CONFIDENTIAL

P.0495

PRIME MINISTER

INDUSTRIAL ELECTRICITY PRICES

MISC 56(81)6,9,11 & 12

BACKGROUND

This group was set up, following the meeting on 8 April of the Ministerial Committee on Economic Strategy (E(81)14th Meeting, Item 1), to consider the amount of an abatement of the increase of 20p on the duty on derv and the scope for further reductions in electricity tariffs for large industrial users and for reductions in the price of foundry coke. The first meeting was on 16 April, under the chairmanship of the Chancellor of the Exchequer while you were in India, and led to the announcement of the abatement on derv. The Chancellor also chaired the second meeting on 14 May when the papers now before the group were commissioned. As you agreed when the group was set up, each Minister may bring an official to the meetings.

The Chancellor will be bringing two: P. Middleton and Wicks from the Treasury's energy division.
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2. On 8 April, E Committee ruled out the possibility of giving help to electricity users on a basis of the Government selecting particular beneficiaries; instead they wanted changes in tariff structure which would have the effect of benefiting large industrial users. MISC 56 has therefore been looking for a solution whereby criteria related to electricity usage (maximum demand and load factor) would help companies in those sectors which are most vulnerable to overseas competitors who benefit from lower electricity prices (ie, chemicals, paper and board, textiles and iron and steel) and, so far as possible, avoid helping those companies not facing such competition and/or not in need of financial assistance.

3. MISC 56(81)6 represents the third attempt to find an approach which satisfies these criteria - not perfectly but as near as is practicable. Three possibilities are summarised in paragraph 10 - each would involve giving a 10 per cent discount to qualifying consumers for one year.

4. Officials recommend that the best solution would be to offer the discount to all consumers with a maximum demand of over 5 megawatts (MW) and a

50 per cent load factor, but with a 30 per cent load factor for iron and steel alone. This would cost £110 million. The preferential treatment for iron and steel would be criticised by other sectors but is necessary if steel producers (mainly private sector) using the electric arc process are to be helped and the possibility of applying the 30 per cent load factor generally is ruled out on the grounds that the scheme would then cost £140 million. This preferred option is the second scheme described in more detail in paragraph 9 of the paper.

5. The alternative of a sliding scale approach - paragraph 10(i) and, in more detail, paragraphs 7 and 8 - has some advantages in focusing on companies in need but it is complicated and fails to cover smaller iron and steel producers. It would cost £105 million.

6. In looking at these, and any other alternatives, the group should bear in mind that all the possibilities suffer from the following major disadvantages:-

(a) Without actually picking out particular beneficiaries (which E Committee rejected) the Government risks spending more money and still being criticised for offering too little, too late and to the wrong beneficiaries.

(b) At about £110 million for a year the cost is high, and in practice it could be very difficult to switch off assistance after one year when, as the Secretary of State for Energy points out in his paper on the longer term (MISC 56(81)9), the present price disparities with France and Germany may well continue for some considerable time.

(c) Legislation may be necessary, although this is still uncertain - if assistance were confined to one year the Department of Energy would hope to pay compensation to the electricity industry under the powers of the Appropriation Act and to avoid legislation to remove the industry's statutory obligation to avoid undue preference in pricing on the (questionable) grounds that it would be a Government rather than electricity industry scheme.

(d) There would be difficulties with the European Commission. There is a Treaty requirement for the Commission to be informed "in sufficient time to enable it to submit its comments, on any plans to grant or alter aid"; and the introduction of any such proposals would be in conflict with the high-principled line taken by the United Kingdom so far on the need for economic energy pricing in all member states.

7. The Group will also want to look at the proposals in the context of the broader and longer-term issues discussed in the memoranda by the Secretary of State for Energy (MISC 56(81)9), the Central Policy Review Staff (MISC (81)11) and the Department of Industry's assessment of the effects on particular industrial sectors of electricity prices (MISC 56(81)12). The Group commissioned these papers on the grounds that the expense and difficulties of a short-term scheme needed to be justified in the context of an assessment of whether the sectors which were likely to benefit were of sufficient importance to justify this help and of whether in the longer term there was a realistic prospect of electricity prices coming down and so removing the need for bridging help.

8. The Department of Industry (MISC 56(81)12) discuss the four main sectors affected and give their assessment in paragraphs 23-26 and their conclusions in paragraph 27. Their judgement seems broadly to be that, if world demand were more buoyant and prices firmer, companies within these sectors would probably cope with their electricity cost disadvantage. The present recession, puts them under particular pressure and some temporary relief could be useful in helping the better firms through the recession and in avoiding closures.

9. The Secretary of State for Energy concludes (MISC 56(81)9) that disparities with French and German electricity prices are likely to persist into the 1990s since it is unrealistic to look for early benefits from cost reductions by the National Coal Board, and the expected benefits from the nuclear programme turn on making substantial improvements in construction times and performance and, even then, will not be felt until well into the 1990s.

10. The CPRS, in MISC 56(81)11, argue that subsidies now to keep energy-intensive industries in business must be accompanied by urgent action to tackle the coal and the nuclear problems - in particular dealing with the problems of the National Nuclear Corporation (their paragraph 4).

HANDLING

11. It would be helpful if the Secretary of State for Energy, in introducing his papers, could bring the group up to date with the pressures from the NEDC and from the CBI for the Government to take further action. The Department of Industry's paper was circulated while the Secretary of State for Industry was still in America, and he will wish to give his views on the industrial case for some action, and perhaps to comment on whether the recent changes in the dollar/sterling exchange rate affect the arguments. Mr Ibbs will wish to speak to the CPRS paper and the Chancellor of the Exchequer to comment, in particular, on the expenditure and PSBR implications. You will then wish to hear the views of the Secretary of State for Scotland and the Chancellor of the Duchy of Lancaster.

When you decided to set up this group on 8 April, the $/£ rate was 2.21 and the effective 99.4
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12. The Group will wish to avoid getting too much into technical details. The main question is whether the game is worth the candle. There are still considerable pressures on the Government to take further action to help these industries, and failure to do so could well lead to closures and substantial job losses. On the other hand there would be substantial additional public expenditure, which will be difficult to confine to one year; the possibility of legislation, and the near certainty of it if the scheme goes beyond one year; possible difficulties with the European Commisson; and the certainty that, while some industries and critics will be pleased, others will feel hard done by and will continue to press their own case.

13. I very much doubt whether it is worth calling for further work from Departments. The broad options for the Group seem to be:-

Either

(a) To invite the Secretary of State for Energy to have confidential discussions with the electricity supply industry on one or more of the options discussed in MISC 56(81)6 and to report further. If it were then decided that the scheme should go ahead, it would be necessary for it to be approved by the Cabinet in view of the substantial claim which it would involve on the Contingency Reserve and of the possibility of continuing substantial expenditure in the later years.

Or

(b) The idea could be dropped entirely, in which case further consideration would have to be given to public presentation of this decision - the ease of this would turn in part on the decisions which the Group has to take on the proposals to stimulate energy conservation and to help with subsidies of foundry coke.

CONCLUSIONS

14. In summing up the discussion you will wish to record conclusions on which of the two broad options summarised in paragraph 13 above the Group favours.

P Le CHEMINANT

Cabinet Office
9 June 1981