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Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Nigel Lawson MP
 Secretary of State
 Department of Energy
 Thames House South
 Millbank
 London SW1P 4QJ

3 March 1982

L. Nigel

[Handwritten mark]

ENERGY CONSERVATION: ASSISTANCE FOR LARGE ENERGY USERS

Thank you for your letter of 22 February. You will have seen Patrick Jenkin's letter to the Chancellor of 16 February.

Whatever attractions the scheme you propose might have, it certainly has substantial drawbacks. First, it would cost some £56 million over the next few years and would require additional civil service manpower. Second, while firms may face cash flow constraints it is doubtful that this scheme would induce much extra investment in energy conservation rather than subsidising projects which would have gone ahead anyway. This would point to a check for additionality project by project on the lines Patrick Jenkin suggests but that would add to the administrative costs and manpower. Even with such checks, it is not clear that the scheme would stimulate net extra investment rather than lead firms to switch money from other areas into energy conservation. It was for reasons on these lines that we could not agree to the proposals you brought forward by your Department in the Public Expenditure Survey.

In addition, your new proposal would give rise to severe borderline problems. Patrick Jenkin has rightly emphasised that many private sector steelmakers would feel aggrieved by a 4,000 tonnes of coal equivalent threshold. Similar hard cases would be raised if the limit was lowered to 2,000 tce as you now suggest.

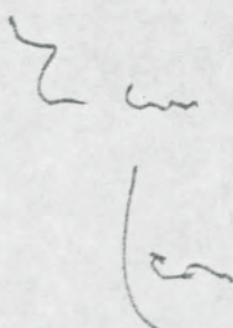
More generally, it seems difficult to justify concentrating assistance of this sort on large energy users. We would deliberately be excluding the smaller firm from any benefits which the scheme might have. It is very doubtful whether this would be a sustainable position, especially in view of our commitment to the smaller business and the fact that some of the small and medium-sized firms excluded would be in direct competition with beneficiaries of the scheme. It is relevant here that when David Howell put forward rather similar proposals in the Summer he

argued that this form of assistance was particularly appropriate for small firms.

In short, there would be great pressure on Government to generalise the scheme to the rest of industry at much greater cost. If we refused to extend the scheme, any plaudits received from its original introduction would be swamped by the objections of those excluded.

On balance, therefore, the Chancellor and I do not believe a scheme on the lines you propose would be justified.

I am sending copies of this letter to the Prime Minister, Peter Carrington, George Younger, Nicholas Edwards, Patrick Jenkin, Sir Robert Armstrong and Robin Ibbs.

Handwritten signature of Leon Brittan, consisting of a stylized 'L' followed by 'Brittan'.

LEON BRITTAN

3 MAR 1982



CONFIDENTIAL



Secretary of State for Industry

cc AD
SV

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 3301
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2 March 1982

Prime Minister

MS 2/3

The Rt Hon Leon Brittan QC, MP
Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
LONDON
SW1

Dear Leon,

ENERGY CONSERVATION : ASSISTANCE TO LARGE ENERGY USERS

I have seen a copy of Nigel Lawson's letter of 22 February to you about proposals for an energy conservation scheme to assist large energy users. I strongly support the broad outlines of the scheme. We are under continuing heavy criticism over fuel prices, and there is no doubt that in some cases they are seriously damaging to competitiveness. A scheme to enhance conservation would be a desirable complement to action on electricity prices. I have, however, a number of points I would like to make on it.

2. The first is the proposal that there should be no requirement of additionality ie whether the investment would have gone ahead without Government assistance. A requirement for additionality is a feature of the schemes operated by my Department and I must say that I find arguments for there being no such requirement in this scheme unconvincing. Judgements about additionality are certainly difficult, but there is no evidence that industry reacts adversely to the principle. I do not think it right to argue that the whole scheme would be "additional" because this form of investment is generally not taking place. There may indeed be less investment in energy conservation projects than we would have liked to see, but there has nevertheless been substantial investment in energy conservation measures. Although including such a requirement could affect the staff numbers, I believe it is desirable on a number of counts. First, the broad principle that it is pointless to pay people to do what they would do anyway is hard to question. Secondly it can provide a flexibility in selecting suitable cases. Finally it allows negotiations to take place with applicants so that the level of assistance provided is kept to a minimum rather than granted automatically at a fixed rate.

