PART 2

Confidential Filing

Gas and Electricity Pricing Policy.
External Financing Limit 1979-80.
Reference to the Monopolies and Mergers Commission of the Electricity Supply Industry and the Gas Industry

NATIONALISED INDUSTRIES

Part 1: September 1979
Part 2: March 1980

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~26.3.80~~		~~25.9.80~~					
~~31.3.80~~		~~29.9.80~~					
~~16.4.80~~		~~21.10.80~~					
~~23.4.80~~		~~27.10.80~~					
~~2.4.4.80~~		~~31.10.80~~					
~~13.5.80~~		2.10.80					
~~15.5.80~~		—ends—					
~~7.7.80~~							
~~9.7.80~~							
~~16.7.80~~							
~~24.7.80~~							
~~25.7.80~~							
~~4.8.80~~							
~~11.8.80~~							
~~26.8.80~~							
~~2.9.80~~							
~~5.9.80~~							
~~8.9.80.~~							
~~10.9.80.~~							
~~17-9-80.~~							

PART 2 ends:-

CST to S/S Energy 2.10.80

PART 3 begins:-

E(80)120 17.10.80

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
E (80) 34	21.4.80
E (80) 14th Meeting, Minute 2	24.4.80
E (80) 76	24.7.80
E (80) 86	1.8.80
E (80) 29th Meeting, Minute 4	4.8.80

The documents listed above, which were enclosed on this file, have been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate **CAB** (CABINET OFFICE) CLASSES

Signed AWayland Date 17 June 2010

PREM Records Team

Nat Ind:
cc Mr Duguid

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon David Howell MP
Secretary of State
Department of Energy
Thames House South
Millbank
London SW1

2 October 1980

Dear David,

CEGB FUEL STOCKS AND THE ELECTRICITY SUPPLY INDUSTRY'S EFL 1980-81

Norman Lamont wrote to me on 25 September in your absence abroad to seek my agreement that we should consider the electricity supply industry's latest figures for their EFL outturn for 1980-81 before coming forward with any proposal for amending their EFL to take account of the decision at E(80)29th on fuel stocks.

As Norman Lamont said, new forecasts are due from the industry for the EFL for 1980-81; indeed I understand that they have just been received, though have not yet been discussed with the industry. In these circumstances I agree that it would be sensible to defer consideration of any amendment to the industry's EFL until these figures have been studied. But I must insist that by the end of this month we must decide what amendment, if any, should be made to the industry's EFL to reflect E Committee's decision on coal stocks. I should therefore be glad if you could let me have your proposals for the EFL by Friday 24 October at the latest. I know that you will impress upon the industry to do all it can to absorb the costs of higher stocks and any other adverse changes for its EFL. There should be at least some scope for this since I note from Norman Lamont's letter that your understanding is that fuel costs will not be as high as the industry previously forecast.

I also note from the letter that if the cost of the decision to maintain stockbuilding is to be limited to £80 million, the NCB would have to put to stock 1m tonnes of coal which, Norman Lamont says, could not be sold in the current state of the market. If it is indeed impossible to sell this coal, I think that the NCB must be asked now to prepare, on a contingency basis, measures which could be taken to offset the cost to them of the higher coal stocks and so avoid any excess in their EFL. Unless the Board are told about this possibility now, they could well argue, if told in say January, that there is just not time to take offsetting action.

I am sending a copy of this letter to the Prime Minister, members of E, the Secretary of State for Scotland, the Minister for Transport and Sir Robert Armstrong.

Yrs

John Biffen

JOHN BIFFEN

Nat Ind

2

From the
Parliamentary
Secretary

Ministry of Agriculture, Fisheries and Food
Whitehall Place London SW1

Prime Minister
There will be a paper for E on energy pricing in October. I have put a separate note on Bowaters in folder 1.

The Rt Hon Margaret Thatcher MP
Prime Minister
10 Downing Street
London
SW1

MT

25th September 1980

Dear Prime Minister,

At the meeting which I attended last Thursday to discuss with you the future of Bowaters, the subject of energy prices was raised. While this is still fresh in your mind I would like you to see these figures which apply to three particular energy intensive industries for which I have some responsibility (in the case of paper it is as a customer of the forestry industry). In papermills and glasshouses energy is about 40% of the direct production cost, in fishing it is about 25%.

Index weighted average fuel costs to producers.

	Newsprint from timber	Fishing	Heated Glasshouses
UK	100	100	100
Western Canada	26		
Sweden	46		
Netherlands		74	57
France		67	

Capital Investment	Not Separately Available	£500m	£500m
Employees		20,000	20,000
Self Sufficiency		50%	50%

To make the point I have not included the numerous reservations necessary to qualify statistical information of this sort.

Our policy for pricing energy is not a matter for me and I quite understand the reasons behind the Government's present approach. However, it would appear that other countries do not treat these problems in the same way and although I have no doubt that at some time in the future they will regret their failure to face reality, that will not be until considerable structural damage has been done here. We are now left with the prospect of only one paper mill taking home grown timber and many tomato growers will not be planting this Autumn. The Fishing Industry has received much needed short-term help of course.

In Peter Walker's absence I am sure he would like me to keep you informed.

I am copying this to Keith Joseph, Tom Trenchard, Norman Lamont, Michael Roberts and Alex Fletcher who were present at our meeting.

Yours ever

Jerry.

JERRY WIGGIN

cc. A. Duguid

DEPARTMENT OF ENERGY
THAMES HOUSE SOUTH
MILLBANK
LONDON SW1P 4QJ
Direct Line 01-211 4953
Switchboard 01-211 3000

From the
Parliamentary Secretary

Rt Hon John Biffen MP
Chief Secretary
to the Treasury
Treasury
Parliament Street
SW1P 3HE

25 September 1980

Dear John

CEGB FUEL STOCKS AND THE ELECTRICITY SUPPLY INDUSTRY'S EFL 1980/81

At E(80) 29th David Howell was invited to produce specific proposals in September for an amendment to the Electricity Supply Industry's EFL to take account of the decision at that meeting on fuel stocks. There are now indications that the industry's latest financial forecasts, due at the end of the month, will embody further significant changes in other assumptions (not all necessarily in the same direction.) For example, our understanding is that fuel costs will not be as high as the industry previously forecast. It would seem sensible to consider the latest figures before coming forward with any proposal for amendment. I am writing in David's absence abroad to invite your agreement to this, though I set out below, for the record, the estimated financial effect of our decision on stockbuilding, other things being equal.

