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10 DOWNING STREET

THE PRIME MINISTER

14 December 1982

Dear Robin,

Thank you for your letter of 22 October. The Government has, as you know, recently undertaken a thorough study of electricity pricing, in which we have paid particular attention to the position of large and electricity-intensive processes such as ICI's chlorine manufacturing operations at Runcorn. Against this background we have examined very carefully the case you put. We concluded, however, that the price currently paid by ICI Runcorn leaves little or no room for further reduction unless compensating reductions in the electricity supply industry's costs could be found. A subsidy, at the expense of other consumers or the taxpayer, would be unacceptable.

Nevertheless, I understand that Nigel Lawson has suggested to you that modest but worth-while cost advantages might result if new arrangements, justified by the very large scale of electricity demand at Runcorn, and involving either the direct supply of electricity or possibly the sale or lease of a power station, could be agreed directly between the CEGB and ICI. I understand you are already in touch with the CEGB about this. A direct supply arrangement would, of course, formally require the Secretary of State's authorisation.

I very much hope that arrangements along these lines, offering some assistance to your Runcorn operations, can be agreed.

Yours sincerely

Margaret Thatcher

Sir Robin Ibbs

c/c JV

Nat Ind

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

01 211 6402

Michael Scholar Esq
10 Downing Street
LONDON
SW1

13 December 1982

Dear Michael,

ELECTRICITY PRICES

As requested in your letter of 2 December, I attach a draft reply to Sir Robin Ibbs' letter of 22 October. This has been drafted in consultation with the other departments concerned.

Last week, my Secretary of State explained to Sir Robin and to Sir Walter Marshall the conclusions reached by Ministers at their meeting on 2 December, and ICI and the CEGB have begun discussions. Both accepted that the discussions should be kept confidential at this stage but, if a direct supply is authorised, it will inevitably become public knowledge.

Copies of this letter and enclosure go to the recipients of yours.

Yours ever

Julian West

pp JULIAN WEST
Private Secretary

CONFIDENTIAL

Pl type for PM
MCS 13/12

Sir Robin Ibbs
ICI
Imperial Chemical House
Millbank
LONDON
SW1P 3JF

December 1982

ELECTRICITY PRICES

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Nevertheless, I understand that Nigel Lawson has suggested to you that modest but worthwhile cost advantages might result if new arrangements, justified by the very large scale of electricity demand at Runcorn, and involving either the direct supply of electricity or possibly the sale or lease of a power station, could be agreed directly between the CEGB and ICI. I understand you are already in touch with the CEGB about this. A direct supply arrangement would of course formally require the Secretary of State's authorisation.

I very much hope that arrangements along these lines, offering some assistance to your Runcorn operations, can be agreed.

Nat Ind

Gas & Elec

MR. SCHOLAR

PA

MW 13/12

ELECTRICITY PRICES: SIR ROBIN IBBS' LETTER OF 22 OCTOBER

I think Robin Ibbs has a substantive point in his complaint about British electricity prices compared with those on the Continent. There is some plasticity in the price comparison caused by exchange rate variations, which Robin Ibbs does not mention. But I do not think this much mitigates the thrust of his argument.

One of the main culprits is the coal industry. This is indeed a prime example of an industry sheltering behind import restrictions and charging a high price for its coal. (At the same time, it also draws substantial subsidies from the Treasury.) Once protection is ceded, then the distortions spread like cancer throughout the whole of the economy. And we get constant appeals to shelter industries and consumers from the ravages wrought by the protected miners. So we are induced to subsidise to mitigate the original folly of protection. Folly is heaped on folly - and good money chases bad.

I agree, however, that in this case there is another major culprit, the electricity generating industry. Again, it is an industry protected by natural barriers as well as our own legislative restrictions on entry and competition.

However, beginning from where we are now, I would argue that there is a very strong case for promising future reductions in the price of electricity. In part, these would arise from using an "inverse elasticity rule" (or to use the railway jargon, charging what the traffic will bear). Thus, since the elasticity of demand for electricity for some industrial processes like chlorine generation is very high indeed, we should levy charges only just above the short-run marginal cost, while there is considerable spare capacity available. Secondly, we ought to reduce the costs of electricity supply mainly by reducing the costs of coal and improving the performance of the electricity generating operation. But this is a long run business.

I cannot, however, see that it is wise for us to enter into a contract for five years or more for a fixed nominal price, as Robin Ibbs suggests the Germans do. I would be rather surprised if there were not suitable variation clauses in that contract which,

/for example,

for example, waive the terms of it under conditions where there was an explosion in the price of energy. But an appropriately-worded contract is by no means infeasible or undesirable.

1 November 1982

ALAN WALTERS

cc J.V

Prime Minister (2)

To note

MCS 28/10

CONFIDENTIAL

Qa 06120

To: PRIME MINISTER

From: JOHN SPARROW

28 October 1982

Electricity Prices

1. I have seen a copy of Robin Ibbs's letter to you on the impact of electricity prices on ICI's operations, and Michael Scholar's minutes of 22 and 25 October.

