

CONFIDENTIAL

PRIME MINISTER

ENERGY PRICES

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 discussion.
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This is a series of first submissions on energy prices. I suspect that it will raise a lot of questions in your mind; if it does, they might best be answered by talking to Mr Howell (and officials) before the E meetings on energy matters?

MS
 26/8

In view of the strong lobbying from industries which feel hard-pressed by increases in energy prices generally over the past year, we clearly need to consider our present approach to energy pricing in the context of our economic strategy.

2. My Department is urgently reviewing our pricing policy and examining options for the immediate future. This work will take account both of gas pricing and the pricing of other forms of energy. There are important inter-relationships between the different fuels and these need to be looked at together. The Treasury, Department of Industry and CPRS will be associated with this review. I am suggesting to the Secretary of State for Industry and other colleagues concerned that the results of this work should be examined by the proposed inter-departmental working group which is being set up to scrutinise the evidence which the CBI are to collect, following the recent NEDC meeting, on international energy cost comparisons.

3. I aim to submit a paper on industrial energy pricing to colleagues in September. Meantime, in response to the request in your Private Secretary's letter of 4th August, I attach a preliminary note by my Department on energy prices to the chemical industry, with particular reference to gas pricing. This is a factual note based on the latest information available here and in Community countries. The note concludes that:

- a) Average gas prices to British industry were not out of line with other EEC countries in January:
- b) Electricity prices at that time for reasonably large industrial loads were generally in line with those elsewhere:
- c) More recently our fuel oil prices have moved ahead:

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- d) Our coal prices were comparable to other Community-produced supplies.

This note is essentially a preliminary survey in somewhat generalised terms and with statistical matter of variable quality. The further studies we have in hand should produce a better basis for discussions with industry and for policy decisions.

3. I am copying this minute to members of E Committee and to Sir Robert Armstrong.

21st August 1980.

JH
7



ENERGY PRICES TO THE CHEMICAL INDUSTRY

1. There has been much concern expressed in recent weeks that the prices paid for energy by British industry may be higher than those paid by their European competitors. The Chemical Industries Association (CIA) has made much of the running though they would not argue that their industry is worse placed than British industry as a whole. The main emphasis of the CIA campaign has been on gas prices.

2. This note considers two questions:

- i) is the price paid for gas by our chemical industry in fact higher than that paid by their Continental competitors?
- ii) if it were, what would be the impact on our industry's competitiveness?

The Annexes B, C and D deal with the other fuels.

Are our prices higher?

3. Valid international comparisons of gas prices in particular are difficult. The gas market is the least transparent, and is subject to the longest lags, of any energy market. Prices to large consumers are often the subject of confidential contracts. Where tariffs apply these may be complex, involving escalation related to oil prices and regional variation. Gas prices are inevitably linked in one way or another to those of oil since for most users the two fuels are in principle interchangeable. But in practice gas prices tend to lag behind those for oil, particularly when the latter have increased sharply. For these reasons reliable, up-to-date figures for average prices paid by industry in other countries are not easily obtained.

4. The Department of Energy publish each quarter an average industrial gas price based on a survey of 900 large consumers. For the first quarter of 1980 (the most recent data available) the figure is 15.96 pence/therm. This includes a few old, low-priced contracts, in particular part of the very large supply to ICI. Omission of these would add up to two pence to the average price figure, i.e. bringing it up towards 18p/therm.

5. The most recent reliable data on industrial gas prices in the other EC countries are those compiled by the Statistical Office of the European Communities for January 1980. These are shown at Annex A for representative cities. It will be seen that the average price paid in Britain in January - mentioned above - was not out of line with those paid in the other countries, even if the old low-priced contracts mentioned above are omitted.



