Prime Minister

There is a Treasury paper in this folder which you have not seen - came in after the w/end.

M.

CONFIDENTIAL

P.0496

PRIME MINISTER

STIMULATION OF INDUSTRIAL INVESTMENT IN ENERGY CONSERVATION
MISC 56(81) 8 and 13

BACKGROUND

The Secretary of State for Energy has been trying for some time to persuade colleagues to support fresh efforts to stimulate energy conservation, particularly by industry, and more recently to encourage a switch from oil to coal burning. Agreement was reached earlier this year on a 2-year, £50 million grant scheme towards the costs incurred in converting boilers from oil to coal firing, and this was announced in the Budget Speech.

2. The proposals in his memorandum MISC 56(81)8, which elaborates on earlier recommendations considered by the Group at their last meeting, are for a deferred interest loan scheme to encourage companies to invest more in energy saving projects and fuel substitution schemes vital to the long-term competitiveness of United Kingdom industry. The Secretary of State estimates that a scheme open for application for three years could generate about £1 billion of new investment in conservation projects. He sees it as part of a package of measures necessary to respond to criticisms of industrial energy prices and to reduce pressure for a sequence of costly concessions at the expense of economic pricing and of the Public Sector Borrowing Requirement.

3. Under the proposed scheme, loans would be made by Finance for Industry (FFI) and by the clearing banks on commercial criteria for projects meeting energy guidelines set by the Government. The interest due in the first three years of each loan would be deferred; to give an incentive to firms to take up loans, they would not pay interest on this deferred interest. The Government would pay the banks amounts equivalent to the interest deferred and recoup the money later when the firms started to make payments to the banks. These outgoings account for the £300 million estimated public expenditure costs from 1981-82 to 1985-86. The subsidy resulting from not charging interest on

the deferred interest would be about £240 million over 19 years, of which £15 million would fall in the first five years. It is explained in paragraph 7 of MISC 56(81)8 that the Bank of England has suggested that the clearers would probably expect some element of guarantee to be available in some cases if they were to operate the scheme.

4. The number of additional Civil Servants would be small only if FFI and the clearers agreed to do most of the work themselves and any guarantees were limited.

5. Legislation to provide for the payments would be needed as soon as possible; although in the meantime it would be possible to proceed on the authority of the Appropriation Act.

6. In MISC 56(81) 13 the Chancellor of the Exchequer sets out four reasons why he thinks the Group should reject the proposals:-

(i) The public expenditure costs of £300 million in the first five years for which the Department of Energy are offering no offsetting savings (plus a contingent liability of perhaps £80 million if some guarantees were given).

(ii) The monetary consequences - if the monetary targets are to be achieved, increased bank lending for this purpose is at the expense of lending elsewhere.

(iii) Industrial policy - on the grounds that if energy conservation investment is attractive firms should do it anyway without intervention by Government.

(iv) Staff numbers - these could turn out to be high.

HANDLING

7. After the Secretary of State for Energy has introduced his paper you might invite the Chancellor of the Exchequer to comment and the Secretary of State for Industry to give his views on the industrial case, or otherwise, for this assistance.

8. In examining the proposal you will wish to consider each of the four points made by the Chancellor of the Exchequer and also the problem of legislation.

CONCLUSIONS

9. In the light of the discussion the Group will wish:-

Either to reject the proposals, as recommended by the Chancellor of the Exchequer,

Or to invite the Secretary of State for Energy to arrange for further confidential discussion between his Department, the Treasury, FFI and the banks on the details of the scheme and to report back. If this is the conclusion you will wish to emphasise that final approval of any scheme must be reserved to the Cabinet in view of the substantial additional public expenditure involved.

P Le CHEMINANT

Cabinet Office
9 June 1981