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FROM: CHIEF SECRETARY
DATE: 29 June 1984

PRIME MINISTER

KINSALE GAS

I have seen a copy of Jim Prior's minute of 22 June to you.

When we discussed Kinsale Gas last September, we made a finely balanced judgement - that social and political factors were sufficient to justify proceeding with what was, at best, a project of marginal viability. Since then, the scales have been tipped decisively against the project. As an illustration of the scale of the shift, I understand that the price to be paid for Kinsale gas is now 35p - 39p a therm and that this would have to be reduced by 15p, even to regain the marginal viability we thought we had last September.

Jim Prior argues that if the £14m that would have to be spent closing the gas industry (in the event of our dropping the Kinsale gas project) is deducted from the cost of Kinsale gas, then he has only to reduce the price by 4p a therm to achieve a positive return.

But we cannot accept this analysis. An appraisal of the project on its own shows it to have a negative return. If we are to take account of the project's associated public expenditure savings (from avoiding closure), as Jim argues, then we should also take account of its associated public expenditure costs - namely the increased electricity subsidies that will be necessary because gas will reduce electricity sale revenue. A full public expenditure analysis (as was carried out before) would have been helpful - and would almost certainly show that closure is the cheaper option.

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If we accepted the objective of a 4p per therm reduction in negotiation, therefore we would be:

- i) Accepting that Kinsale gas would never be viable;
- ii) Setting up a second subsidised energy undertaking in Northern Ireland, which would compete with electricity in a way which will increase the subsidies to both;
- iii) Accepting a gas price which was well above recent international agreements, including our own hard fought negotiations with Norway over the Sleipner Field; and
- iv) Weakening our negotiating position over future gas deals.

If Jim were able to argue that there was a chance of achieving a 15p reduction in the price of Kinsale gas, (ie. enough to restore it to, at least marginal viability) I could see that social and political considerations might justify making the attempt.

But if there is no realistic chance of this, then I think it would be wrong to prolong the uncertainty by attempting renegotiation. The project cannot be viable under the most optimistic outcome of such negotiations and we should drop it now.

I am copying this minute to other members of E(LA), Geoffrey Howe, and Sir Robert Armstrong.



PETER REES

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