6. The Chemical Industries Association have collected and published information from their own industry and their European counterparts for new and renewed contract prices (see Annex A). In Britain such prices tend to be higher than average prices because annual fixed price contracts are the rule; when gas renewal prices increase rapidly during or following a period of rising oil prices, the gap between the average price paid across the board and the renewal price on some particular date may be appreciable. For instance, in the first quarter of this year the mean price realised by BGC in new and renewed contracts was 22p/therm. This may be compared with the average price of 15.96p/therm mentioned in paragraph 4. For other EC countries, when more frequent escalation against oil is usual, new and renewed contract prices tend to be closer to average prices.

7. Average prices provide the best measure of the impact of gas purchases on industry's overall costs. On this basis Britain was not out of line with other EC countries in January. No more up-to-date and reliable information is as yet available, either to the Department of Energy or generally. On the other hand, contract renewal prices provide industry with an indication of rising energy costs and perhaps for this reason the CIA have paid most attention to them, and their own figures show lower prices on the Continent (see Annex A).

Gas costs and competitiveness

8. For most industrial sectors energy costs comprise only a few per cent of total costs and gas costs less than one per cent, though the latter will vary from firm to firm, depending on the plant in use. Therefore any gas price differential between Britain and the Continent would in itself have only a very small effect on the competitiveness of our industry.

9. For the chemical industry all fuel purchases amount to about 6 per cent of total costs and gas purchases to about 1½ per cent. The CIA have recently argued that the British chemical industry as a whole is paying more for gas as a fuel than its W German or French counterparts - £130m and £70m respectively this year for the equivalent volume of gas. But the UK prices underlying this conclusion appear to be renewal prices rather than average prices, which would make the calculation inadmissible. We expect that our average price is unlikely to be very different over the course of this year from that of the French and there is the prospect of big price rises in Germany later in the year.

Conclusions

10. The following conclusions may be drawn from available information on energy prices:

This point is valid. It is what they are paying - compd. with whether competition are paying.



No - you
Have to look
at specific
industries.
Average oil
no food.

- (i) Average prices provide the best measure of the impact of gas purchases on industry's overall costs. The latest available data on average gas prices to industry do not show Britain to be out of line with the other EC countries in January. Even if our prices were to move ahead faster in the course of this year than Continental prices the effect on the competitive position of the chemical industry would be very small.
- (ii) The CIA, in their representations on gas, have been careful to refer only to the fuel use of gas by the chemical industry. In fact about 60 per cent of that industry's gas supply is taken by ICI on a 15 year contract at a very low price and used substantially for feedstock. The average price of all gas purchased by the UK chemical industry for all purposes was probably less than 11p/therm last year.
- (iii) As regards the other fuels, our fuel oil prices have recently moved rather ahead of those in most of the other EC countries (see Annex B). Our electricity prices in January for reasonably large industrial loads were in line with those elsewhere though the discounts available to very large users in France, in particular, are greater (see Annex C). Coal prices were comparable to other Community-produced supplies (see Annex D).

Department of Energy
14 August 1980



GAS PRICES TO INDUSTRY: JANUARY 1980

pence/therm

	Eurostat average prices (1)		Chemical Industries Association: new and renewed contracts (2)
	<u>4m.therms/year</u>	<u>40m.therms/year</u>	<u>20m.therms/year</u>
Dusseldorf	24.3	n.a.	15.8
Paris	19.5	19.3	19.3
Rome	19.5	18.9	19.6
Rotterdam	18.3	17.2	17.5
Brussels	17.3	16.8	n.a.
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UK D/Energy		15.96	26-28 (3)

- (1) The Eurostat data are in general actual or average prices paid in selected cities, compiled by the Statistical Office of the European Communities.
- (2) The CIA figures are for new and renewed contract prices for the respective countries.
- (3) The CIA figure for Britain is higher than BGC's estimate both of the mean price for firm contract renewal in January (23.5p/therm) and that for all contracts - firm and interruptible (22p/therm).

D Energy say that the CIA figure of 26-28p/therm is the level BGC have not got to in renewing contracts. For new contracts to brand new customers, they are quoting the full oil-related price of 38-40 p/therm. The market splits roughly 50% domestic / 10% non-domestic tariff / 40% non-domestic contract - including ICI with a huge contract at something like 6 1/2 p/therm.