The CEGB have at our request agreed to maintain their fuel purchases until the end of November at previously planned levels, including NCB coal deliveries at the rate of 75mtpa. However, it now appears that further slippage in coal imports is likely (owing to suppliers' difficulties) and some reduction in oil deliveries next spring is also anticipated. Together, these two factors are expected to reduce fuel stocks at end-March, 1981, by 1mtce, or some £40-£50 m, depending on price and mixture, which cannot now be forecast. Assuming NCB coaltake at the rate of 75mtpa to the end of 1980/81, and on the basis of electricity demand for the year in average weather of 219 Twh, fuel stocks are forecast to reach some 1mtce more than the central estimate implied in the EFL. The CEGB claim that in order to achieve reasonable certainty of remaining within this estimate, they would need, on past experience of winter stock fluctuations, to aim for some 2mtce below it. This means that, without action to curtail coal deliveries, stocks are currently expected to be as much as 1mt, and possibly 3mt, above the level implied in the EFL - some £40-£120 m at assumed end-year coal prices.

For the reasons set out in E(80)76, we would not wish to encourage the CEGB to make further cuts in imports. If later this year we believe that action is desirable to reduce NCB deliveries to power

Rt Hon John Biffen MP
25 September 1980

stations we can take a view. It seems that NCB and British Rail could adjust to a decision in December to cut back by about 1mt on NCB deliveries from January to March at relatively short notice - though those Boards would then face a loss of revenue of up to £35m and £3-4m respectively in 1980-81, depending on when payments are normally made. However, as I have said, a cut back of 1mt of coal by the CEGB would not necessarily ensure compliance with the electricity EFL. For this, coaltake would have to be cut by 3mt. A cut of this magnitude imposed at short notice would however be extremely difficult to accommodate; the NCB would be faced with finding alternative markets for the coal, or losing about £100m of revenue in the last quarter of the year, while British Rail would face a loss of around £10m in freight revenues. On the assumption that only 1mt of coal can be cut at short notice without damaging effects to the NCB and BRB, the risk to the EFL resulting from the decision to maintain stock building would appear to be of the order of £80m. (The loss of even 1mt would, of course, be difficult for the NCB. In the current state of the market they would have to stock it - there is no prospect of selling it elsewhere.)

I am copying this letter to the Prime Minister, Members of E Committee and Sir Robert Armstrong.

Y -

Nan

NORMAN LAMONT

010

cc Duguid

CONFIDENTIAL

Prime Minister 2

Nat Ind.

cc Mr Hoskyns

To note that the Treasury are now suggesting (see x below) that the energy industries could offer lower prices to selected customers.

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

17 September 1980

The Rt. Hon. David Howell MP
Secretary of State for Energy

Dear David

Good! At last! MT.

TL 17/9

ENERGY PRICING

.... I attach a note on energy pricing by my officials which you might like to bear in mind when you are preparing your paper for E Committee on this subject. It is not intended to deal with the equally important question of the control of nationalised industry costs. I am not necessarily committed to all the arguments in the note, but it does seem to me to summarise our existing approach to these matters.

Could I ask that your Department should consider two particular points which arise from the note.

x (i) It suggests that there might be a case for permitting the electricity supply industry to reduce its prices to certain firms provided the revenues generated from those firms still covered the marginal costs of generation and supply and the industry could hold its (higher) prices to its other customers. I recognise that this might require some amendment to the industry's statutory duties but that apart, I wonder whether you see any advantage in the proposal. I would need to be convinced that it would not lead to an increase in public expenditure. We simply cannot afford this particularly in view of the enormous problems posed for public expenditure by the loss-makers and other nationalised industries.

(ii) We will need to see the results of studies by your Department and the CBI on international energy comparison, but quite apart from these studies I wonder whether, as the note suggests, there might be scope for some international action by the UK to try to ensure that energy prices in other countries are set by market principles and subsidisation is avoided. You will remember that this subject was discussed at the Venice Summit and that the recent change in the Canadian

/Government required

CONFIDENTIAL

Government required some departure from the more virtuous Tokyo formula. I should be interested to know what you think of the chances of making any useful progress in this direction.

I should also be interested to have your views on the possibility of encouraging the Generating Boards to increase the facilities available for coal imports. I recognise that this would not provide any competitive stimulus to the NCB in the short term, though the knowledge that the facilities were planned might have some helpful effect in restraining the industry's costs. It would be important for the new import facilities to be owned by the private sector so that their cost would not add to public expenditure. And we would need to be assured that the NCB could cut its own output if it looked as if it would be faced with unsold surpluses because of competition from imported coal. Without such cuts in its own output, the cost of financing unsold NCB stocks would place a heavy burden on public expenditure. I suspect that this could be a real stumbling block since, as your paper E(80)96 shows, there is already a strong prospect that the NCB will have a problem with excess stocks over the next few years. The CEGB are also planning for coal import facilities some way above their current forecasts of imports.

I am sending a copy of this letter to the Prime Minister.

GEOFFREY HOWE

ENERGY PRICES
(Note by Treasury Officials)

Pricing Principles for the Nationalised Energy Industries

In market economies prices are the principal mechanism for ensuring that national resources are used efficiently; ie that consumers' demands are met in the most economical (ie least cost) way given the technology and resources available. Sensible resource use implies that if consumers wish to use say more electricity, they should be prepared to pay the (extra) costs involved in providing it - marginal costs. Supplying at a price below marginal costs would mean that the value to users (measured by the price) was less than the value of resources used to provide the additional supply. A clear waste from the national point of view. It also would be bad business for the supplier since some of the supply would be sold at a price which did not cover costs. Thus in efficient markets the use of national resources will be steered in the right direction in response to financial gains and losses faced by individual buyers and sellers.

2. In competitive markets prices would be pushed towards marginal costs* by the normal trade pressures. Businesses which persistently charged below marginal costs would go out of business and prices above marginal costs would lead to excessive profits which would attract new and less greedy firms.

3. Where supply is in the hands of monopoly suppliers - like the nationalised energy industries - marginal cost prices have to be implemented as a deliberate matter of policy. Marginal cost pricing is well established in the electricity industry and the financial target announced earlier this year reflects a move towards it. But in gas and coal the idea has not caught on. The measurement of marginal costs, never easy, raises particular problems for those industries.

Investment, Spare Capacity and Discriminatory Pricing

4. Investment is an important element of marginal costs; eg if higher demand for electricity means that new power stations are

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* marginal costs are defined here as all the extra costs to the firm in provided extra output.

required earlier, this is a real economic cost which should be reflected in prices if they are to do their job of guiding investment plans and ensuring that energy demands are met in the most economic way. But because lead times in energy are long, investment decisions have to be taken well in advance and in practice it is not possible to plan so far ahead with perfect accuracy. As a result in any particular short period we may find ourselves with too much or too little capacity to meet demand at "long run" marginal cost prices. Where there is significant excess capacity which is likely to persist, it will theoretically make sense, subject to other considerations (which may in practice prove overriding), to shade prices down towards "short run" marginal costs*; ie the additional current outgoings associated with the extra output. Whether this will benefit the industry's finances depends on what happens to receipts in total. If for instance selling more output requires price cuts across the board because price discrimination is unfair (or even illegal), the likely result is that receipts will fall and the cash flow be reduced.

