Prime Minister 1

Agree that we should not finance coal stocks separately from the EFL? (The arguments against seem overwhelming.) On the size of fuel stocks, Mr Howell will be bringing forward a paper. But it is worth remembering that it would be pointless (and costly) to build up stocks if we have decided we can't take the miners on anyway.

Yes

CHIEF SECRETARY TO THE TREASURY

~~cc~~ Mr Hoskyns
Mr Wolfson

PRIME MINISTER

MT

CONTINGENCY FUEL STOCKS

E Committee invited me, in consultation with the Secretary of State for Energy, to consider whether fuel stocks held by the electricity supply industry for contingency purposes could and should be financed separately from the industry's external financing limit (E(80) 8th Meeting, Item 3). Uncertainties on the EFL position this year have delayed a reply.

TL 15/7

Pt 1

We think that it would be possible to devise a scheme whereby contingency stocks could be financed separately from the industry's external financing limit. But there could be considerable problems with such a scheme. It would draw attention to the contingency stocks and could provoke the miners and stimulate the power workers to black the stocks concerned. Moreover, financing contingency stocks separately from the EFL would almost certainly increase public expenditure since the industries would no longer be under pressure to make savings elsewhere to compensate for any higher stocks. And perhaps most important of all, the exemption of such a major part of the electricity supply industry's cash requirements form the control of the EFL system would be inconsistent with our policy on EFLs generally. Once special arrangements had been conceded for the EFL of the electricity supply industry, we would be under intense pressure to agree to similar arrangements for the other nationalised industries. If the scheme was applied to the NCB which is now running into a period when production will be in excess of demand, it could reduce the incentive to close uneconomic capacity. Thus, a scheme to insulate the EFL of the electricity supply industry from variations in stock levels would raise the issues which are now being considered in the Ministerial Group E(NF) under the Chancellor of the Exchequer.

It would, of course, be possible, if we took a policy decision to that effect, simply to increase the industry's EFL so that it could build up a special coal stock for contingency purposes above the stock level it would normally plan to hold. But the problem here is finance. The electricity supply industry's EFL for 1980-81 is likely to imply a winter endurance for the CEGB of some 5-6 weeks assuming average weather. We decided when we discussed the industry's EFL in E Committee that in formulating proposals for further savings in 1980-81 that they should not seek savings by reducing their fuel stocks. David Howell is discussing the fuel stock position with the industry and is proposing to put a paper to E Committee shortly setting out the position on the most up to date information available. To extend endurance by two weeks (or more if electricity demand was restricted) would give rise to an initial cost of some £140 million in 1980 survey prices (in the year the stocks were built up) with storage and interest costs perhaps amounting to £25 million a year thereafter (with perhaps increased working capital requirements for the industry as coal prices rise).

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These extra costs could be financed by higher electricity tariffs. But a 1 per cent increase in tariffs raises only some £70 million in the full 12 months following the increase and there are already significant tariff increases in prospect for the year - 17% in April and 10% in August. If not financed from tariffs and compensating savings were unavoidable, the costs would represent a substantial claim on the Contingency Reserve. Some 4 million tonnes of extra coal would cost some £140 million in 1980 Survey prices and would represent almost one-eighth of the Reserve.

So to sum up, our conclusion is firmly against special financing arrangements outside EFLs for contingency coal stocks at this stage. The financing of adequate stocks should be a normal responsibility of the industry for which the consumer pays. Beyond that, it would be possible to raise the industry's EFL if we were to take a policy decision that the industry should hold stocks at a higher level than it would normally. But such a decision would pre-empt about one-eighth of the Contingency Reserve as originally constituted and more now that some claims on the Reserve have had to be accepted. You are already aware of our great difficulties with the Contingency Reserve this year. I would see very considerable problems with this course. David Howell tells me that he cannot at this stage exclude the possibility that the fuel stocks which the industry can provide for within the terms of the proposed tariff increases and the EFL may not constitute adequate endurance for the winter. He is of course continuing to encourage the industry to hold adequate stocks while remaining within the EFL.

I am sending copies of this minute to members of E Committee, the Secretary of State for Scotland and to Sir Robert Armstrong.

WJB

JOHN BIFFEN
15 July 1980