CONFIDENTIAL

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

7

27 NOVEMBER 1980

COPY NO 1 of 30

EUROPEAN COUNCIL LUXEMBOURG
1/2 DECEMBER 1980
ENERGY

Brief by Department of Energy

OBJECTIVES

1. To secure endorsement by Heads of State of what was agreed at the Energy Council of 27 November on the handling of the oil supply situation.

2. To ensure that the situation is kept flexible for the IEA Ministerial meeting on 9 December as it is essential to involve US and Japan in collective action (if a further meeting of the Energy Council is required and necessary before 9 December, so be it).

3. To keep discussion of energy implications of Iraq/Iran conflict calm and constructive.

4. In any wider discussion of energy issues, to indicate contribution UK is making towards achievement of agreed Community energy objectives.

POINTS TO MAKE

5. Energy Ministers have agreed an approach to the oil supply situation to which we are all party. This approach is sound and we should endorse it. The next stage is the IEA Ministerial on 9 December.

Iran/Iraq and the Oil Market

6. Important to avoid panic in oil market. Serious price escalation, prompted by pressure on spot market, would have damaging effect on world economy

CONFIDENTIAL

7. While, overall, the situation has deteriorated since the measures agreed in the IEA on 1 October, there have been signs in the last week that the spot market is softening. Nevertheless, if the war goes on we may still be faced with another big increase in oil prices. The agreement on measures reached at the Energy Council should be sufficient to hold the position at the moment and we should use the present lull in the spot market to plan any further action, but such action will be acceptable only if

(i) there can be confidence that the measures adopted will have the intended effect and not simply introduce new rigidities into the market; and

(ii) there is unanimous commitment to them by the consumers (ie EC and IEA).

8. (Defensive) If any Heads of State suggest reopening the Conclusions reached at the Council of Energy Ministers this should be resisted. The results of the Energy Council involve technical and complex issues. Any further work on this would need to involve Energy Ministers and would have to be completed before the IEA Ministerial on 9 December.

9. Note that IEA Ministers will be meeting on 8/9 December; and that there is likely to be strong US pressure for import ceilings. We have reservations, but if the question of ceilings arises as a necessary part of an otherwise beneficial package, and if all consuming countries were committed to it, we would be prepared to consider it constructively. We must all keep in close touch. Right for Community to keep situation under review.

10. (Defensive, if there is pressure for specific commitments over supply of UKCS oil) UK fully committed to IEA and Community arrangements for sharing in supply crisis. UKCS production currently at or very near the maximum consistent with good oilfield management: virtually no scope for increasing production in short term.

Achievement of Wider Energy Objectives

11. Need to shift the balance within energy economies widely recognised (eg May Council of Energy Ministers). Public opinion will expect vigorous policy measures by Governments.

12. Main contribution towards the process will come from national energy programmes complemented where appropriate by action at Community level and by international collaboration. Community has valuable role to play in ensuring convergence of national energy programmes to meet agreed objectives.

13. UK is playing its part in reducing oil dependence by the Community through its nuclear programme and coal production. Development of UK oil reserves making substantial contribution to reduction of Community dependence on imported oil; in first 8 months of 1980, two-thirds of total UK crude oil exports (some 16.1m tonnes) went to other EC Member States.

14. We continue to believe that economic pricing is key to rational and efficient use of energy. UK is pressing ahead with realistic energy pricing policies.

15. US energy prices still at unrealistically low levels. This is undesirable in energy terms, and has damaging consequences for European industry, especially textiles. The Community should press the new US administration to deregulate gas prices rapidly.

Community Energy Initiative (if raised)

16. Commission ideas interesting but complex. We will continue to participate constructively in examination of particular aspects (eg scope for additional Community investment in energy projects).

17. Increased Community investment in coal production would help reduce Community dependence on imported energy and on oil. Could also make a useful contribution to budget restructuring by expanding non-agricultural expenditure. Particularly important that Community move quickly to provide support for increased indigenous coal production.

Oil Import Levy (Do not raise)

18. We should need to consider carefully the implications of a Community oil levy and the wider issues that might be involved. We await clarification of Commission's ideas.

ESSENTIAL FACTS

Impact of Iran/Iraq Crisis

19. When the war started OPEC oil production was running 2 mbd above demand. The loss of supply from Iran and Iraq amounts to some 4 mbd which has been offset by about 1 mbd extra OPEC production, mainly from Saudi Arabia and Kuwait. It has also been offset by the suspension of the 10% cut in OPEC production generally which had been agreed by OPEC Ministers at their last meeting before the war broke out. These figures suggest that, provided the recent reduction in demand continues and we do not have an exceptionally severe winter, the supply/demand balance is only about 1 mbd worse than would have existed if the war had not occurred.

20. The loss of Iranian and Iraqi oil has hit certain countries and companies severely, others not at all. Within IEA, Turkey and Portugal have been particularly badly hit as have France, Brazil and India amongst non-IEA countries. Spain, Greece, Ireland, Austria, Italy and Japan together with a number of LDCs have been significantly affected. Some companies, notably ARAMCO partners have not suffered at all: others, including some national oil companies as well as BP and Shell (already crude short) have lost a good deal.