2. The points raised by Robin Ibbs were all covered in the CPRS report on Electricity Prices. The letter is consistent with the facts given in that report and confirms our view that ICI might well withdraw from at least part of the chlorine-based sector in the United Kingdom (with up to 4,000 ICI job losses) if the prices currently paid by ICI in the UK and in Germany do not come closer together. We considered that the scale of the problem would reduce as German contracts come up for renegotiation, and that there were other strategic reasons which would affect ICI's decisions on withdrawal. The letter contains one new piece of information, which as we explained ICI had not made available to us - that ICI's German contract is firm for a further five years. But the fact remains that if ICI wanted to shift their chlorine production from the UK to Germany it would require additional electricity supply arrangements, almost certainly on less favourable terms.

3. In deciding what needs to be done it is relevant to consider the reasons for the disparity, and prospects not only for ICI but also its competitors. The majority of German contracts will be renegotiated on to cost reflective terms. There are only two examples of special contracts of which we are aware which appear to include subsidies by local government for industrial policy reasons - the Reynolds aluminium contract in Hamburg and the ICI contract at Wilhelmshaven. It is reasonable to assume that Dow Chemicals who are located in the Wilhelmshaven region have a similar contract. However, we believe that these contracts containing industrial subsidies are not widespread and that although a few of ICI's competitors may still enjoy subsidised contracts in the future, the main reasons for future price differentials are likely to be cost differences in electricity generation.

4. Our report also showed that ICI's chlorine business is the one major industrial sector critically threatened by electricity prices. We recommended that if selective assistance is considered appropriate for ICI then this should be given directly and not through electricity prices, to avoid distorting the tariffs for industrial and other users.

5. In view of all this I would like to suggest that the analysis and conclusions of the CPRS report should be discussed by those Ministers concerned before a reply to Robin Ibbs is drafted. This should also enable the broader issues of electricity pricing for industry arising out of the recommendations made by Coopers and Lybrand to be taken into account in considering your reply.

I have now indicated your wish for a discussion MCS

6. I am sending a copy of this minute to the Secretaries of State for Energy and Industry, and to Sir Robert Armstrong. You will recall that copies of the CPRS report also went to the Chancellor and to the Secretaries of State for Scotland and Wales.

B.

Nat. Ind: Gas + Elect. Policy Pt. 7

FILE CONFIDENTIAL bc: JV da

Nat. Ind.

10 DOWNING STREET

From the Private Secretary

28 October 1982

Dear Julian,

Electricity Prices

The Prime Minister has seen a copy of the Secretary of State for Industry's letter to your Secretary of State of 27 October about the CPRS Report on electricity prices for industry and the more specific problems highlighted in Sir Robin Ibbs' letter to the Prime Minister of 22 October.

The Prime Minister thinks it would be useful to discuss the CPRS Report and these other issues after the public expenditure announcements have been made.

I am sending a copy of this to Margaret O'Mara (HM Treasury), John Gieve (HM Treasury), Muir Russell (Scottish Office), Jonathan Spencer (Department of Industry), Richard Hatfield (Cabinet Office) and Gerry Spence (CPRS).

Yours sincerely,

Michael Scholar

Julian West, Esq.,
Department of Energy.

CONFIDENTIAL da

File 2

Nat Ind 089

10 DOWNING STREET

From the Private Secretary

25 October 1982

ELECTRICITY PRICES

I wrote to you on 22 October about the letter the Prime Minister has received from Sir Robin Ibbs about electricity prices for the production of chlorine.

The Prime Minister saw Sir Robin's letter over the weekend. She commented that she raised this very point at the discussion of electricity prices with your Secretary of State and Treasury Ministers last week. She has further commented that ICI's case is powerful, and that the Government must find a way to meet it.

I would be grateful if you would take account of these comments in preparing your draft reply for the Prime Minister's signature.

I am sending a copy of this letter to Jonathan Spencer (Department of Industry) and John Sparrow (CPRS, Cabinet Office).

M. C. SCHOLAR

Julian West, Esq.,
Department of Energy.

FILE

COMMERCIAL IN CONFIDENCE

da

10 DOWNING STREET

From the Private Secretary

22 October 1982

Dear Julian,

I enclose a copy of a letter which the Prime Minister has received from Sir Robin Ibbs about the price of electricity for chlorine plant.

I would be grateful if you, in consultation with Jonathan Spencer (Department of Industry) and John Sparrow (CPRS) to whom I am copying this letter, would let me have a draft reply for the Prime Minister's signature by 2 November. I believe that the Prime Minister will look particularly for some commentary on the point made at the top of page 2 of the letter, that the gap between German and UK prices is only a temporary phenomenon.

Yours sincerely,

Michael Scholar

Julian West, Esq.,
Department of Energy.

