

DOCUMENT
THIS IS THE PROPERTY OF HER BRITANNIC MAJESTY'S GOVERNMENT

E(81)39
3 April 1981

CABINET
MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

INDUSTRIAL ENERGY PRICES

MEMORANDUM BY THE SECRETARY OF STATE FOR ENERGY

INTRODUCTION

1. The pressure for action on industrial energy prices has not receded following the measures announced in the Budget. It has increased. Industry has made it clear in the NEDC and elsewhere that they consider the Budget measures were an inadequate response to the price disparities set out in the Task Force's Report. Our supporters in the House and in the country generally echo the complaints of industry. I believe we must provide industry with further help now rather than later. If we wait the cost will be greater.

Budget Proposals

2. Before the Budget I put a number of proposals on energy prices and taxes to the Chancellor. I am grateful to him for implementing some in full and others in part. He did not, however, feel able to agree to any action on the Heavy Fuel Oil duty, on which we both received most representations from industry, because of the Frigg complication (See Annex A). I also proposed that the tax on derv should be increased by only 7p and in any case by less than any increase in the duty on petrol. Industry has been particularly critical of the 20p increase in duty on derv, which puts UK prices well above those in the rest of Europe and will cost business £270 million per annum, ie more than the £168 million energy package in the Budget.

3. It will be essential to take action on these points in any further package, if it is to be acceptable to industry. Specific

(a) We should remit 100% of the duty on HFO to certain energy-intensive industries accounting for some 30% of HFO consumption. (See illustrative list in Annex A.) This must be subject to advice by the Attorney-General, whom I have consulted, that such action is unlikely to give rise to Frigg complications. Cost £40-50 million.

(b) If some concession had to be made in the Finance Bill on transport fuel duties, the duty on diesel should be reduced by 3p/4p below the duty on petrol. Cost £40-55 million.

4. The NEDO Task Force's Report showed that while for 95% of individual industrial customers prices were broadly in line with Europe, nevertheless:

(a) electricity prices for large, high load factor users were up to 35% higher than in France and Germany (when measured in sterling);

(b) our firm gas prices were 10%-20% and interruptible prices 5%-10% higher than in the rest of Europe.

The Budget measures will reduce the bills of certain high load users, by as much as 8%. The disparity will still be significant. For gas users, the new measures should steadily close, but may not eliminate the gap over the year. If sterling rises sharply again, the gap could stay wide. Because of the impact of the Budget as a whole, and of other increases in industry's costs, including rates, the further measures in para 3 alone will no longer be considered adequate.

Across-the-Board Cuts

5. I am against across-the-board gas and electricity price cuts for all industrial users. These would involve:

- i. cost-ineffective help to industry;
- ii. abandonment of a major strand of Government policy;

- iii. renegeing on international commitments; and
- iv. enormous costs.

For example for the UK as a whole:

(a) Electricity

- i. a 10% cut in all industrial electricity prices would cost £300 million per annum gross in reduced revenues in a full year;
- ii. a 25% cut for all large users (2.5MW and above) would cost about £350 million;
- iii. a 25% cut for all very large users (20MW) about £130 million.

(b) Gas

- i. a 20% cut in firm gas prices would cost £160 million;
- ii. a 10% cut in interruptible gas prices £70 million.

6. I have pressed the gas and electricity industries to show maximum flexibility in their pricing to the benefit of large users; for example, bulk supply discounts and premium interruptible contracts for gas. I shall continue to press and am hopeful that they will come forward with new arrangements. However, such measures will bring neither early nor substantial relief.

A Selective Approach

7. Any further immediate assistance, to give transitional help now, should be more selective, directed mainly to providing help to certain energy-intensive users of electricity, which the NEDO Task Force showed are suffering the biggest disadvantage - for example, steel, paper-making, ^{some chemicals} textiles and ceramics. Such assistance might be provided under the Industry Act. But this could run into EEC difficulties. An alternative approach, which I am prepared to follow, would be to require the electricity supply industry to provide electricity to

selected companies at prices competitive with those in Europe. We could do this in one of two ways: either by charging smaller industrial and commercial and domestic, consumers more; or by receiving a grant from the Exchequer. Either way, it will be for the Department of Industry to choose which companies should be provided with such a grant. This will, inevitably, be difficult. I cannot recommend the first course - higher charges for smaller consumers. The second option - a grant subsidy - could be difficult both to contain and to end: the criteria will need to be defined carefully. An outline of this proposal is in Annex B. The costs of such action could be over £50 million in the current year, depending on the method chosen and the number of users actually assisted. In either option it has to be recognised that discriminating in favour of bulk users more than we have already done could be challenged in the courts. If successfully challenged, legislation might be necessary.

8 In addition, we should be ready to assist one-off schemes, involving the NCB, the CEBG and the industry or company concerned, will require close co-ordination between the Industry and Energy departments of the kind already being used in the ICI-Runcorn case.