21. IEA's most recent assessment is that, given present expectations of little oil from Iran or Iraq until the beginning of Q2 1981 at the earliest, stock levels in the IEA will fall from 460m tonnes at end September 1980 to 440m tonnes at end December (a level somewhat higher than that of 1 January 1980).

22. Key problem is price rather than supply. IEA on 1 October agreed measures to meet the gap between supply and demand by using some stocks while retaining adequate strategic reserves, and to discourage abnormal purchases on spot market. These may need reinforcement if the increases in spot prices resume and the OPEC producers are tempted to lift official prices.

23. There are strong indications that, at the IEA Governing Board at Ministerial level on 8/9 December, the US will press hard for import ceilings as a necessary political quid pro quo for the use of oil presently in the hands of US companies to rectify local and company supply imbalances brought about by the cessation of Iranian and Iraqi exports. There is likely to be support for this approach and, if a consensus was clearly developing, the UK could support it, although we have reservations about the value of the measure. There are clear signs that we could negotiate a net import ceiling for the UK which would not require us to introduce measures of demand restraint, and it would be a sine qua non of any measures which the UK accepted that their impact on the British consumer would be less severe, less immediate and less visible than for our European and IEA partners.

Energy Councils

24. The Energy Council on 27 November reached agreement on how to handle the oil supplies situation. These Conclusions (Annex 1) represent a sound approach to the problems we face and the European Council should endorse them.

The important paragraphs of the Conclusions are 6 and 7. The preamble to Para 6 acknowledges the importance of involving other industrialised consumer countries (ie the USA and Japan) in collective action. The measures set out in the indents to para 6 are useful but not over-restrictive - these steps keep the situation flexible for the IEA Ministerial on 9 December. The thinking behind para 7 is a valuable recognition of our main objective and can be developed in the light of changing circumstances if necessary. Above all, the Conclusions contain no reference to import ceilings.

25. The 13 May Energy Council agreed:

- to reduce oil consumption in EC to about 40% of gross primary energy consumption in 1990;
- to cover 70 to 75% of primary energy requirements for production of electricity in 1990 by means of solid fuels and nuclear energy;
- recognised importance of energy pricing policy reflecting representative conditions on world market, longer-term trends, costs of replacing and developing energy resources.

Venice Summit

26. Recognised importance of breaking existing link between economic growth and oil consumption; maximum reliance to be placed on price mechanism.

UK Record

27. A good record - about 43% of UK's gross primary energy consumption in 1979 came from oil;

- UK coal production 1979 122m tonnes - substantial contribution to EC energy supplies;
- nuclear provides about 12% of our electricity. Its contribution expected to increase to about 20% in early 1980s. Secretary of State for Energy announced in December 1979 that electricity supply industry expect to order at least 1 nuclear station a year in decade from 1982 (15GW of new capacity by 2000).

Commission Energy Initiative

28. Commission presented Communication to Luxembourg European Council in April on need for increased energy investment in Community and proposing Community programme to support investment in energy savings, oil substitution, coal and development of alternative energies. Commission also put forward proposals on energy price and tax harmonisation in Community and on ways of raising Community funds from energy (eg import levy, production/consumption taxes).

Energy Council, 13 May, asked Commission to consult Member States to assess whether there was a need for Community support for energy investment. Officials have had useful discussions with Commission on investment opportunities in UK (Cross-Channel link, Heysham II, Selby, PWR). Ministers have agreed that the UK would be a net beneficiary of a scheme to encourage investment in coal production and possibly other energy sources. Much will depend on what the Commission proposes. The expansion of non-agricultural expenditure could make a useful, if modest, contribution to our budget restructuring objectives. Presentationally it is important to press for policies which will yield us a net benefit and which fit into Community objectives and policies.

Oil Import Levy (Not for disclosure)

29. OD on 13 October agreed the UK should not advocate an oil levy but that internal studies of its feasibility should continue. A scheme could be devised which would bring us benefit, but many issues (industrial competivity, length of negotiations, energy policy effects). to be considered before we can reach a view.

US Energy Prices

30. The Natural Gas Policy Act of 1978 provides continued controls on prices till January 1 1985 with possible extension after 6-month period until January 1978. The controls allow for increase in price on new gas.

Community Support for Coal Production

31. The Secretary of State for Energy wrote to Commissioner Brunner on 4 October 1979 proposing a Community fund of 250 meua, initially over 3 years, to support coal production in the Community. Its prospects seem poor, but our initiative may improve our chances of coal production support in the context of Community Budget Restructuring.

Potential for increasing UKCS production in short-term

32. The UK provided the Community's Oil Group with a paper on the potential for increasing production in the short-term. There is no real scope - operators are already trying to use their capital equipment to maximum advantage. There may, for technical reasons, occasionally be times when some very limited production increases might be possible. But even then the economic cost would be high, both in terms of gas lost by flaring and in possible reservoir damage, which would lead to a loss in ultimately recovered reserves. This would raise the question of at what price any such oil should be made available.

