4.42 CONFIDENTIAL B cc NO

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

PRIME MINISTER

SLEIPNER

With AT?

I have seen Peter Walker's minute to you of 8 June.

2. I think there is a risk of confusion over Peter's statement that colleagues have agreed we should proceed with Sleipner. As you will recall, both Norman Tebbit and I have made clear in correspondence that the introduction of an export regime should be an essential element in any agreement to the Sleipner contract.

3. In 1974 BGC contracted with the Norwegians to import gas from the Frigg field in similar volume to that envisaged for the purchase of Sleipner. There can be no doubt that the Frigg deal has had a very harmful impact on the development of the UK's own gas resources. BGC's need for gas from UK fields was dramatically reduced and as a result, the Corporation offered potential developers of UK gas fields prices far below international levels. This stopped the development of our own fields and brought exploration for new gas discoveries to a standstill for several years.

4. The delay placed a heavy burden on our economy. The balance of payments cost of Frigg is running at about £1½ billion a year. The failure to develop our own gas resources has reduced our wealth as a nation, has hit jobs and profits in the UK offshore construction industry and has meant fewer tax receipts for the Exchequer (but correspondingly higher tax revenue for the Norwegian Government).

5. If we agree to the Sleipner purchase we risk repeating these unfortunate effects. Peter Walker's minute makes clear that, even if no further discoveries of UK gas are made, his department's best estimate is that BGC's existing contracts plus Sleipner will lead to an excess of supply over demand in the mid 1990s. This is true even at the bottom end of the range of supply from Sleipner.

6. This is not a prospect which will encourage companies to explore for UK gas. Indeed the companies themselves will view the situation even more gloomily. As Peter makes clear, the majority of the oil companies expect a significantly (up to 50 per cent) higher supply of gas from fields already contracted to BGC than does Peter's department. If (as is likely) they are right, this would lead to an even greater excess of supply.

7. The costs involved if the Sleipner deal were allowed to crowd out the development of our own gas are quite clear. In balance of payments terms Sleipner would cost £1½-1¾ billion a year in the mid 1990s, rising to around £2 billion at the turn of the century (in 1983 prices). The loss of tax revenue would be some £400 million a year in the mid 1990s (in 1983 prices) and the loss of national wealth would be of a similar size. On top of this, orders, jobs and profits in UK industry would again be forgone. I cannot believe this is an acceptable price to pay for any extra security of supply Sleipner provides in the mid 1990s.

particularly when we are facing too too much rather than too little gas.

8. There are two main options for reducing these costs:

(a) to reject Sleipner and rely on other gas sources, principally our own;

(b) to agree to Sleipner on the basis proposed by Peter Walker but to couple this with freedom to export gas from the UKCS.

Of the two, I prefer the latter, although I should feel more confident if I believed BGC had thoroughly explored an alternative offer from the Dutch to supply us with gas.

9. The attraction of an export regime is that it would allow the development of our natural gas resources to be determined by the market place. This is the policy we have followed very successfully with oil to the enormous benefit of the economy. The problem for companies wanting to develop gas fields and explore for gas in the 1970s and early 1980s was that they had nobody to whom to sell if BGC did not want their gas. An export regime would allow them to turn elsewhere. It is not right that the development of our natural resources should be determined by BGC's use of its dominant buying power.

CHANCELLOR OF THE EXCHEQUER

10. I believe Peter Walker's concerns about an export regime are misplaced. He predicts a sharp impact on prices. It is true that prices paid for new gas supplies on the UKCS should rise to international levels in order to encourage exploration and development. But the price of new supply levels should not be confused with the prices charged to gas consumers. At most prices might be about 4 per cent higher by the mid 1990s, with the bulk of the increase coming after 1990. This assumes that gas charges to consumers are based on the average cost of gas to BGC. It reflects the fact that for many years to come BGC's new supplies will represent only a small part of total BGC gas supplies; most will come from gas already contracted. If gas were properly priced on the cost of marginal supplies, exports would have even less effect; the Sleipner contract would itself be likely to represent the marginal cost for years to come.

11. Peter also foresees exports leading to an interruption in development. Of course, whenever exports are allowed, oil companies will reassess their position in the changed circumstances. But Peter is not opposing exports in principle for this reason; only the timing of their introduction. In my view, we should introduce exports now. If we do not, the signing of the Sleipner purchase will deal a severe blow to confidence on the UKCS and produce a major and lasting fall in activity. By comparison, any temporary interruption for reassessment will be small and short lived.

12. Against this background, I consider the best approach would be to permit an unrestricted export regime for gas in order to ensure the proper economic development of UK gas and the earlier discovery of major new reserves. Not only would this be a major benefit to our own economy. It would also mean UK gas was playing its full and proper part in reducing West European dependency on Soviet gas.

13. By contrast, the discretionary regime proposed by Peter would be seen by oil companies as arbitrary and uncertain. Given BGC's long record of obstruction to UK gas development, they would have doubts about the way in which discretionary powers would be exercised. A discretionary regime would add further uncertainty to the inevitable business risks associated with gas exploration and development. Confidence would not be sustained and investment would not go ahead.

14. If our colleagues nevertheless feel that some reserve powers of control are desirable in order to maintain security of supply, we should need to ensure that two conditions were satisfied.

15. First, any regime should allow immediate exports in order to overcome current inhibitions on activity. Even now BGC are only prepared to buy UK gas if they can acquire it at a 15-20 per cent discount below international prices. (But they are prepared to pay the international price for Sleipner). In at least one case they have told a company they do not wish to discuss the development of the gas field for two years.

16. Second, the regime should be based on clear objective criteria. Otherwise companies will not have the confidence to press ahead with the massive expenditures involved in exploration and development. There are a number of possible criteria. One approach would be to link exports to the level of proven reserves which were not already contracted to export. If the level were to fall below a particular benchmark figure, no further exports would be permitted until the level of proven reserves had risen sufficiently. This would encourage the oil companies to continue the search for new gas fields. Another approach would allow exports at least until a particular date. The latter is the approach successfully used in the past in providing the same companies with assurances about oil depletion policy.

17. In summary I believe we should only agree to the Sleipner deal if we can agree to the immediate export of gas from the UKCS. In my view this export regime should be unrestricted but, if there are to be restrictions, these must be based on clear objective criteria. If this is not acceptable, I see no satisfactory alternative but the rejection of Sleipner.

18. Copies of this minute go to the other members of ES, George Younger and to Sir Robert Armstrong.

NL.

(N.L.)

12 June 1984