5. A private firm would not price down this far unless it saw some compelling longer term advantage eg survival. A nationalised industry would survive but there would be a cost either to the PSBR or, if the PSBR was to remain constant in terms of additional cuts in public expenditure, increases in taxes etc. It is hardly sensible to adopt pricing policies which increase the PSBR, if this runs directly counter to the Government's overall policy which is designed to secure the best economic outcome in the longer term. Further expenditure cuts and tax increases may be extremely costly in terms of the sacrifices entailed and these would have to be balanced against the advantage to the nation of cheaper electricity etc. But it would make sense both for private firms and nationalised industries to exploit any opportunities for discriminatory pricing down as a temporary expedient if this increased short-term cash flow. The opportunities will depend on the industry's cost structure and market position (and perhaps on its statutory obligations - though these could be changed if necessary).

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* There may be other options eg stockbuilding, which may in some circumstances make better sense.

6. Pricing down would have to be limited say to contracts over a specified time period and the temporary nature of the arrangement made clear. (How easy in practice it would be to resist demands for continued cut price supplies when the circumstances had changed is another matter.)

7. At present we have too much capacity in electricity and too little in gas. To the extent that short run marginal cost arguments justify (temporarily) lower electricity prices the same arguments would lead to (temporarily) higher prices for gas.

Relationship with Oil Prices

6. It is not possible to generalise further about pricing opportunities in the short run. But it is worth noting the implications of marginal cost pricing for fuel price relativities over the longer term. As oil gets dearer, people will switch to other fuels and it will make sense to meet these demands provided users are willing to pay (marginal) costs. It is unlikely that over the rest of the century, supplies of other fuels can be increased without incurring higher costs, so that rising oil prices will tend to raise the price of other fuels. This however is not monopolistic greed or "parity pricing" but common sense. We cannot do much about rising oil prices, but we can adapt our fuel policy to minimise the costs. Keeping other fuels' price artificially low would simply make things worse because there would be reduced encouragement to expand their supply and because incentives for energy conservation would be reduced.

Public Expenditure and the PSBR

7. The overriding need to contain public expenditure and the PSBR during the next few years gives added reason for charging economic prices for the products of the nationalised energy industries since their prices have a direct impact on public expenditure through the industries' external financing requirements. For example, the effect on the gas and electricity industries' cash flows of prices across the board lower/than they otherwise might have been is:

	£m (outturn) Effect in 1981-82
Electricity	
a) 10% price shortfall (all customers)	700
b) 10% price shortfall (industrial only)	200
c) 20% price shortfall (large users only)	240
Gas	
a) 10% price shortfall (domestic)	150
b) 10% price shortfall (industrial)	30* (£60m following year)

* Effect of staggered contract renewals.

The increase in public expenditure and the PSBR will be somewhat smaller to the extent of, for example, the reduced energy costs borne by the public sector and the increased tax revenues from higher company profits. Even so, it is clear that reductions in gas and particularly electricity prices have considerable consequences for both PSBR and public expenditure.

8. To the extent that increases in energy prices reduce the PSBR, they also tend to ease the pressure on the money supply. This effect would not be as large in the short term as that produced by an increase in direct taxes with comparable revenue implications because the temporary increase in the general price level would itself tend to increase the demand for money. Nonetheless, interest rates could be slightly lower for a given rate of monetary growth.

Industry and Energy Prices

9. It is understandable that industry should seek reductions in energy prices as one of a number of possible forms of relief during

the current recession and severe liquidity squeeze. However, there are some strong reasons, apart from energy pricing policy, for resisting any general move in this direction.

a) A financial squeeze is the necessary consequence of the Government's monetary policy, and is one of the main means by which inflation is being reduced. Substantial and widespread assistance to the corporate sector, via lower energy prices, would be inconsistent with the Government's economic policy.

b) General reductions in the price of particular fuels would probably not be a very cost-effective way of helping to maintain the long-term viability of the generality of firms which are particularly seriously affected by the recession.

c) Subsidised energy prices are not in the long-run interests of industry because they would tend to reduce the incentive to adopt more energy efficient technology and would thus leave industry in a less competitive situation than otherwise when the subsidies were eventually withdrawn.

10. However, the general considerations are not inconsistent with the possibility of more flexible industrial energy pricing at the margin. The recession is reducing the demand for energy for industrial purposes so helping to create excess capacity in some energy industries. As suggested in paragraph 4 it may well be, in this situation, in the (revenue maximising) interest of some supplying industries (eg electricity) to shade energy prices, or at least price increases, or to make selective cuts in prices to customers who might otherwise go out of business. These decisions are essentially a matter for the commercial judgement of the energy industries concerned.

11. It is doubtful however whether more flexible industrial energy pricing (stopping short of pricing which was totally uncommercial) would make a significant difference to the decisions by particular

companies on whether to continue in business or to close. On average industrial energy represents only around 3 per cent of total costs of manufacturing industry. In those sectors where energy costs represent a much larger proportion of total costs, the scale of price reductions likely to be feasible would probably not make a great difference to the overall financial position of companies.

12. Bowater's plant at Ellesmere Port is a case in point. It suffers cost disadvantages compared with average costs in Canada and Scandinavia of about £6m-£7m, split equally between wood pulp, coal and electricity. The Electricity Board would have to halve the price of electricity supplied to Ellesmere Port to bring it into line with Canadian/Scandinavian levels and would almost certainly have been subsidising Bowater at that level. The Forestry Commission were prepared to reduce the price they charged for wood if Bowater would accept a change in specification which would have reduced harvesting costs, but this would have saved no more than £¾m. To have halved wood prices, which would have required a subsidy to the Forestry Commission and to the private wood owners because the reduced price would not have covered harvesting and transport costs, would have saved only £2m. Moreover, the problems of UK newsprint producers are not confined to higher input costs, but include severe pressure on selling prices due to the fact that world newsprint prices are set by the price of Canadian newsprint which, due to a combination of depreciation of the Canadian dollar and appreciation of the pound, has nowhere nearly moved in line with rising UK production costs.

International Energy Prices

13. The Government is studying with the CBI comparisons of international energy pices. Whatever conclusions are reached in that study on levels of energy prices here and abroad, it will be in the UK's interest to ensure that energy in other countries is priced according to market principles. Otherwise British industry, whatever its position now, would certainly have cause for complaint about competitors' "unfair" use of cheap energy inputs. International efforts to conserve energy would also be hindered if energy prices in other countries were artifically restrained.

