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Pof Nat. Ind.

10 DOWNING STREET

From the Private Secretary 2 December 1982

Dear Julian,

The Prime Minister held a discussion this morning about electricity prices for industry. Apart from your Secretary of State, the Chancellor of the Exchequer, the Secretaries of State for Industry and Scotland, the Chief Secretary to the Treasury, Sir Robert Armstrong, Mr. Sparrow and Mr. Gregson were also present.

Your Secretary of State said that the CPRS study was a good one, and that he agreed with the main thrust of its conclusions and recommendations. In particular, it was important that electricity prices in the UK should be properly based on economic prices, without any subsidy from the taxpayer or cross-subsidy from other consumers (paragraph 6.29 of the report). He agreed that the bulk of international price differences for electricity were cost-based, and that there was no systematic bias against heavy users of electricity in the United Kingdom. The CPRS had identified only one case in which an international electricity price disadvantage put at risk the continuation of a significant industrial activity with a long term future in the United Kingdom - the production of chlorine. Accordingly he had looked again, in the light of Sir Robin Ibbs' letter of 22 October to the Prime Minister, at what could be done to help ICI's chlorine operation at Runcorn. He proposed that he should use Section 2(6) of the 1957 Electricity Act to authorise the CEGB to give Runcorn a direct supply, as they already did for Anglesey Aluminium. These two plants were by far the largest private sector electricity consumers in the UK: they both consumed almost 1½ TWh hours per annum, so that a sound ring fence could be built around them, given that each of the next six largest industrial users consumed between 0.5 and 0.7 TWh hours per annum. ICI already paid, because of the Bulk Supply Tariff, 35% less for its electricity than the average price paid by industrial users. This concession would reduce their price a further 5%, and would cost around £1½ million a year. The CEGB would absorb this cost within their existing External Finance Limit. ICI would, thus, be paying little more than the fuel cost of their electricity. The recent depreciation of sterling (6% against the deutschmark over the past fortnight), and the prospect of the Government's general standstill in electricity prices compared to the increases to be expected elsewhere next year, would together reduce the gap between ICI's

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costs and their competitors' by a further 10% or so. Any wider help for Runcorn, or for any other energy intensive industry, would be a reversal of the Government's economic pricing policy, would involve either cross-subsidisation or an increase in taxation or public borrowing, and would require primary legislation to amend the existing statutes on undue preference. This would expose electricity pricing to a flood of special pleading.

In discussion it was noted that the change in pricing policy which was being proposed would result in an electricity price still very much higher than what would have been necessary to keep the aluminium smelter at Invergordon going; the assistance which the Government had offered to potential purchasers of the Invergordon smelter was far in excess of the benefit which the proposed new pricing policy would confer upon Runcorn. It would be essential, if the Energy Secretary's proposal were agreed, not to extend this pricing policy to the smaller chlorine producers, since such action would destroy the ring fence. It was noted that the only other comparably heavy user of electricity, British Rail, already had an arrangement, laid down by statute, to purchase its electricity direct from the CEGB. The case for amending the existing statutory provisions on undue preference was that some electricity boards were applying this principle too rigidly. But the objections to amending these provisions were formidable and the right way of dealing with excessive rigidity in their interpretation was to urge the boards concerned to act in a more commercial way.

In further discussion, the Secretary of State for Industry said that ICI presented an exceptional case, because of the size of its operation, fierceness of the competition in Europe, and the fact that their plant at Wilhelmshaven gave them a yardstick against which to measure the burden of their UK electricity price. They estimated that their costs were some 25% out of line with those of their competitors. He feared that the changes in their situation which the Energy Secretary had listed would not be sufficient to persuade them to retain their plant in the UK. In discussion it was agreed that there could be no question of paying an operating subsidy to ICI under the Industry Act. The root of the problem was the excessive price for coal, which led directly to excessive electricity prices. ICI had suggested (it was not clear how seriously) that they might lease or buy a coal-fired power station, and make a contract with the NCB for the purchase of coal. There could be no question of requiring the NCB to provide them with coal for such a power station at the export price. But there would be no objection to their pursuing with the CEGB the proposal for a lease or purchase of a power station; and they were free, as things stood, to buy coal from any source that they chose, at whatever price it was on offer.

Summing up the discussion, the Prime Minister said that the main thrust of the CPRS report's conclusions and recommendations were accepted. There should be no departure from the general principle that electricity prices should be properly based on economic prices, without any subsidy from the taxpayer or cross-subsidy from other consumers. Electricity prices were, however,

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systematically too high, because coal prices were too high. So far as the difficulties for ICI were concerned, the Secretary of State for Energy was authorised to use the 1957 Electricity Act as he proposed to permit the CEGB to give Runcorn a direct supply. This was on the basis that there would be no change to the CEGB's External Finance Limit. ICI could also be told that there was no obstacle to their approaching the CEGB with a view to leasing or buying a power station; but it should be made clear to them that there was no question of any subsidy either for this, or for the purchase of coal. The Secretaries of State for Energy and Industry should agree, in the light of these conclusions, the line they would take with ICI.

I would be grateful if you could let me have as soon as possible the draft reply for the Prime Minister's signature to Sir Robin Ibbs' letter to her of 22 October.

I am sending a copy of this letter to John Kerr (HM Treasury), Jonathan Spencer (Department of Industry), Muir Russell (Scottish Office), John Gieve (Chief Secretary's Office), Richard Hatfield (Cabinet Office), Gerry Spence (CPRS) and Peter Gregson (Cabinet Office).

Yours sincerely,

Michael Scholar

Julian West, Esq.,
Department of Energy.