, such as petrol, are less heavily taxed here than elsewhere.

	HFO prices (including duty) 1st December, 1980 £/tonne
UK	92.6
FR Germany	96.0
France	96.0
Netherlands	91.8
Belgium	106.4
Italy	87.2
Ireland	99.0
Denmark	95.0

Source: EEC Oil Bulletin.

Q10: Does not the duty on heavy fuel oil increase the price of interruptible gas contracts which are linked to it?

A: It is true that the duty affects the comparison. But our heavy fuel oil prices recently have been lower than most of our competitors' despite the duty, and the prices for renewed interruptible supplies at 22-24 pence per therm are not out of line with other countries.

Q11: What evidence do you have on electricity prices?

A: From the figures in this second table for electricity prices, Britain does not seem to be out of line. Indeed, our small businesses benefit from the statutory requirement for the electricity industry not to give undue preference to any particular category of customer. But because the French electricity industry has five times our proportion of cheap hydro-electric and nuclear power, large users there get a discount. So we have urged our electricity industry to make sure that is being as flexible as it can be towards industrial users.

Prices for "middle sized" industrial consumer (1) at 1st October 1980.

	pence per kWh
UK	2.82-3.46
FR Germany	2.89-3.47
France	2.52
Netherlands	2.31-3.44
Belgium	3.06
Italy	3.10
Ireland	3.61

(1) 2.5 MW maximum demand, 47% load factor.

Source: Electricity Council Estimates.

Q12: What about coal?

A: There have been a few complaints on coal prices too. But there is no restriction on importing coal, other than the fact that foreign coal is usually not competitive with ours after transport costs. For example Bowater's, who announced the closure of their Ellesmere Port Plant, could not have imported cheaper coal than the Coal Board offered them.

Q13: What have the Government done about the problems they already know of?

A: The Government have taken action on a number of points. First, they have asked British Gas to review its price for new gas supplies. Because of the shortage of gas, it has discouraged new industrial customers by offering them gas at about 40 pence per therm. Only a tiny number are supplied at that price, but these contract prices distort comparisons.

What is more, British Gas has for years followed a policy of broadly relating the price of gas to industry to the price of the equivalent oil product. It has modified this policy, and now sells even firmly guaranteed supplies of gas at 75% of gas oil.

The Government have asked the electricity supply industry actively to ensure that its customers are benefiting from the best available type of contract, and to conduct a review of its bulk supply tariff.

The Government is also actively pursuing examples of energy subsidy abroad which give foreign competitors an unfair advantage. The case of Dutch gas prices for horticulture has reached the European Court.

The Government will be taking full part in the urgent work being undertaken by NEDC to eliminate the remaining disagreement on which parts of industry are facing particular problems.

Q14: Now that we are almost self-sufficient in energy, why should our energy prices still follow world trends?

A: We have to trade our oil in world markets, and so cannot be isolated from events in the rest of the world. If we sold our oil cheap at home, other people would buy it and sell it on elsewhere at world prices. They would make the profit and receive the revenue which we had foregone. We are not Saudi Arabia. Our self-sufficiency may only last 10 years, and if we undervalued it now, we would merely use up our oil more quickly. Some countries, like the USA and Holland, tried to price their energy below world levels. They created problems for themselves and for the whole world, and are now reversing those policies.

Q15: But why should we accept a world price which is just a cartel price imposed by OPEC?

A: The balance between world oil supplies and the demand for them is very tight and getting tighter. That is the basic reason why prices are at their present level. And that is why the loss of production from a single oil producer can lead to enormous price increases. For every 3 barrels of oil which the world uses, it discovers only 2 barrels of new supplies. We, in common with all industrialised countries, must reduce our dependence on oil. Paying the economic price will play an important part in that, and will also encourage new exploration.

Q16: Even if that is the case with oil, why should world trends affect the price of our gas, which is mainly home-produced and not internationally traded?

A: As oil becomes scarcer and more expensive, that makes the alternative fuels more valuable. Our gas is a finite source too. Unless its price bears some relation to oil, demand will soon outstrip supply. We would rapidly run down our reserves of gas and so become more dependent on oil at a time when we should be

moving away from it. In any case, for the Gas Corporation to follow sensible business practice, it must move its price towards the cost of new supplies. For some of those, it will have to import from Norway, and compete against international buyers who are willing to pay an oil-related price. Even new supplies from under British waters are going to cost many times more than we are used to paying.

Q17: <u>But since British Gas already makes huge profits, surely that shows that the price is already too high?</u>

A: "British Gas's profits are high largely because it buys most of its gas on long-term contracts which may now appear cheap, and which are exempt from PRT. It still would not make sense to under-value gas sold in the market because of that. The difference between what it costs British Gas and the gas's true value represents the benefit to the nation of having our own supplies. The benefit that goes to British Gas should accrue to the nation at large, and so, that money will now be transferred from British Gas to the Exchequer by means of a special gas levy".

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