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2.

3. The need for flexibility may be greater in this scheme than in some others because I see some difficulty in focussing accurately on the energy conservation aspects of major investment projects. Some of the projects mentioned in the annex would involve wholesale reconstruction or reorganisation of plants. It may well be difficult to separate out a specific energy conservation content, but it might also be anomalous to assist a whole scheme of which energy conservation is clearly only one feature.

4. Finally on the mechanics of the scheme I wonder whether the double threshold for eligibility is really necessary. Our experience with the coal fired boiler scheme was that we drew the qualifying criteria tightly specifically to limit the case load, and have now increased the coverage because take-up fell below expectations. I agree that the energy conservation scheme should focus on larger users, but I think that a single threshold of a minimum saving of 2000 tons of coal equivalent a year should be sufficient safeguard against an excessive number of applications.

5. The paper touches only briefly on administration. I think it is important to avoid the situation that arose last year over the coal fired boiler scheme. This was decided close to the Budget when very little preparatory work had been undertaken. As a consequence two months elapsed before full details could be published and this had the effect of holding up all orders on boiler makers and equipment suppliers for a considerable length of time. The Government will be severely criticised if the same occurs this year.

6. No suggestion has been made that the Department of Industry should be involved in the administration of the scheme. I should, however, make clear that if this were to be thought appropriate we should expect an appropriate adjustment to the Department's staff ceilings to cover this new work.

7. Finally I should confirm the point in paragraph 13 of the paper about the statutory ceiling under Section 8 of the Industry Act. As you know, we are close to the cumulative ceiling and any announcement of an energy conservation scheme should include appropriate qualifications.

8. I am sending a copy of this letter to the recipients of Nigel Lawson's.

- 2 MAR 1982

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2.



SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ
01 211 6402

Prime Minister -

If - as I suspect they will -
the Treasury oppose this, the quickest
way of reaching a decision
will probably be to bring the
matter to E.

AKL
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Rt Hon Leon Brittan QC MP
Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
LONDON SW1

22 February 1982

ml

Dear Chief Secretary


ENERGY CONSERVATION: ASSISTANCE FOR LARGE ENERGY USERS

It was agreed at our meeting on 10 February that I should pursue with you my proposal to assist large energy - particularly electricity - users to invest in energy conservation projects.

My officials have now prepared the attached note which develops the proposal in my letter of 1 February in the light of the points raised at our discussion. It has been prepared in consultation with officials from the Departments most concerned (including the CPRS) although your officials have reserved the right to continue to oppose the scheme.

I believe we should go ahead with the proposal on the basis outlined. We would be able to limit fairly precisely the number of takers if we specified a minimum level of energy use: the paper works on the basis of 5 million therms per year, (although I would not be averse to setting it at 2.5 million if that were helpful to George Younger). Alternatively, having established a very limited pool by setting a 5 million therm minimum for energy use, I believe we should open the scheme to projects saving a minimum of 2000 tce rather than 4,000 as initially suggested. This would meet the point in Patrick Jenkin's letter of 16 February to Geoffrey Howe and should also help George Younger.

I feel strongly that the scheme will not be attractive enough unless the assistance is given outright as proposed in para 9 of the paper. In other words the first two years of interest on loans for eligible projects would be waived entirely. This would entail a cost of £56 million in the first four years rather than £50 million in order to promote £200 million of investment (based on a 15% interest rate). The cost in the first year would still be no more than £3 million. I also now accept that the scheme will not only be seen more widely as being fair but will also avoid European Community objections if it is aimed at large energy users in general, without any explicit preference for electricity users. This accords with Patrick Jenkin's view. The big electricity users also use other fuels and would benefit from this scheme by bringing forward projects saving any form of fuel. However I consider it would be helpful to assess the potential of electricity saving projects in primary energy terms.



I hope you will now be able to agree in principle to these proposals so that we can get ahead with working out more of the details before the Budget. Subject to the results of further work, I suggest the attached form of words to announce the scheme. I would also suggest that it would be desirable to clear our lines with the Commission (as we did for the Coal Fired Boiler Scheme last year) before any announcement is made.

I am more than ever convinced that there is real merit, and substantial political mileage, in going ahead with the scheme proposed here.

