MR TURNBULL 1 August 1985

THIRD TRANCHE

Peter Walker's beguiling logic argues that if the NCB foregoes sales revenue of £50 million p.a. (declining) so as to fuel cheaper electricity to major industrial customers, thousands of jobs will be saved or created, and our balance of payments would benefit by hundreds of millions - perhaps more. This line of argument is a complete reversal of the economic principles which this Government has stood for.

At great cost, we have fought and won a coal strike over the principle that the capacity of the UK coal industry should be governed by the size of the market which can be served on a sustainable commercial basis. Since the industry must still slim down to come within sight of this objective, the marginal tonne of coal is produced not at £32 per tonne, but at least £60 per tonne. Moreover, we are not in the interim position of having surplus coal production for which the only outlet is dumping at a distress price. For the next year or more, the CEGB need all that the NCB can produce to rebuild power station stocks. Meanwhile there is a pressing need to close down uneconomic capacity, not keep it open to supply the 'third tranche'. The restructuring of the coal industry is already overdue.

Of course, ICI, BSC, Reed, Pilkington and their like lobby vigorously for cheaper electricity - as they do for lower interest and exchange rates, which are no doubt also important influences on the business decisions now being attributed to uncompetitively-priced electricity. The attached note from Peter Warry exposes the implausibility of some of the arguments deployed. Nonetheless, there may be a case for the ESI to defend its baseload industrial business, or expand it by winning new customers from other fuels. From the point of view of making a commercial return on under-utilised assets handling a highly variable demand pattern, this class of customer is undoubtedly valuable. Maybe the Germans, French and Italians have done no more than recognise this fact, whereas we have got too hung up on the principal of non-discrimination across the industrial sector. These are business judgements which the ESI should be making in its own self interest.

AN ALTERNATIVE APPROACH

1. Why not encourage the CEGB to exploit to the full its opportunities to acquire cheap fuel or electricity on the margin. The electricity link with France is capable of providing twice as much electricity as the estimated third tranche at the same low price. What about spot acquisitions of coal on the international market? Peter Walker's paper tells us that at current exchange rates coal can be purchased for £27 per tonne. What about marginal supplies of electricity from private sector power plants?

2. Complement this by removing the CEGB's commitment to take 95% of its coal from the NCB.

3. On the strength of lower marginal supply costs the ESI should have more scope on the margin to be flexible and innovative in defending or expanding its industrial market.

4. Now let the NCB fight on a normal commercial basis for its markets, the majority of which are in any case protected by location and fixed investment in coal-fired plants. That will drive the essential closure of uneconomic capacity, vigorous control of costs, and expansion of low cost sources such as opencast.

CONCLUSION

You may recall that some three years ago proposals similar to the third tranche were extensively examined and rejected by MISC 56. With a coal dispute over market-related economics behind us, the economic and political objections are no less compelling.

JW

JOHN WYBREW

ATTACHMENT.

MR WYBREW 31 July 1985

THE THIRD TRANCHE FOLLY

NEDO believe the third tranche will increase demand by 5,500 GWH, save 15,000 jobs and create 1,000 new ones. DTI seem to think it may only be half this number. Over half the demand (and presumably jobs) is attributed to ICI. 925 jobs would apparently be saved at Runcorn by preventing ICI withdrawing from the export market for chlorine, but this is contradicted later (paragraph 22) when DTI say that by implication the reduced output would be on the domestic side. A further 6,000 jobs are apparently to be saved at Billingham as ICI would no longer propose to close its fertiliser division. With other benefits elsewhere, the third tranche is apparently to save something like 7% of ICI's manpower - believe this if you will.

The other substantial beneficiary is seen as steel, with up to 3,000 jobs being saved. This is crazy as the problem in steel is not in producing the stuff but in obtaining sufficient quota from the European Commission to sell it. Lower prices will not help. The main beneficiary is engineering steels where the Government has just agreed to spend £55m on the Phoenix II reconstruction. This sector is entirely divorced from commercial reality, and lower electricity prices will merely alter the amount of money lost, not the number of jobs that remain.

Clearly, some jobs will be created, but whether this will be more than the number of jobs lost through higher taxes on industry, or higher taxes on individuals leading to demands for higher wages from industry, is arguable. The third tranche must move pricing still further away from proper long-run marginal costing and therefore diminish the overall productivity of the nation. Unless one can argue that the propensity to create jobs is higher in these highly capital intensive areas (chemicals, steel, glass etc), than in other segments of the economy, then clearly the third tranche can only lose jobs overall, not create them.

The only possible basis for supporting the third tranche is if the scheme were financed by savings in even less worthwhile follies already being undertaken by the DTI. At this stage, we don't have sufficient information to know whether more jobs are lost through wasting money on industrial support than they would be lost through wasting money on the third tranche.

Peter Warry

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