14. Against this background it is worth considering whether the UK should mount an initiative eg in the International Energy Agency. A low key initiative might simply be to raise in the Agency's Standing Group on Long Term Co-operation the case for charging for energy at market prices with the aim of persuading the Ministerial Governing Board to promulgate a recommendation on these lines together with proposals for monitoring its implementation. A more radical proposal would be to try to gain wide international acceptance that trade in products which embodied unreasonably cheap use of energy inputs was "unfair". For example, the Community and/or other international bodies dealing with energy might over a period of time evolve a GATT-like character whereby trade in certain goods subject to extreme kinds of subsidisation by cheap energy inputs could be restrained.

15. Our ample supplies of indigenous energy (coal, oil and gas) would provide us with a firm platform for such an initiative. We could argue that despite our plentiful supplies we are adopting market pricing principles in the interests of conservation and are eschewing subsidisation. Properly handled an initiative ought not to raise the thorny questions of Community competence over North Sea oil.

16. An initiative by the UK on these lines could be justified on its merits. Ministers might also find it politically helpful in this country to be able to demonstrate that the Government is trying to take action internationally to try to prevent unfair competition in energy products.

cc A. Duguid

NORTHERN IRELAND OFFICE
GREAT GEORGE STREET,
LONDON SW1P 3AJ

Nat Ind.

SECRETARY OF STATE
FOR
NORTHERN IRELAND

Rt Hon David Howell MP
Secretary of State for Energy
Thames House
Millbank
London SW1P 4QJ

R 17/9

17 September 1980

Dear David,

REVIEW OF INDUSTRIAL ENERGY PRICES

I read with interest your letter of 31 August to Keith Joseph dealing with the proposal to establish an inter-departmental Working Party to scrutinise CBI evidence on international energy-cost comparisons and also suggesting the establishment of an urgent review of UK industrial energy pricing policy.

As you will know from our recent talk and your visit to the Province, I have intractable problems in relation to both energy pricing and industrial development and Northern Ireland already has considerable experience of the interface between these two subjects. In 1977 a £100m subsidy programme (in practice the provision of £20m each year until 1982) was introduced to offset the effect on industry of high electricity prices in Northern Ireland. The most recent round of oil price increases has had, however, a particularly severe effect on the Northern Ireland Electricity Service which is largely oil dependent. Despite the existing subsidy programme, only urgent intervention and the injection of additional resources has enabled me to hold Northern Ireland industrial electricity charges in a stable relationship with similar charges in Great Britain until the inter-departmental Committee which is reviewing the future basis for electricity supply in Northern Ireland can report.

The problem of high electricity prices is worsened by the distressing nature of the general industrial situation in Northern Ireland and by the very much greater importance of oil in the Province's industrial energy supply, which means that industrial consumers in Northern Ireland are much more vulnerable to oil price increases than is the case at the national level.

In view of this particular combination of energy pricing and industrial problems I would wish to be fully associated with the work proposed on international cost comparisons by having my officials attend the Working Party meetings as full members, rather than receiving copies of the papers as you suggest. I understand that the review of industrial pricing policy which you have put in hand is at this stage primarily of an internal nature but my officials will be anxious to provide whatever assistance they can in this work. I would hope that they could be kept fully informed and can be involved in the discussion which you propose should take place before you circulate a paper to colleagues later this month.

I am sending copies of this to recipients of your letter.

Yours ever

Humphrey

cc Mr Duguid

From the
Parliamentary
Secretary

Ministry of Agriculture, Fisheries and Food
Whitehall Place London SW1

Rt Hon David Howell MP
Secretary of State
Department of Energy
Thames House South
Millbank
London
SW1

FR
17/9

17 September 1980

Dear David,

ENERGY PRICES

I have seen copies of your minute of 21 August to the Prime Minister, and of Jim Prior's letter to you of 10 September.

I know that Peter Walker is extremely concerned about the possible consequences of uncompetitiveness induced by energy pricing policy, and has already earlier this year drawn attention specifically to the plight of the horticulture and fishing industries which face competition from EC countries providing open fuel subsidies. Of equal concern on a worldwide scale is the effect of fuel costs upon the competitiveness of our food and drink manufacturers. The price of fuel particularly affects the high value products which enter international trade and creates an additional burden to that imposed by high exchange and interest rates.

In Peter Walker's absence I am writing to ask that you should keep this Department very closely in touch with the current review and enable us to comment upon the results to their circulation.

I am copying this to members of E Committee and to Sir Robert Armstrong.

Yours ever

Jerry.

JERRY WIGGIN

17 SEP 1980

DEPARTMENT OF ENERGY
THAMES HOUSE SOUTH
MILLBANK
LONDON SW1P 4QJ

01-211 4391

SIR DONALD MAITLAND GCMG OBE
PERMANENT UNDER SECRETARY OF STATE

16 September 1980

Dear Ken,

GAS PRICES

You asked in your letter of 5 September for SEPD to be associated with the study on gas called for in Robert Armstrong's letter of 15 August.

It has been agreed with No.10 that this study would be subsumed in the paper on industrial energy pricing which my Secretary of State has proposed for E Committee at the end of this month. This paper will be put for discussion to the interdepartmental group on industrial energy pricing comparisons chaired by John Guinness here.

Following your Secretary of State's letter to mine of 5 September, it was already intended that Hamish Laing would be associated with the Guinness Group. No doubt he will wish to attend the meeting to discuss the policy paper.

Yours ever,

Donald

Sir William Fraser KCB
New St. Andrews House
Edinburgh EH1 3SX

17 SEP 1980

MC

CONFIDENTIAL

Nat Inds

cc Mr Duguid

SECRETARY OF STATE FOR EMPLOYMENT

Caxton House Tothill Street London SW1H 9NA

Telephone Direct Line 01-213 6400

Switchboard 01-213 3000

Rt Hon David Howell MP
Secretary of State
Department of Energy
Thames House South
Millbank
LONDON SW1

10 September 1980

Dear David

ENERGY PRICES

I was on the point of raising the question of energy prices with you when I saw your minute to the Prime Minister of 21 August. I must say that the consistent impression I derive from my business contacts is that a number of our industries have to pay appreciably higher prices for fuel than their continental counter-parts. It therefore surprised me to see from the note enclosed with your minute that gas, electricity and coal prices in this country were all in line with those obtaining in EC countries.

I do not think that what I hear from industrialists can be dismissed as anecodtal evidence. Nor do I believe that it can be explained away as illustrating the difference between "average" and "renewal" costs. I suspect that one factor which may not have been given full weight is the ability of other EC Governments and their firms to disguise the impact of hidden subsidies, in contrast with the more "open" society we enjoy here.

This is of course a question of cardinal importance: it would make no sense for us to be considering questions of industrial support on the one hand while on the other we allowed industry to continue to suffer higher fuel prices than those of their competitors.

