PARLIAMENTARY UNDER SECRETARY OF STATE

DEPARTMENT OF ENERGY
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Prime Minister (2)

A further subsidy (£8m) for foundry coke.

MCS 20/12

CONFIDENTIAL

COMMERCIAL-IN-CONFIDENCE

Rt Hon Leon Brittan QC MP
Chief Secretary
HM Treasury
Parliament Street
LONDON SW1

17 December 1982

Dear Leon,

FOUNDRY COKE PRICES

As you will remember, we agreed last February to extend until 31 December the assistance which we have given to the National Coal Board since June 1981 to hold down the list prices for foundry coke charged by the two UK producers, National Smokeless Fuels Limited (NSF), a wholly owned subsidiary of the NCB, and British Benzol Carbonising Limited. We made that aid conditional on NSF's producing a plan for eliminating uneconomic capacity and returning to viability. I have received this plan, which has been sent to your officials, and expect to write to you about it shortly. Since, however, I am satisfied that a decision on foundry coke would not affect the wider choices which we shall need to make NSF's future generally, and since time is pressing, I propose that we shall now deal separately with the continuance of this aid.

The present level of grant to NSF is £6m over the period April-December with a further £1m of support to British Benzol Carbonising through NCB. This is roughly equivalent to £25/t of foundry coke sales. However, taking account of cost increases since March, NSF would need to increase prices by £28/t to cover their operating costs of making and selling foundry coke. Their other products, principally blast furnace and domestic coke are also loss-makers. After this aid to hold down foundry coke list prices and coke stocking aid (which, as you know, will not be paid after 1982-83) they forecast a loss of £17.2m for 1982-83.

NSF's present list price for foundry coke is £93.30/t ex-oven. (Their average proceeds are lower because of discounting). The latest changes in exchange rates mean that UK list prices for foundry coke are now in line with most of those on the Continent, France excepted.

The foundry industry is still in decline and, even with the benefit of recent decisions on industrial gas and electricity prices, is in no position to pay an extra £28/t for coke now. Although coke accounts on average for only 6% of foundry costs, the pressure on margins is already such that many firms including large modern foundries, would go to the wall. NSF would therefore be forced either to concede discounts or to accept the loss of business either because of closures or to imports. This need not, however, rule out any price increase at all. It seems that the market would allow an increase of some £10/t by January 1984, although there are different options on the phasing.

Happily, new trends in NSF's control of costs give us an opportunity to bring the aid to an end. The management are tackling their problems constructively and have made determined efforts to increase efficiency and reduce costs. They have cut total operating costs - other than payments for coal - by 2.5% in real terms in each of the last two years, largely by tighter manning levels. The price which they pay for coal is now fully aligned with the price of imported coal. More important, they have decided to close one of their foundry coke ovens in 1983, probably the middle of the year. When that is done, they will be able to meet UK demand for foundry coke from their remaining ovens at full throughput. On this basis, with a price increase of £10/t, the production of foundry coke should be reasonably profitable from 1984.

I suggest that we should take this opportunity to bring the present aid to an end at 31 December 1983. NSF should then be able to operate economically. Their prices will reflect the costs of production at an economic level and will not be inflated by low throughput. Thereafter we should leave the market to determine their prices and sales. It would not, however, be realistic to seek to cut off the aid at 31 December this year. As I explained above, NSF could not increase their prices enough to cover the loss of aid and, since neither they nor NCB are in a position to absorb increases losses, the loss of revenue would simply add to the PSBR. Politically too, an abrupt ending of the aid would create the maximum pressure for its continuance, and would be hard to defend at a time when we are arranging for industrial gas and electricity prices to be held steady.

If we continue aid, however, it should cover NSF's operating losses on foundry coke only to the extent that they cannot be made up by a reasonable price increase. I see two options:-

a. assume price increases of £5/t list prices on 1 January 1983 and a further £5/t on 1 July 1983. Allowing for the continuing need for discounts to foundries whose survival is at stake, the cost would be £7m in the calendar year 1983;

b. assume price increases of £5/t on 1 July 1983 and a further £5/t on 1 January 1984. On the same basis the total cost would be some £9m.

For comparison, if NSF's list prices remained unchanged throughout the year the aid required would be some £9.5m. Although the state of the foundry industry makes me hesitate about forcing up their raw material prices too quickly, I judge that an increase of £5/t from 1 January 1983 is reasonable. Further, foundry coke prices have not increased since July 1981 (when we arranged for them to be reduced to their 1980 levels) and there is a good case for asserting the principle that foundry coke prices are not fixed for all time.

I have also considered the position of British Benzol Carbonising. As a small private sector producer in competition with NSF they are in a vulnerable and politically sensitive, position. Although their financial position has improved over the last year, they are not in a position to compete with NSF unless they too enjoy a measure of support, nor are they in a position to withstand the strains which would result from an abrupt ending of our aid on foundry coke prices.

Further, I believe that the best chance of avoiding their becoming a permanent pensioner of NCB, lies in phasing out the aid to them, at the same time as we phase it out to NSF. I therefore propose that we arrange for continuing aid to them through NCB as before. The cost would be some £1m in the calendar year.

The total aid would therefore be £8m. As before this should take the form of an increase in NCB's deficit and EFL, which the NCB would then pass on to NSF and British Benzol Carbonising as they have done so far.

As before, I would propose to announce our decision on these arrangements in a low key written answer as soon as possible. I hope that NSF would be able to arrange any price increases for as early in January as possible. I am sending copies of this letter to the Prime Minister, the Members of E Committee, Norman Lamont, Sir Robert Armstrong and Mr Sparrow.

Yours
John

JOHN MOORE

COPIED TO

Prime Minister –
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Mr. Lamont D/Industry
Sir. Robert Armstrong
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