Department of Energy
28 November 1980

Annex 1

CONFIDENTIAL

CONCLUSIONS OF ENERGY COUNCIL
27 NOVEMBER ON OIL SUPPLIES

OIL SUPPLIES

The Council held an exchange of views on the oil supply situation as a result of the stoppage of deliveries from Iraq and Iran.

2. Demand has been reduced considerably, particularly because of the present levels of economic activity, but also owing to the results obtained as regards oil savings and the substitution of alternative energy sources. For this reason, and taking into account the withdrawals which will be made against the large stocks held, there is no overall oil shortfall, even though there may be some limited difficulties for certain countries and certain companies.

3. The Council welcomes the increase in oil production decided on by certain OPEC governments in order to prevent the situation from deterirorating and to help the consumer countries which are most affected.

4. In the present circumstances, price increases on the oil markets are unjstified and both producer and consumer countries have a common responsibility for and interest in preventing speculative upward trends.

5. The Council expresses its determination to do everything in its power to prevent tension on the oil markets during the coming months. Bearing in mind the very rapid rate of increase which has occurred over the past few years, a further price increase would seriously handicap world economic prospects and, in particular, would heighten the problems of the oil-importing developing countries.

6. Provided that other industrialised consumer countries do likewise, the Member States of the Community undertake to adopt the following course of action:

(A) Ask oil companies to use stocks in excess of regulation reserve obligations. The significant measures which they have agreed on will be implemented in a comparable and equitable manner insofar as they are necessary to avoid tension on the market.

The Member States and the Commission will collaborate on the co-ordination and verification of these measures.*

(B) - Take all the necessary measures, in conjunction with the oil companies, to prevent import prices varying from normal prices.

- Or ask the oil companies to refrain from making abnormal purchases.

* It is understood that the United Kingdom will not be required to reduce stocks to a level lower than that required of the other member states.

CONFIDENTIAL

(C) Encourage adjustment of supplies in such a way as to correct imbalances which pose particular problems for some Member States and encourage the relevant international organisations to assist the oil companies in remedying specific imbalances which may occur between them.

(D) Further encourage the saving of oil and its replacement by other forms of energy in both the public and the private sector in order to reduce consumption.

(E) Support domestic production at a high level.

7. The main objective will be to avoid an overall demand for imported oil at a higher level than that which can be made available by the producing countries. Trends in supply and demand and in stocks will be closely followed by the Commission in conjunction with the member states. If necessary, policies will be adapted to moderate import requirements, taking account of the various degrees of dependence vis-a-vis these policies.

The Council has invited the member states to take appropriate measures in close co-operation with the Commission.

CONFIDENTIAL

EEC OIL SHARING SCHEME

I The scheme is embodied in Council Decision 77/706 EEC of 7 November 1977 and Commission Decision 79/639/EEC of 15 June 1979. It would operate in 3 stages:

(i) in stage 1, each Member State would be required to reduce consumption of all petroleum products by a maximum of 10% for up to 2 months;

(ii) in stage 2, each Member State would be required to reduce its consumption of fuel oil used in electricity generation on a variable basis, according to the total amount of energy consumed by that State for electricity generation coupled with its practical capacity for fuel-switching in power stations; demand restraint of other petroleum products would continue on a uniform basis. A Member State which had capacity for substituting other fuels for the oil normally burned in power stations, and which could thereby reduce its consumption of oil by more than the Community average, would have an obligation to allocate the excess into the Community for distribution to those Member States less well placed;

(iii) in stage 3, which is likely to be introduced only in the event of a shortfall exceeding 12%, overall EEC consumption of petroleum products would be reduced by more than 10%; the reduction would be on a variable basis amongst Member States according to each Member State's total consumption of energy. As under stage 2, a Member State which reduced consumption by more than the average would allocate the excess into the Community.

Interface with the IEA Allocation Scheme

2. The EEC scheme would be implemented in a "period of supply difficulties"; the Commission has said that by this is meant a shortfall ofover 7% for the group as a whole, i.e. a shortfall comparable to one in which the IEA general trigger would be pulled to activate IEA sharing arrangements. The IEA allocation system would then operate

parallel with stage 1 and subsequently stage 2 of the EEC scheme. The interface of stage 2 of the EEC scheme with the IEA system has been worked out in detail. The interface of stage 3 with IEA arrangements has not yet been as clearly defined, but the Commission's thinking is that stage 3 would be introduced only when the IEA decided, in view of a seriously declining level of stocks, that countries' supply rights under its allocation scheme would have to be substantially reduced.

Implications for the UK

3. Under stage 1 of the scheme the UK would be required to reduce its consumption of petroleum products, although the extent of the reduction would depend on how quickly we wished to draw down stocks above the obligatory emergency reserve level. Under stage 2, where actual oil allocation is involved, it is likely that in addition to restraining consumption the UK would have a small allocation obligation to other Member States. The exact amount would depend on the UK's capacity at the time to substitute other fuels for oil in the generation of electricity; it has, however, been agreed that the UK's obligation will not normally exceed 50,000 tonnes per month. This amount would be in addition to any obligation the UK might incur under the IEA sharing system. If stage 3 of the scheme were activated the UK's allocation obligation, again additional to its IEA commitments, might be substantially greater.

OPH

13 November