I feel so strongly on this issue that I should like my economists to be represented on the inter-departmental working group which is to scrutinize the CBI's evidence on international cost comparisons. I take it that the results of this scrutiny will be available before you circulate your paper to colleagues later this month on industrial energy pricing?

I am copying this to members of E Committee and to Sir Robert Armstrong

Yours

Jim

10 SEP 1980

Nat Ind

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

8 September 1980

The Rt. Hon. David Howell MP
Secretary of State for Energy

cc Mr Ingham

Dear David

INTERNATIONAL ENERGY COST COMPARISONS

I have seen a copy of your letter of 31 August to Keith Joseph with proposals for collecting information on international energy cost comparisons.

I agree that it would indeed be worthwhile establishing a working party, with which the CBI would be associated, to try to establish agreed comparisons of international energy costs. The working party might also try to establish the availability of gas supplies in the relevant countries overseas. For, as you realize only too well, gas availability can be as important to industry as its price; you have reminded me, indeed, that some industries in this country complain as much about the lack of gas supplies as about price. I also agree that the establishment of the fact finding study with the CBI should be publicised, though this will need to be done in a way which avoids any implication that we believe energy prices here to be out of line with those in the Community.

I would want the Treasury to be members of the working party, though I doubt whether the Treasury representative (Wicks) need attend detailed discussions with the CBI.

I am sending a copy of this letter to the Prime Minister, the Secretaries of State for Industry, Scotland, Northern Ireland, Sir Robert Armstrong and Mr Ibbs.

Lo —

GEOFFREY HOWE

Geoffrey

With the Compliments

of

The Permanent Under Secretary of State

Scottish Office

New St. Andrew's House
Edinburgh EH1 3SX
031-556 8400

FROM THE PERMANENT UNDER-SECRETARY OF STATE, SCOTTISH OFFICE

Sir William Fraser KCB

NEW ST. ANDREWS HOUSE
ST. JAMES CENTRE
EDINBURGH EH1 3SX

Telephone 031-556 8400

Nat Ind

5 September 1980

CONFIDENTIAL

Sir Donald Maitland GCMG CBE
Department of Energy
Thames House South
Millbank
LONDON
SW1P 4QJ

8/9

Dear Donald,

GAS PRICES

I have only very recently seen a copy of Robert Armstrong's letter of 15 August on this subject.

Although the letter was not originally copied to the Scottish Office, the proposals to be examined could have very significant implications for the investment plans and financing requirements of the Scottish Electricity Boards. I would be grateful, therefore, if you would arrange for the Scottish Economic Planning Department to be associated with the study suggested by the Prime Minister. The SEPD contact is J F (Hamish) Laing.

I am sending copies of this letter to Robert Armstrong, Douglas Wass, Peter Carey, Robin Ibbs and Nick Sanders.

Yours,

Kenneth Fraser

PERSONAL AND CONFIDENTIAL

JS.

cc Master set

File Nat Ind

10 DOWNING STREET

From the Private Secretary

2 September 1980

Dear Julian

ENERGY PRICING

As you know, your Secretary of State, with Sir Donald Maitland and Mr. MacIntyre, discussed energy pricing with the Prime Minister this morning. The Chancellor of the Exchequer, with Mr. Middleton and Mr. Wicks, was also present.

The discussion provided an opportunity for the Prime Minister to give a provisional reaction to your Secretary of State's minute of 21 August, so that he and the Chancellor of the Exchequer would be aware of the avenues which the Prime Minister will wish to see explored in the further papers now under preparation.

The Prime Minister's approach stems from her concern that industry is facing simultaneous problems as a result of a strong pound, high interest rates and high energy costs. She is not convinced that even the most efficient industry is capable of coping with all three problems at a time of recession. She therefore wishes to ensure that Ministers carefully examine our energy pricing strategy against this background.

The Prime Minister quoted her own experience of private industry where, for part of the trading year, companies will sell at minimal margins or even occasionally below cost in order to spread the year's overheads. She sees no parallel to this approach in our nationalised industries, and she believes that some reconsideration is necessary. High energy prices are apparently a significant factor in recent and threatened plant closures. But the result of these closures will simply be to reduce the revenue to the industry providing energy for each plant which is closed, which will simply compound the problem of spreading the energy producers' overheads. In present circumstances, the possibilities of differential pricing would need studying.

The Prime Minister also explained her current thinking on gas pricing. The artificial pricing of oil had allowed coal costs to rise to artificial levels. Current pricing strategy was intended to put gas on a par with the other fuels, rather than to force other fuels down to gas levels. The Government's approach on these matters had important consequences for other aspects of Government

/policy.

policy. Any change in the gas pricing strategy would have an effect on the PSBR contribution made by the gas industry, but this might be recovered by increased revenue generated elsewhere. Your Secretary of State emphasised the problems faced by the gas industry in meeting current demand, which made it important not to raise industrial demand. ICI's recent profits fall was due in part to the shortage of gas. He accepted the psychological importance of the Government's energy pricing strategy, and undertook to find a means of satisfying industry that energy costs in this country were rising no more than elsewhere. The paper he had in preparation would seek ways of taking the political heat out of the energy pricing issues.

The Prime Minister emphasised that she wanted to see the Government looking at the problem of industrial costs across the board. She feared that there still tended to be a compartmentalised approach within individual Ministries. It was particulary important to look at costs and efficiency within the nationalised industries. The Monopolies and Mergers Commission's report on the electricity industry, due at the end of the year, would be of particular interest.

The discussion ranged around the issues raised by the Prime Minister. I have not attempted to record this in detail as it was essentially background for the further discussion which will take place when your Secretary of State's paper is circulated.

I am sending copies of this letter to John Wiggins (HM Treasury), Ian Ellison (Department of Industry) and David Wright (Cabinet Office).

Yours ever

Mike Pattison

Julian West, Esq,,
Department of Energy.

2

Prime Minister
This exercise will be relevant to your discussion yesterday on energy pricing.
MAP 3/IX

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

01 211 6402

The Rt Hon Sir Keith Joseph Bt MP
Department of Industry
Ashdown House
123 Victoria Street
London SW1E 6RB

31 August 1980

Dear Keith

Thank you for your letter of 8 August (not to all) proposing attached that an interdepartmental Working Party consisting of members of Treasury and our two Departments, with which the CBI should be associated, should be set up to scrutinise the evidence the CBI is collecting on international energy cost comparisons and to try to establish agreed comparisons.