9. There is a gap of some 30% between UK and other European list prices for foundry coke, despite the fact that the coking coal is provided here at the same price as imports. This is because we pay smaller subsidies under ECSC rules than other countries. I recommend action. A reduction in list prices of some £10/ton, with some further selective discounts, would not eliminate the gap between UK and Continental list prices, but would ensure that UK delivered prices were below those of imports. This concession would ease pressure on the foundry industry, and I should not recommend going further. The cost of enabling National Smokeless Fuels Limited, the largest producer of foundry coke, to reduce prices in this way might be up to £10 million which could not be recovered from other coal users.

10. I do not think further action on gas prices is required at the moment. No other country in Europe has frozen its prices until the end of the year. By then other European gas prices could be close to ours, in some cases higher. We would need to review the position in the autumn.

Conclusions

11. It will be difficult to find additional funds to help industry with their energy prices. But the political and industrial pressures on us are very severe and the position very hard to defend when our oil and gas industries are gathering huge revenues for the Exchequer. We can help industry transitionally without abandoning sound energy pricing policy, and do so at far less cost than overall price cuts would involve. I therefore invite colleagues to agree to the proposals set out in paragraphs 3 and 7 to 9 above.

Department of Energy

3 April 1981

D.A.R.H.

Factory
Steel
Chemicals
Textiles
Papermaking

FUEL OIL DUTY

1. The Chancellor decided in the Budget not to reduce the duty on fuel oil from its present level of 3¹/₂p/gallon (£8/tonne) because of the effect this would have in raising the cost of Frigg gas imported from Norway.
2. There is a clause in the Frigg contract which has the effect of decreasing the price BGC has to pay for Frigg gas as the rate of HFO duty rises, but increasing the price to BGC if HFO duty is reduced. For example, if the duty is reduced by 75%, for every £1 of benefit industry receives in the form of lower prices, BGC will have to pay £2 to the French and Norwegian producers of Frigg gas.
3. It would be possible to renegotiate the Norwegian Frigg contract so that this consequence did not arise. This would however take time. The British Gas Corporation's negotiating position has not been strengthened by the publicity given to the problem following references to it in the Budget statement and since. The price concessions they would have to make as a quid pro quo for changing the contract terms would probably be no less than the Frigg penalties of reducing the duty.
4. We have, however, consulted the Attorney-General about whether and how far present exemptions from duty liability (eg horticulture) could be widened without affecting gas costs. Subject to his advice it may be possible to exempt up to 30% of total fuel oil consumption without serious risk of eventual arbitration on the Frigg contract going against us. Candidates within this limit would need to be selected by D/Industry but could possibly include:

Pottery
Glass
Chemicals
Textiles
Papermaking

CONFIDENTIAL
CONFIDENTIAL



THE SCOPE FOR GIVING SELECTIVE ASSISTANCE TO BULK USERS OF ELECTRICITY.

1. This note considers how selective assistance might be provided to large industrial users of electricity. To bridge the gap with current continental prices could require discounts of up to 25% or more. Such selective discounts would involve the electricity supply industry (esi) in discrimination and selling below short-run costs. Both might constitute undue preference which under its statutes the industry should avoid. The esi would need Government assurance of amending legislation if there were legal challenge.

Scope, Cost and Duration

2. D/Industry will advise which companies should be helped. If from bulk users above, say, 2.5 Mw maximum demand we selected those with a 50% load factor to be given a 25% discount the cost could be about £150m. Pending D/Industry advice the scale of selective assistance might be £50m or more (including perhaps £5-10m for ICI chlorine alone). It is hoped that the disparity between UK and continental bulk prices will reduce over the next year with continental increases and exchange rate movements but it is unlikely to disappear in the short-term. There will be pressure for indefinite help but prudence suggests at most a short-term (one year) commitment with an undertaking to review.

Method

3. Direct supply by CEGB to selected consumers based on cheap NCB coal may offer the least problematical route. CEGB can supply direct to individual consumers with the Secretary of State's consent. This provides a mechanism for selection although there would be technical difficulties to overcome in transferring customers from Area Boards to the CEGB, and Area Boards may well oppose this. NCB has already suggested making a cheaper tranche of coal available for the benefit of CEGB's industrial customers (though it has in mind extra NCB coal sales to push out imports). No immediate legislation would be necessary but public expenditure implications need further examination. There may be a problem over undue preference, though this is not for certain - temporary assistance based on a special coal deal might, in the present economic climate, escape challenge.

4. There are other possibilities. Direct compensation to the esi would however require legislation and would attract a great deal of domestic and international attention. Direct sale of cheaper coal to individual companies by NCB for onward transmission at cost by CEGB is not favoured by either Board.

* This deals with the position in England and Wales. But any selective assistance would obviously need to encompass bulk users in Scotland and Northern Ireland.

CONFIDENTIAL