I am sending copies of this letter to the Prime Minister, Peter Carrington, George Younger, Nicholas Edwards, Patrick Jenkin, Sir Robert Armstrong and Robin Ibbotson.

Yours sincerely

David Hurley

pp NIGEL LAWSON

(approved by the Secretary of State
and signed in his absence)

ENERGY CONSERVATION: ASSISTANCE FOR LARGE ENERGY USERS
NOTE BY DEPARTMENT OF ENERGY

Introduction

1 The Secretary of State for Energy's letter of 1 February to the Chancellor of the Exchequer set out a proposal to give assistance to large energy users to invest in substantial energy conservation projects. This note develops the proposal in the light of the discussion with the Chancellor on Wednesday 10 February.

Scope and purpose

2 £50 million would be made available by Government as interest relief on the first two years of loans for energy saving projects. This would **assist** approximately £200 million of new investment (assuming a 15% interest rate). It would complement the new load management arrangements for large electricity users by encouraging large energy users to make some of the investments which are needed to reduce the energy demands of their industries so that they can compete more effectively in a world of increasing energy prices. The kinds of projects which might come forward are illustrated in Annex A.

3 It is proposed that the scheme should be open to all large energy users (the definition of which is considered below). The simpler approach would be to confine it to electricity users as the group whose energy cost disadvantage in relation to foreign competition is now shown to be greatest and whom there is the greatest need to placate. But to do so would inevitably lead to complaint from UK companies using other fuels and would provoke an adverse Community reaction on the grounds that favouring one form of fuel would make the scheme - in effect - a price subsidy rather than an energy conservation scheme. Moreover, many of the large electricity users could only be helped by conservation projects saving other fuels as well as electricity; nevertheless the major electricity users, **would be covered by the proposed scheme. Table 1 shows the sectors (but not the individual users) which would be helped by the load management arrangements.**

defined so as to limit the pool of potential takers. The best option would seem to be to define both the companies, by limiting eligibility to those consuming more than a given quantity of energy, and the projects, as those which would save more than a stated quantity of energy. If the energy consumption criterion were 5m therms of delivered energy this would limit the potential to no more than 600 establishments - and only a proportion of these would be likely to bring forward projects. (If the level were 2.5m therms about 1,000 establishments could qualify.) The letter of 1 February proposed 4,000 tce as the minimum quantity of energy to be saved by each project. However, given the suggested limitation on the total pool, this could prove too restrictive. A minimum of 2,000 tce would seem more appropriate while still preventing very large numbers of potential lower cost projects from qualifying. Attempting to taper assistance around a standard of 4,000 tce would make the scheme administratively cumbersome. In addition we believe that in order to encourage electricity-saving projects these should be judged in terms of primary energy saving. Otherwise, electricity saving projects would be at a disadvantage because they would have to save three times as much primary energy as others.

6 In any event, if it could be clearly stated at the outset that £50 million was the absolute limit of assistance available and that it would be given on a first come first served basis there should be no real difficulty in resisting pressure to exceed it.

7 There are no other criteria which could be adopted without complicating unduly the administration of the scheme. It would in particular be virtually impossible to tie assistance to firms facing heavy competition from foreign concerns benefitting from lower energy prices; not only is there a range of different energy prices between different countries and different types of user but also frequent changes in price relativity arising both from price changes and from exchange rate movements and other factors.

Form of assistance

8 Assistance would take the form of interest relief on the first two years of loans for eligible projects. This could be

given in three possible ways:

- (i) deferral of interest which would then be repaid with accrued interest;
- (ii) deferral of interest which would then be repaid without accrued interest;
- (iii) waiver of interest ie no repayment.

Any of these methods will lead to a significant cash flow benefit in the first two years (amounting to about £250,000 for a £1 million project) after which the benefits from the investments should begin to be felt. The difference to the Exchequer would be negligible over the first four years of the scheme (option iii would cost £56 million as against £50 million for option i and ii). A comparison of the costs is set out in Table 2.

9 It will be most important to tailor the assistance so as to stimulate industry to undertake projects. The Bank of England have suggested that firms could find the prospect of repaying the deferred interest after 2 years a significant disincentive; given the relatively small expenditure implications ^{over the first few years} /waiving the interest repayment might therefore be the best option. It would also make the scheme simpler to operate.