I welcome your suggestion. May I suggest that as we have most of the data available on the subject, which we are trying to add to, it might make most sense if my Department chaired the Working Party. If you agree, I would propose that John Guinness, the Under Secretary in charge of my Energy Policy Division, should act as Chairman. Perhaps you and Geoffrey Howe could nominate members, who could get in direct touch with Guinness (Telephone No 211 5838). The CPRS might also wish to nominate a member. Given their responsibilities George Younger and Humphrey Atkins might wish to receive copies of the group's papers.

While I agree with your view that the new Working Party should essentially be a fact-finding and a fact-clarifying body - it should not discuss let alone negotiate possible policy options with the CBI - I also think we need to have a fundamental, but urgent look at our energy pricing policy as it affects industry. For this purpose I have put work in hand within the department on an urgent review of energy pricing as it affects industry. This review, which I hope can be completed within about a month, is to cover the whole gamut of issues related to energy pricing policy, which have been recently raised including the study of gas pricing policy, which Sir Robert Armstrong reported in his letter of 15 August to Sir Donald Maitland that the Prime Minister has called for. My officials will be consulting yours as necessary in the course of the study, and when a draft has been prepared I am sure that it would be useful for our officials together with Treasury and CPRS officials to have a preliminary discussion in the new interdepartmental Working Group before I circulate a paper to colleagues in September on Industrial Energy Pricing Policy.

I think we should give publicity to the fact that we are setting up a new Working Group to collaborate with the CBI on the fact-finding exercise - news of it would in any case leak when we approached the CBI. The existence of this Working Group should help to enable us to reduce the temperature at least for the time being by suggesting to industries that write to one or other of us that we must first establish the facts and that we are now doing this with the CBI.

I am sending copies of this letter to the Prime Minister, the Chancellor of the Exchequer, the Secretary of State for Scotland, the Secretary of State for Northern Ireland, Sir Robert Armstrong and Mr Ibbs. I am also sending them copies of your letter, other than to the Chancellor who has already received a copy of it.

Yours ever

David

D A R HOWELL

National Institute Economic Review 3/80 August 1980

 2

REAL PRICES OF ENERGY

by Jenny Morel[1]

National Institute of Economic and Social Research

PRIME MINISTER

You might like to glance at this (and the graph at flag A in particular) before your meeting with Mr Howell next week.

MS 28/8

During the last eight years there have been dramatic increases in the world price of oil. However, the incentive to use less energy comes from increases in the 'real' prices paid by consumers for fuel and the increases in these prices have been far smaller. This note examines the changes since 1973 in real prices for different fuels in different sectors in the UK and compares these price movements with those in some other Western developed countries.

The world dollar price of oil has risen more than 13-fold since 1972.[2] This has given rise to much publicity and to worries about the effects on other prices, on the balances of payments, and on real incomes and the level of activity in the oil-dependent economies of the industrialised countries. While the oil price rises are the best-known feature there have been other important changes in the prices and availability of energy. Coal supplies have been becoming more expensive, the risks and costs of nuclear power have been subject to wide debate, reserves of natural gas are limited, and new alternative energy sources face many development problems before they will be available for use on a large scale.

There are many reasons for governments to encourage conservation of energy: to reduce reliance on the Middle East, to cut trade deficits caused by the rising cost of oil imports, to avoid unpopular options such as nuclear power, and, in the longer term, to ease the transition to a future less dependent on scarce energy. In the UK the main reliance for cutting consumption is placed on price increases. While estimates of the strength of response to a given price change vary widely, most people accept that price changes do have some effect on energy demand. This note investigates the price changes themselves, which provide the potential stimulus to conserve energy, but not the strength of any response to these changes.

Energy prices

How much energy consumers use is not influenced directly by the price of primary energy such as crude oil but rather by the prices paid by the consumers for delivered fuels. These prices include processing, transport and other distribution charges, which would not be expected to have risen as rapidly as crude oil prices, and taxes, which may increase or diminish the price rises. The prices paid by final consumers for oil products have certainly not risen as dramatically as the price of crude oil.

Secondly, in studying consumers' responses to price changes it is primarily the change in the 'real' or relative price which is important, not that in money terms. This is particularly so in an inflationary period such as the seventies. Here the real price is defined as the price of the commodity relative to the prices of all goods and services which could be purchased at the same time.

Thirdly, there is of course no one final real price of all energy paid by all consumers. The prices of different fuels have changed in very different ways since 1973: oil products becoming more expensive, natural gas for a period being relatively abundant and correspondingly cheap, coal being subsidised to keep it competitive and so on. There are also good reasons for disaggregating by class of consumer. Not only would one expect the response to price changes to differ among sectors (the demand for fuel for pleasure boating may well be more price elastic than that for commercial fishing) but the price signal itself may well differ among sectors, for example if taxes or subsidies are not applied uniformly.

Fourthly, it is the change in price rather than the actual price level which is expected to modify consumption. To facilitate the measuring and comparing of price changes, all the price series for this note[3] were calculated as indices with the real price for 1973, the beginning of the oil crisis,[4] set to 100 to show clearly the effects of the more aggressive pricing policies followed since then.

Ideally it is the changes in marginal prices which should be studied, but the lack of suitable data makes this impracticable and average prices are therefore used, in the hope that changes in these approximate the changes in marginal prices, or at least the changes that consumers perceive (many consumers may be aware only of their total expenditure and not of the marginal rate).

---

[1] I wish to acknowledge the assistance of G. F. Ray, under whose supervision this work was carried out as part of a larger project on 'The real price of energy and its effects' funded by the SSRC.

[2] See Statistical Appendix, table 21: the Arabian light crude price, which has increased less than the OPEC average, increased from \$2.10 in 1972 to \$28.00 in the second quarter of 1980.

[3] Copies of the series calculated are available on writing to NIESR.

[4] The first of the big oil price increases was in October 1973 but most of the effect on prices to the consumer did not come through until the following year.

The data for this note were taken primarily from the *Digest of UK Energy Statistics*. In general the prices were obtained by dividing the expenditure figures given by sector and fuel by the figures for the corresponding quantities of final energy delivered, as these give the best coverage by fuel and by sector, although the expenditure figures do contain an element of estimation. Comparison with other price series available does not give any reason to doubt these estimates.

The consumer price index, CPI, is used to deflate prices for the domestic sector; the wholesale price index for manufactured goods (i.e. for output), MPI, is used for industry on the basis that this includes capital, labour, and raw material prices; the GDP deflator is used for the services and transport sectors and 'all consumers' because it is the only readily available very general price index. This last has some disadvantages, in particular that it does not reflect tax changes so that with the introduction of VAT in 1973 the CPI and MPI will have been increased but not this last index and real prices deflated by the GDP deflator will have risen more than those deflated by these other indices.

