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PRIME MINISTER

23 July 1985

POWER STATION ENDURANCE

First, which measures are worthwhile?

Neither the very limited scope for strengthening the Scottish interconnector by the Winter of 1987/8 (9 days extra endurance in 12 months for £60 million) nor the possibility of more substantial strengthening in 7-10 years' time, are cost-effective insurance arrangements.

The CEGB can get better value from a multitude of modest initiatives which collectively provide a high degree of flexibility without jeopardising the continued support of the power workers. Permanently and efficiently modifying the start-up oil burners in conventional coal-fired stations should give us contingency oil-fired capacity averaging roughly 50% of normal. Routinely transporting coal and oil by road or barge will reduce the risk of future supply disruptions by militant rail unions.

At least in the medium term, oil looks a good prospect as a back-up fuel. Oil prices in dollars are likely to remain soft - especially residual fuel oil. This, and the strength of sterling against the dollar, have considerably narrowed the cost penalty of burning oil instead of coal. With gas prices likely to rise in real terms, and the cost of converting coal-fired stations to dual-fired coal/gas stations being expensive

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(because of safety measures), the wider use of gas as a back-up fuel is understandably ruled out.

The steps being taken by the CEGB are sensible. However, you might question whether, by waiting, we are foregoing the opportunity to conclude favourable commercial terms for the second phase of the Cross Channel electricity link. The greater our perceived need, the harder the French will negotiate. Peter Walker will say that he doesn't want to antagonise the power unions. But low-cost security measures should be good news for the electricity industry, because they will ultimately increase the appeal of electricity to consumers.

Coal Stocks at Power Stations

This difficult judgement touches on some of the Government's more important objectives. We must deny Scargill any realistic prospect of disrupting electricity supplies over at least the next two Winters. We must avoid giving the NCB any pretext for delaying the closure of economic pits or, more widely, the restructuring of the industry. We need to retain the support and co-operation of the power unions - a vital defence against a militant, disruptive NUM. We must not compromise the Government's tough line on public expenditure.

The safe course has an obvious appeal. Set our sights on 12 months' endurance (32 mt) by October 1986. Financing the additional £370 million of working capital will cost the CEGB

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an additional £50 million pa. For the consumer, that would represent perhaps a $\frac{1}{2}\%$ increase of tariffs - arguably, a reasonable price to pay for increased supply security.

electricity consumers did very well during the strike. They should be asked to contribute to the insurance premium against the next one.

But there are disadvantages. The foreseen row with the electricity industry if they have to carry the cost will help neither supply endurance nor our vigorous attack on public sector expenditure. It will tend to set back the restructuring the coal industry, by delaying for yet another year (or more) the time when the NCB has to confront its normal market prospects. The Treasury will claim that the burden on the PSBR through lost coal exports is not £85 million (for 3 mt) as stated in Peter Walker's paper, but probably twice that number.

An Intermediate Course

There is an intermediate course which we recommend.

- Reaffirm the objective of 6 months' endurance at the start of next winter. We cannot achieve more.
- Leave until Spring 1986 the decision of whether to go for 6 or 12 months' endurance for the following Winter. That is a prudent position which need not antagonise the electricity industry or compromise the Government's hard line on public sector expenditure. There is enough genuine uncertainty to avoid becoming hooked on specific numbers.

But if decision is delayed can 12 months still be achieved.

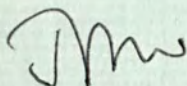
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- Do not constrain coal production from economic pits over the coming Winter. If export opportunities arise at attractive prices, the NCB should grab them. Real market outlets must be developed.

- If we were to decide on a maximum of 6 months' endurance, the CEGB's coal stocks would, under average Winter conditions, be drawn down from 23 mt this Autumn to 19 mt in Spring 1986. If, on the other hand, we keep the priority on rebuilding coal stocks while still allowing for attractive export opportunities - probably few - it is likely that the NCB could sustain supplies to the CEGB, such as to finish the Winter with power station stocks around 21 mt. From that starting point, it should still be possible to build stocks over the Summer of 1986 to close to the 32 mt needed for 12 months' endurance. Cheap fuel oil might be used selectively to assist the stockbuild process.

We understand that the lack of a recommendation by Peter Walker indicates his uncertainty. The Treasury appreciate the risks which weigh against sticking at 6 months' endurance, but at this stage would rather not be committed firmly to 12 months' endurance by October 1986.



JOHN WYBREW

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