10 The attractiveness of the scheme to industry could also be adversely affected if it has to be proved in each case that the scheme would not have gone ahead without Government assistance ("additionality"). We believe there is a case for arguing that the scheme as a whole is "additional" in that it would promote a form of investment which is generally not taking place. On the other hand all other assistance for large projects currently given under S 8 of the Industry Act is assessed for additionality.

Administration

11 An essential feature of the scheme is that it would give interest relief on bank loans ^{for} /eligible conservation projects .

based on normal commercial criteria. Money would be channelled through the banks, which might also take on (subject to consultation) some of the work of project assessment. In any event a small unit of 8-10 people including 2 technically qualified assessors would be needed in Government to run the scheme; and there would probably need to be more if the banks could not do any of the project assessment and if additionality had to be proved in each case.

PESC implications

12 Table 2 shows the public expenditure impact. It is very difficult to estimate how quickly expenditure on such a scheme would build up. Costs will almost certainly be very small in the first year or so - and since borrowing for big projects would normally be phased over a lengthy period the build-up could well be slower than indicated.

Legal powers

13 The scheme would need to operate under section 8 of the Industry Act 1972 which provides for selective assistance to industry. The section sets a limit on the total amount of assistance and that limit has now nearly been reached. Likely expenditure on this proposed scheme would not exceed the limit during its first year but it probably would in subsequent years. DOI plan (for their own schemes) to institute the necessary legislation to raise the limit during the current session and it should be passed soon enough for our purposes. There is nevertheless some risk inherent in making a commitment to expenditure not all of which is currently authorised by existing legislation. Any budget statement will therefore need to make clear that existing powers are not sufficient and will need to be extended.

European Community

14 It should be noted that the scheme will have to be notified to the European Commission as a state aid. Given the Commission's sympathy for energy conservation schemes and the schemes which other member states have instituted, this should not be an obstacle.

Conclusion

15 We therefore conclude that the scheme should go ahead **covering**

(a) **firms** using more than 5 million therm;
and (b) for projects saving more than 2000 tce primary energy;
We also recommend that the interest relief given under the scheme
should not be recovered.

Department of Energy

17 February 1982

EXAMPLES OF POSSIBLE PROJECTS

The following examples have been selected to indicate the kind of projects which might come forward in certain of the main sectors we would wish to see helped. They are simply a selection of potential projects which happen to be known to D/En through the administration of the Energy Conservation Demonstration Projects Scheme. There can of course be no certainty that these particular projects would come forward under a scheme.

<u>Company</u>	<u>Project</u>	<u>Cap Cost</u> £M	<u>Energy Savings (tce)</u> (primary)
<u>Cement</u>			
Blue Circle (Shoreham) and Tunnel Cement	Conversion from wet to Dry Air process	£4M	20,000
Blue Circle (Northfleet)	Wet to Dry process conversion	£15M	150,000
ICI Buckstone and Ketton Cement	Conversion from Wet to Dry Air process	£4M	20,000
<u>Pottery</u>			
Staffs Potteries	Fast and once firing tableware	£1.5M	3,000
<u>Chemicals</u>			
Albright and Wilson	Use of Gas Turbine exhaust for spray drying	£2.0M	8,000

ICI Petrochem (Wilton)	Re-organisation and distillation train	£0.4M	10,000
Monsanto (Coleraine) (NI)	Organic Rankine Cycle project power generation from waste low grade steam	£1.5M	28,000
<u>Food</u>			
ABM (Airdrie)	Gas engine driven heat pump for malt kilning	£5.0M	20,000
Canada Dry	Heat pump for heat recovery from waste water	£0.45M	
Pedigree Petfood	CHP, coal fired, scheme (40 MW)	£6.0M	25,000
<u>Horticulture</u>			
Humber Growers	Geothermal heated glasshouse with heat pump	£2.0M	10,000
Consortium of Growers/ CEGB (Didcot)	Use of reject heat for horticulture	£2.0M	5,000
<u>Paper</u>			
East Lancs Paper Mill	Waste fired, fluidised bed, steam raising	£6.0M	29,000
<u>Other</u>			
Dunlop	Manufacture of building aggregate from coal waste	£1.75M	"