Oil products

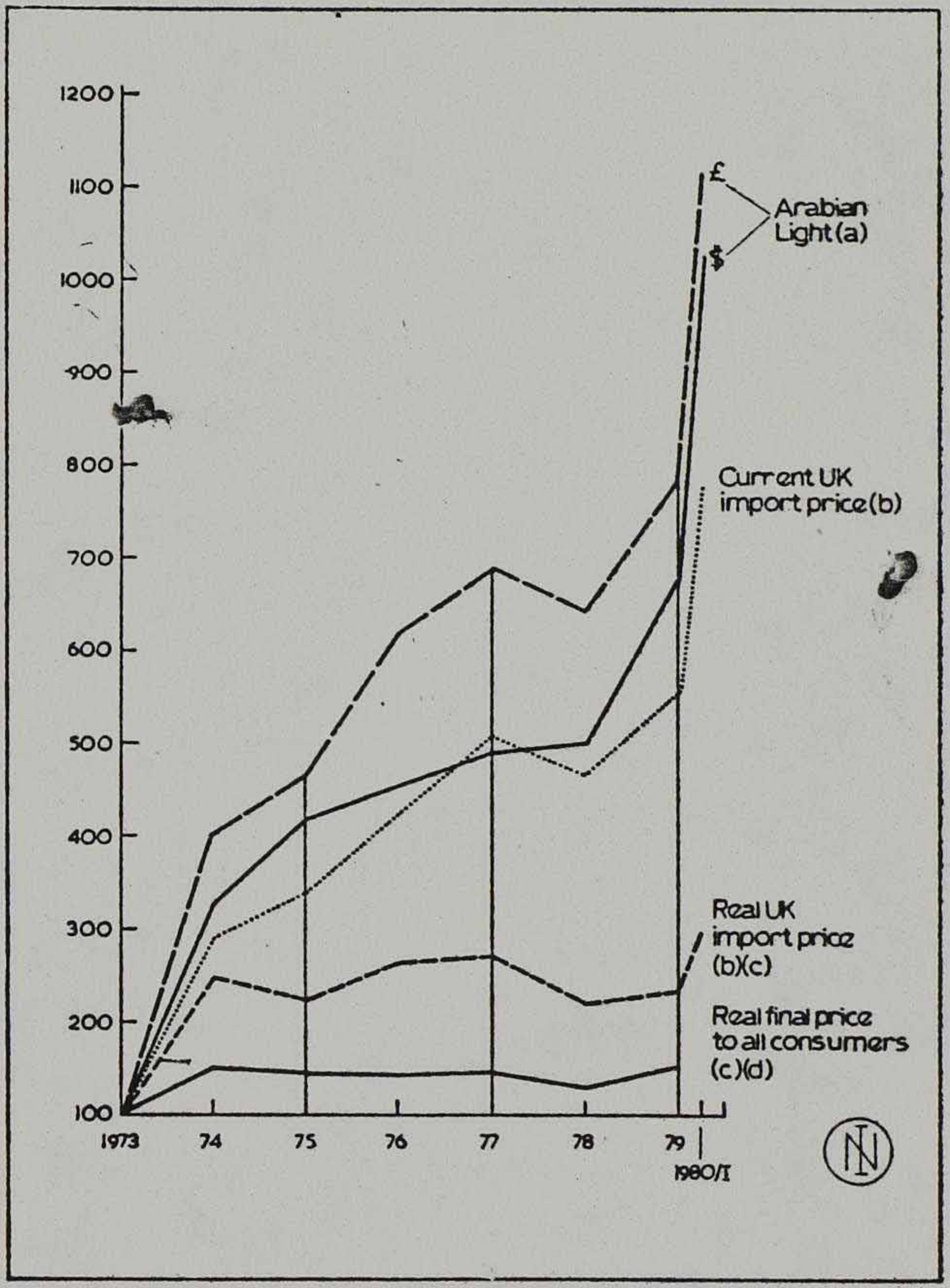
While the US dollar price of Arabian crude in the second quarter of 1980 was more than 13 times its 1972 level, in sterling the increase was still greater, over 14-fold.(1) The c.i.f. UK price, as one might expect, increased somewhat less; in the first quarter of 1980 it was just over 7½ times its average 1973 level. In real terms, deflated by the GDP deflator or by an export price index (of goods and services), this increase is less than 3-fold (2.97 and 2.80 respectively). Between 1973 and 1979 the average real c.i.f. price of imported crude increased by 134 per cent.(2) One would expect the real price to final consumers to have increased somewhat less than this as the processing charges increase more in line with the general rate of domestic inflation than the world oil price. Overall this expectation is borne out (chart 1): the average real final price to all consumers rose by 50 per cent in 1974, fell back to 30 per cent above its 1973 level in 1978 and then rose again to be just over 50 per cent above its 1973 level in 1979. But there have been quite different changes in different sectors, as shown in chart 2. The transport sector, responsible for over a half of all final consumption of oil products, experienced the smallest real increase. Here the real price of oil products rose initially by 27 per cent, fell gradually until 1978, and then rose again to be

(1)The increase in the Saudi light crude price was less than that of the OPEC average price, which increased from about the same base to over $31.00 in the second quarter of 1980 (NIESR estimate)—compared with the Saudi price of $28.

(2)Deflated by the GDP deflator. Deflating by an export price index gives an increase of 122 per cent over this period.

Chart 1. The price of oil, 1973–80

Index numbers, 1973=100



Source: *Digest of UK Energy Statistics;* Statistical Appendix table 21, NIESR calculations.

(a) State sales price (prior to 1977 average selling price) of Arabian light crude oil in US $ and, converted at the current rate, in £.

(b) All crude oils, c.i.f. UK.

(c) Deflated by GDP deflator.

(d) Average of all oil products; 1980 data not available.