OIL

1. Liquid fuels comprised 31 per cent of the chemical industry's fuel purchases last year.

2. The CIA have argued that UK heavy fuel oil prices are higher than in other EC countries and that the difference is exacerbated by the high level of excise duty here. In the past UK fuel oil prices have broadly moved in line with those in other EC countries although the relativities have fluctuated somewhat, particularly in 1979. The CIA's data, while not statistically satisfactory, are nevertheless consistent with other information available to the Department of Energy which suggest that on some measures UK prices for heavy fuel oil have recently moved ahead:

	<u>\$/tonne</u>	
	<u>EC: Consumer prices(1)</u>	<u>OPAL: Net market realisations (2)</u>
Belgium	187	166.3
Denmark	201	-
France	185	189.6
F R Germany	182	182.5
Ireland	214	-
Italy	187	184.9
Netherlands	194	189.9
UK	206	196.3
EC weighted average	191	-

Notes:

(1) Bulletin of 17 July; net of taxes and duties; small consumers.

(2) Private consultants' end June 1980 market survey of large consumers; net of taxes and duties.

3. There are significant statistical problems in establishing valid price comparisons. Several factors may be involved in this recent movement. Some other EC countries have selective price controls linked to spot prices of certain petroleum products; recently these have moved down with possible repercussive effects. Moreover, countries such as Germany and



Benelux can benefit from such a movement more rapidly through their greater dependence on supplies from the spot market. In contrast the UK tends to be self sufficient in fuel oil production and we believe a higher proportion of sales are on a contractual basis. The UK oil companies have also told the Department that they seek to recover a higher proportion of their overall costs from heavy products. The question of relative oil product prices is under current examination in the Department of Energy, particularly whether there is any evidence that their level and distribution do not properly reflect market pressures.

4. Our level of duty on heavy fuel oil is effectively the highest in Europe* but even so this contributes only a relatively small percentage (8-9%) to the overall fuel oil cost. Moreover, the UK has been above the general EC level for many years. On the other hand our level of duty on petrol is amongst the lowest in Europe.

* (Ireland alone excepted)



ELECTRICITY

1. International comparisons of electricity prices are difficult because of the lack of information about the terms and conditions of supply, particularly to large users. Nevertheless, available data for reasonably large industrial loads in January 1980 do not show Britain to be generally out of line:

	<u>pence/kWh</u>
UK	1.866 - 2.298
F R Germany	1.984 - 2.401
France	1.770 - 1.920
Italy	2.133
Netherlands	2.833

2. However, the discounts offered to very large, high load factor users, typical for some chemical processes, are not as great in the UK as they are in France or Germany. France, in particular, offers a markedly lower price for such loads which are especially suitable for its large nuclear programme.

3. UK prices to industry could rise by about 30 per cent by the end of this financial year, depending on the size of future coal and oil price increases. This is likely to be higher than increases in other EC countries and could result in some cost disadvantage to our chemical industry for whom electricity comprises about 36 per cent of all fuel purchases.



COAL

1. Steam coal is only a minor direct fuel input for the UK chemical industry ($3\frac{1}{2}$ per cent by value in 1979). Although prices to industry vary widely throughout the EC estimates from various sources show that NCB prices are not out of line with other Community-produced supplies.

<u>Source</u>	<u>£ per tonne</u>		
	<u>France</u>	<u>F R Germany</u>	<u>UK</u>
CIA (July 1980, pithead prices)	-	55	40
European Commission (April 1980, pithead prices)	43	50	38-45

2. However, coal supplies from third countries with more favourable geological conditions (e.g. USA, Australia, S Africa) do at present undercut Community coal at locations close to port facilities and distant from coalfields.

<u>Source</u>	<u>£ per tonne</u>	
	<u>Rotterdam</u>	<u>Thameside Ports</u>
Coal Week (June 1980, Cif. port)	22-24	27

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