Simon - TR Holdings	Waste fired, fluidised bed, steam raising	£1.50M	5,000
Marley Tiles	Sand pigmenting using fluidised bed	£3.75M	2,000
<u>Aluminium (recycling)</u>			
Brit Alum Alloys Warrington or ALCAN, Enfield	Metallurgical Furnace replacement - scrap pre heating	£1.0M	20-50,000
BCL Alloys (GKN subid) Telford	New plant recycling low grade alum scrap	£0.5-1.0M	20-50,000 (National energy saving achieved in these cases by replacing virgin aluminium)

TABLE 1

SECTOR	No of establishments using over (therms)			Whether helped by electricity load management scheme
	2.5m	5m	10m	
Other mining & quarrying	7	3	1	✓
Food, drink and tobacco	121	61	24	-
Coal & Petroleum products	30	22	18	✓
Chemicals and allied industries	147	88	51	✓
Metal manufacture	224	179	38	✓
Mechanical engineering	38	10	2	✓
Investment engineering	3	1	0	
Electrical engineering	45	21	8	
Shipbuilding and marine engineering	7	4	0	✓
Vehicles	37	23	11	✓
Other metal goods	28	13	2	
Textiles	70	29	12	✓
Leather, leather goods & fur	-	-	-	-
Clothing & footwear	-	-	-	-
Bricks, pottery, glass, cement	120	62	37	✓
Timber, furniture	-	-	-	-
Paper, printing & publishing	88	54	23	✓
Other manufacturing	33	13	5	-
Gas, electricity, water	7	4	2	✓
TOTAL ALLSECTORS	1005	603	246	

Note Energy use data is derived from 1974 Business Purchases Enquiry which can still be held to be relevant at least for large firms. It is shortly to be updated to 1979. The sectors are therefore based on the 1968 Standard Industrial Classification.

COMPARISON OF PUBLIC EXPENDITURE COSTS

(Actual Exchequer cash outflows less balancing in flows directly accruing from repayments, where appropriate)

YEAR

FORM OF INTEREST SUPPORT		1	2	3	4	5	6	7	8	9	10	Cost over first 4 years £m	Total cost/ benefit £m
		1982/3 £m	1983/4 £m	1984/5 £m	1985/6 £m	1986/7 £m	1987/8 £m	1989/9 £m	1990/1 £m	1991/2 £m	1992/3 £m		
Interest deferred for 2 years-repaid with interest over 6 years	Cash	3	14.6	23.4	4.4	+17.0	+15.6	+14.2	+12.8	+10.4	+5.4	45.4	+30
	NPV	3	12.7	17.7	2.9	+ 9.7	+ 7.8	+ 6.1	+ 4.8	+ 3.4	+1.5	36.3	3.0
Interest deferred for 2 years-repaid without interest over 6 years	Cash	3	14.6	24.6	8.4	+ 9.4	+ 9.4	+ 9.4	+ 9.4	+ 8.4	+4.7	50.6	0
	NPV	3	12.7	18.6	5.5	+ 5.4	+ 4.7	+ 4.1	+ 3.5	+ 2.7	+1.3	39.8	18.1
Interest waived for 2 years-not repaid	Cash	3	14.6	25.5	13.1	-	-	-	-	-	-	56.2	56.2
	NPV	3	12.7	19.3	8.6	-	-	-	-	-	-	43.6	43.6

Notes (1) Assumes 15% interest rate
 (2) Assumes investment takes place according to following pattern:
 1982/3 £20m
 1983/4 £80m
 1984/5 £100m

(3) A + sign indicates an inflow. All other figures are outflows.
 (4) To establish the NPV a discount rate of 15% has been used of which 5% is the Treasury's required real rate of return on public expenditure and 10% is the assumed average rate of inflation over the period.



DRAFT STATEMENT

(to follow the passage on the BST review/new load management arrangements)

ENERGY CONSERVATION: ASSISTANCE FOR LARGE ENERGY USERS

In addition, I propose to make £50 million available to assist heavy energy users to undertake substantial energy saving investments. The assistance, which will be provided under section 8 of the Industry Act 1972, will be available for projects put forward over the next 2 years. It will take the form of relief of the interest on the first 2 years of loans for projects designed to save more than 2000 tce of primary energy per year. Only the heaviest energy users will qualify: they will need to demonstrate that they use more than 5 million therms per year at the establishment where the project would be sited. The scheme will cost £3 million in 1982/3. Details will be announced as soon as possible by my RHF the SOS for Energy.