COMMERCIAL IN CONFIDENCE

dea

10 DOWNING STREET

From the Private Secretary

22 October 1982

Dear Robin,

I am writing on behalf of the Prime Minister to thank you for your letter of 22 October. I will place this before her, and you will be sent a reply as soon as possible.

Yours ever,

Michael Scholar

Sir Robin Ibbs

COMMERCIAL IN CONFIDENCE

Imperial Chemical Industries PLC

Imperial Chemical House
Millbank London SW1P 3JF

Telephone 01-834 4444

From Sir Robin Ibbs

Prime Minister

Robin Ibbs telephoned and I encouraged him to write this to you.

The point at X seems particularly significant.

I have asked for a draft reply.

TLS 22/10

22 October 1982

The Rt. Hon. Mrs. Margaret Thatcher, PC, MP
Prime Minister
10 Downing Street
LONDON, SW1

I raised this very point when we discussed these matters. It's case is powerful. We must find a way to meet it.

Dear Prime Minister,

ELECTRICITY PRICES

ICI has for some time been providing through the Department of Industry information for a CPRS study on electricity prices. I have not been directly involved but I now find that the information asked for has entailed such a plethora of detail that I am concerned that the simple heart of the matter is likely to have been overlooked. I have therefore myself intervened with officials in the Department of Industry and have arranged to meet Patrick Jenkin next week. But this is a matter of such importance to ICI that I am also writing direct to you.

The essential facts are that ICI has £600 million of capital (CCA) invested in the UK in the production of chlorine and associated products by the electrolysis of brine. Although the age and design of the plant varies, the overall operation is efficient and we are world leaders in this technology. However, we make no CCA return on the investment; the best we can do is to break even. This means that the business is not generating the cash required to update and replace the assets. As a result it will progressively decline unless we find a way of making a reasonable profit.

In producing chlorine, 80% of the variable cost (and 50% of the total cost) is electricity. Our competitors in Europe pay on average one third less for electricity than we do. Indeed we ourselves in Germany pay about £16/MWH compared with about £24/MWH in the UK. The result is that compared with Continental operations we have a burden from purchased electricity of about 25% additional variable cost (and of about 12% additional total cost) in a highly competitive business. It is not surprising that the best we can do is break even.

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I have heard it suggested that this may be only a temporary problem because it is alleged that German utilities are renegotiating contracts and raising prices. The fact is that our contract in Germany is firm for a further five years. It is unlikely to be unique and others are probably just as well placed. Furthermore the general trend in Europe does not appear to be towards increasing significantly the price to large users. For example, in Holland the price has recently been cut by 30% on a "temporary" basis through to 1986.

Experience makes me doubt whether a way out of this problem of uncompetitive electricity price can be found within the present constraints of "showing no undue preference between consumers." The practical question for Ministers may therefore be whether they regard the prospect of a progressively declining chlorine-based sector of industry, and the wider consequences of this, as being preferable to easing the pricing arrangements to an extent comparable to that in competitor European countries. The sum of money involved in closing the gap is £20 million per annum.

If the basic manufacture of chlorine is unable to generate the funds needed to invest and keep the assets up to date, there is no doubt that we shall have to eliminate in stages the weaker part of this business. And as the overall size decreases, the long term viability of what is left in the UK will become increasingly questionable. A likely pattern of events is that over the next three or four years the plant on Teesside, the plant in Northwich and part of the capacity at Runcorn will in turn be closed. (This will amount to a reduction of 400,000 tons per annum of chlorine capacity). There would be corresponding contraction downstream and we estimate that 4,000 jobs would be lost in ICI and its immediate customers, and a further 8,000 jobs in the surrounding communities. The balance of payments loss is estimated to be about £200 million. On the other hand, competitive electricity prices would enable us to generate the cash needed to convert the Teesside plant to flexible load operation and to implement further technological development of the Runcorn chlorine capacity. With competitive electricity we would thus be exploiting our world lead in chlorine technology from a long term competitive UK manufacturing base.

You will appreciate that I am not crudely threatening closure of chlorine plants if we do not have competitive electricity. We shall do our utmost to use our ingenuity to preserve our business; it is just that if assets do not generate cash for their replacement a good businessman has to close them down, and the pressure to do so is that much greater when he can develop the business perfectly satisfactorily in another country. I should add that interdependence of our downstream operations is such that at some point reduced UK manufacture

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of our intermediate EDC (which takes ethylene as well as chlorine and which it has been suggested we might import) would lead to such a reduction in the ethylene load on our Wilton cracker that this would cease to be viable and so put at risk much of our Wilton Site - always supposing that has not already happened for other reasons related to ethylene feedstock that I forebear to mention!

As you know I have always believed there would be little point in having lower priced electricity unless in the longer term we are going to have lower cost electricity. With Walter Marshall at the CEGB this seems a much more realistic objective. In these circumstances it would be a pity if failure to provide the price adjustment needed now resulted in progressive disappearance of the UK chlorine industry so that it is no longer around when electricity generation becomes more efficient.

Yours sincerely,