[I believe that assistance in this form will make the best use of limited public resources. It will help promote projects yielding the maximum energy savings. It will also ease the problems of the largest energy users, among whom will be those large electricity users who will be helped by the new load management terms I have announced.]

22 FEB 1982





Secretary of State for Industry

Prime Minister
ms 18/2
DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 3301
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16 February 1982

Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
London SW1

✓ AD
JV
MS

Dear Geoffrey,

ENERGY CONSERVATION: ASSISTANCE FOR LARGE ELECTRICITY USERS

Nigel Lawson sent me a copy of his letter to you dated 1 February.

2 As you know, I continue to be very concerned about the difficulties faced by large energy users. The separate proposals already put forward by Nigel on load management will help some electricity users but there will inevitably be some who cannot secure much advantage from this. The fundamental reviews of energy pricing which have been proposed will take some time to complete and in the meantime it would be desirable to help large energy users to undertake energy conservation investment where they are unable to proceed without our assistance.

3 New measures to encourage investment in energy conservation should, in my view, be concentrated on large energy users, who are suffering most from competitive disadvantage compared with manufacturers abroad. Clearly this must include electricity users, but I would not be inclined to accord them a public priority within the suggested scheme. Since the second NEDC Task Force Report, it appears that the gap between UK and Continental prices for heavy fuel oil is widening and we may expect to see a price differential re-emerge on gas when the BGC price freeze ends in March. I would therefore prefer simply to set a minimum threshold for the scheme. The level of this threshold would have to be further considered by officials to take account, for example, of the fact that many private sector steelmakers might be excluded by the 4000 tons of coal equivalent suggested.

4 Likewise officials can consider the relative merits of a new loan facility and a system of grants. Either way I believe we



17 FEB 1982

should have the flexibility to tailor the degree of assistance to the circumstances or particular cases (within a stated maximum) so that we do not provide more in particular cases than is judged necessary. Officials will also need to consider how the new scheme will relate to existing support measures.

5 Finally, I think it would be helpful if Nigel Lawson would indicate soon what legislation he would propose to use for the scheme.

6 I am copying this letter to the Prime Minister, Peter Carrington, George Younger, Nicholas Edwards, Nigel Lawson and Sir Robert Armstrong.

Your ever
Peter

9. JV
A)



Prime Minister

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Oddi wrth Ysgrifennydd Gwladol Cymru The Rt Hon Nicholas Edwards MP From The Secretary of State for Wales

CONFIDENTIAL

16th February 1982

J. Nigel

MS

Nat and

I have read with interest the exchanges on electricity prices, the BST Review and energy conservation following your letters of 29 January and 1 February.

I have made clear my interest in these issues in the past. Large scale energy users - we have many such in Wales - continue to face very considerable problems. Broadly speaking their competitive positions against the energy costs of some European counterparts are no better than when I raised the subject with your predecessor as long ago as November 1980. Whether the proposed new load management terms however welcome are sufficient to over-come the crucial problems of the intensive electricity consumer remains to be seen but the proposal has my support. So too does the proposed energy conservation scheme which I judge could bring significant benefits not only in energy usage but also in terms of employment and industrial regeneration.

I share the view already expressed that a consultancy study is not necessarily the most appropriate way of handling the BST Review but I would go along with a Whitehall study especially if it dealt with the subject on the wide ranging basis envisaged by Robin Ibbs. At the very minimum we need to be sure, as Patrick said, that the LRMC figures are fairly based.

If there is to be such a study I would hope that my officials can sit in on it. I make that request in view of my industrial responsibilities in Wales but I am very concerned too with the adverse effect on employment that failure to ensure that the BST is properly based could bring.

Finally could I ask you to keep well in mind when you discuss these measures with the Chancellor next week my concern for industrial competitiveness and the effect that progress on your proposals or the lack of it could have on an area like Wales.

I am copying this letter to recipients of your letters.

The Rt Hon Nigel Lawson MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
LONDON

J. Lawson
Nigel

17 FEB 1982





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Foreign and Commonwealth Office
London SW1

5 February 1982

Dear Nigel.

ENERGY CONSERVATION: ASSISTANCE FOR LARGE ELECTRICITY USERS

Thank you for copying to Peter Carrington your letter of 1 February to the Chancellor. I have also now seen your letter of 29 January.

*with
request
both if
revised*

Both the scheme to assist certain energy intensive industries with energy saving investment and the adjustments in electricity tariffs to benefit major industrial consumers will no doubt help the industries concerned. You will appreciate I am sure the need to consider carefully how to handle the likely reactions to these schemes in both the European Community and the International Energy Agency.

Since we have hitherto strongly pressed the case for prices to be set at economic levels and for subsidies which affect energy costs to be identified and where appropriate eliminated, other Governments may ask how these proposals can be reconciled with our view that price is the key to ensuring an adequate level of investment in more rational and efficient energy use.

In particular, we shall, as you recognise, need to notify the Commission of our scheme of support to industry for energy saving investment. I agree that the fact that the scheme is aimed at encouraging energy conservation should help, as should the existence of similar schemes in other Member States. We must not take, however, the Commission's acquiescence for granted. Their concern will be to see that the scheme does not distort competition or give UK firms an unfair trading advantage and we will no doubt keep this in mind in framing the details of the scheme and in its presentation. It will be important to sound out the Commission in good time before any public announcement and to acknowledge the need for Commission clearance. Our officials should discuss how this can best be handled.

Yours ever

The Rt Hon Nigel Lawson MP
Secretary of State for Energy
Thames House South
Millbank
LONDON
SW1

Thompson

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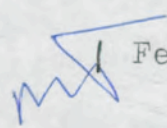
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Prime Minister

MUS 5/2

01 211 6402

Rt Hon Sir Geoffrey Howe QC MP
The Chancellor of the Exchequer
Treasury Chambers
Parliament St
London SW1

 February 1982

Dear Chancellor

ENERGY CONSERVATION: ASSISTANCE FOR LARGE ELECTRICITY USERS

In my letter of 29 January I said that I would be writing again about a scheme to promote investment in projects which would save large amounts of energy concentrated on the same types of consumers as we are assisting through the electricity price measures. I now write with my proposals.

What I have in mind is support to the tune of £50m committed over 1982/3 and 1983/4 and spent over 1982/3 and the three succeeding years for new investment in manufacturing industry on projects which would save large quantities of energy - defined as 4,000 tons of coal equivalent a year or more. Projects meeting this criterion would in most cases have a total cost of around £1m. Priority would be given to large and high intensive users of electricity and this would be openly stated. Assistance should be at a level which would give a reasonable prospect of ensuring that projects go ahead in the present difficult investment climate.

My soundings of industry suggest that the best way of achieving this would probably be a new loan facility channelled through the banks with the Government support being used to waive interest for the first two years and to defer repayments during that period (in effect a variant of the proposal David Howell put forward in MISC 56 (81)5 Revise last May but - and this is the crucial point - concentrated on a limited number of large projects). I would not rule out a grant scheme if further discussion suggested that that would be effective: but I suspect

that would require grants of about 35% of the cost of projects rather than the 25% under the Boiler Substitution Scheme.

A scheme on these lines would kill two birds with one stone. It would assist the large energy users with the cost of their fuel bills and at the same time constitute a valid addition to our energy conservation programme.

We would have to notify the European Commission of our proposals. The fact that they are designed to use energy more efficiently should ensure a sympathetic hearing. In general they would be similar to arrangements already introduced by the French and German Governments.

I would also support Patrick Jenkin's proposal (Item 19 of Annex to letter of 26 January) for increased grants on energy conservation demonstration projects and a new heat pump scheme. I would like to see any additional funds allocated for the demonstration scheme also concentrated on large projects. But the best prospect of securing quick improvements in energy efficiency lies in higher investment in existing techniques rather than in demonstrating new techniques, important though that is for the future. My proposal is designed to promote that prospect.

I believe that my proposals on electricity pricing and the promotion of large energy conservation projects taken together should take most of the steam out of the political pressure on energy prices. At least they will give us a firm position on which to stand. I therefore urge you to give the proposals in this letter a sympathetic hearing. If you are in principle favourably inclined towards them I suggest that officials should get together urgently to work out the details. The aim should be to announce those details shortly after the main announcement in your Budget speech.

I am sending copies of this letter to the Prime Minister, Peter Carrington, George Younger, Nicholas Edwards, Patrick Jenkin and Sir Robert Armstrong.

Yours sincerely
David Huntley

PP NIGEL LAWSON
(Approved by the Secretary of State and signed in his absence)