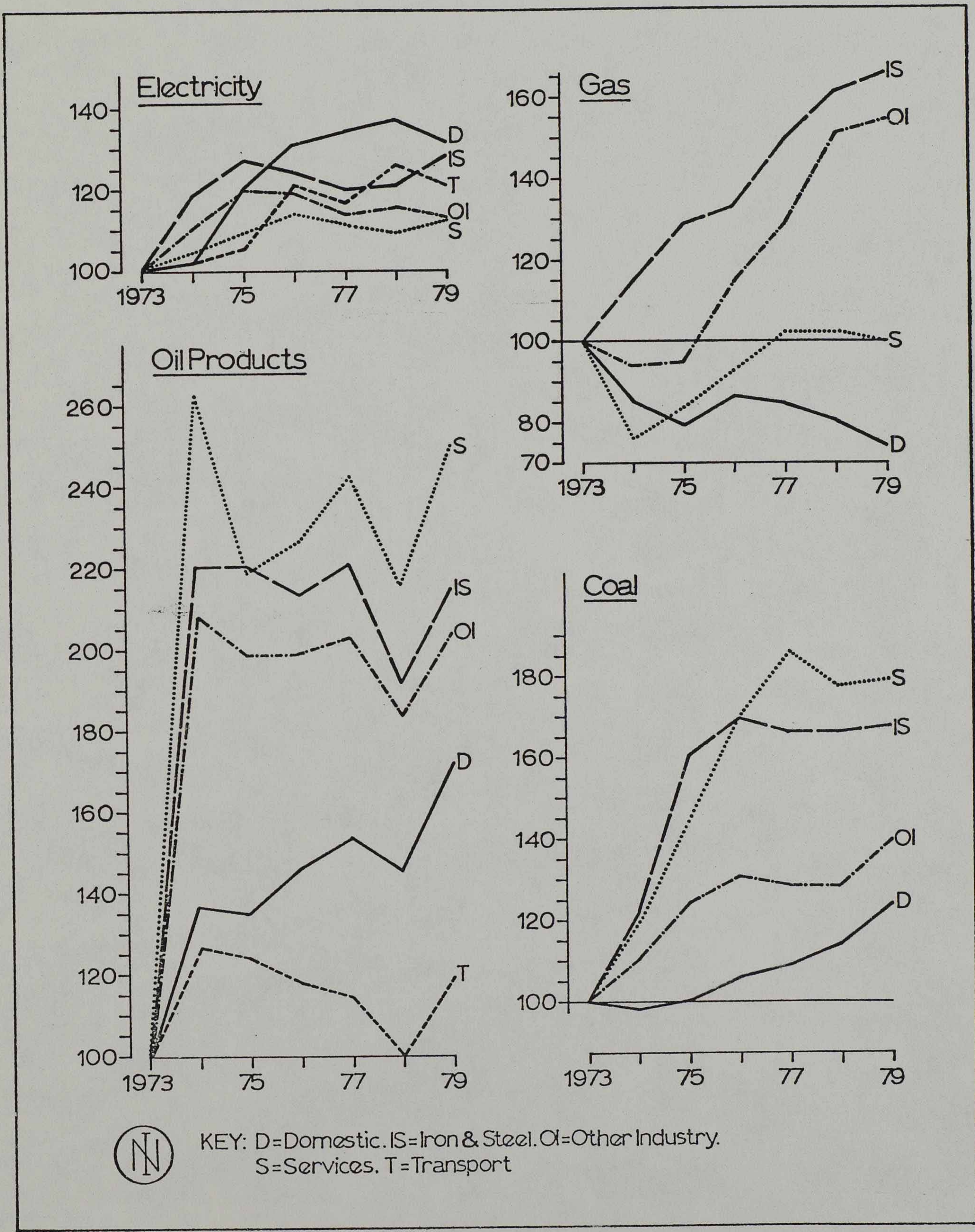
20 per cent above its 1973 level in 1979. At the other extreme, the real price of oil products in the public services and miscellaneous sector increased between 1973 and 1974 to more than 2½ times its 1973 level and after some fluctuation was still almost as high in 1979. The transport sector is the only one in which consumption of oil products was higher in 1979 than in 1973. While recession may have affected other sectors more and the possibility of substituting other fuels may be very small in this sector, the different real price movement is likely to be responsible for some of this difference.

One reason that the post-oil crisis percentage increase in real prices was lower in the transport sector may be that prices were already higher there, so that although prices increased by more pence per therm this was a smaller percentage increase. Another reason for lower percentage increases in real prices in the transport sector is the dampening influence of duty not having increased in line with inflation.

The real price of oil products in the transport sector

Chart 2. Real fuel prices, 1973–9

Index numbers, 1973=100



Source: *Digest of UK Energy Statistics*, NIESR calculations. (See text.)

net of taxes[1] rose 80 per cent between 1973 and 1975, not as high as the increases in real prices in the industry and services sectors but considerably greater than the 27 per cent increase of the real price including VAT and duty. Table 1 shows how the real price of motor spirit in London, both including and excluding taxes, has changed since 1973.

Table 1. The price of four star motor spirit in Inner London

	Price	Real price	Real price net of duty and VAT
	Pence/ gallon	Indices, January 1973=100	
January 1973 ..	37	100	100
1975 ..	73	137	172
1977 ..	78	111	143
1979 ..	76	90	113
1980 ..	121	120	173
March 1980 ..	138	133	179

Source: *Transport Statistics Great Britain (1968–78)*, table 168.
Note: Figures for 1980 provided directly by Shell UK Ltd. Real prices are deflated by the GDP deflator for the corresponding quarter (Statistical Appendix, table 1).

A comparison with the United States, Japan, France and West Germany shown in chart 3[2] reveals that in these countries as well the real price of motor spirit has risen very little (the largest sustained increase being in France where the real price in January 1978 was 19 per cent above its January 1973 level). The increase in the real price of heavy fuel oil was considerably larger: ranging from January 1978 real prices 68 per cent and 78 per cent above their January 1973 levels in Germany and the UK respectively to 128 per cent higher in Japan.

Electricity

Chart 2 shows, sector by sector, how the real price of electricity in the UK has changed in recent years. For all consumers the average real price was falling until 1973, after which it began to rise, presumably as a result of higher oil and coal prices, to be 21 per cent higher in 1979 than it was in 1973.

For the three sectors which are significant users of electricity—domestic, other industry, services—the detailed patterns of real price changes again differ markedly, the domestic sector having experienced higher real percentage increases than the others.

The OECD price series for industrial users of 15 GWh of electricity a year show that the real price of industrial electricity by 1978 had risen considerably more in both France and Japan than in the UK, while in Germany it had risen still less (chart 3). Unfortunately data are not given for the US.

According to the OECD series, however, the UK domestic sector suffered a greater increase in real prices than these other countries: in Japan the real price of domestic electricity has fallen considerably.

Gas

The real price of gas in the UK on average fell until 1975, then rose slightly, and for the last three years has remained at about its 1973 level. Again there are notable differences between sectors, with the real price paid by industry rising considerably while that paid by the domestic sector has continued to fall.

Any international comparison of gas prices in industry could be misleading given the differing origins of gas, regional differences within countries and the special deals often negotiated by particular industries. From the OECD statistics it appears that the real price of gas in the domestic sector in Germany was about 30 per cent above its 1973 level in 1977 and 1978 (previously it had been falling) while in France there has been little change in the real price of domestic gas since the late 1960s.

While consumption of gas in the UK has risen in the 'other industry', services and domestic sectors, the increases have been particularly large in the last two: in the domestic sector this was presumably a result of the declining real price and the unfavourable movement in the electricity price, while in the services sector the fairly static real gas price compares very favourably with large increases in coal and oil product prices.

Coal

Coal[3] is the only fuel for which the real price in all sectors in the UK has been increasing fairly steadily since 1967 and since 1973 the increase in the average real price for all consumers is comparable to that in the real price of the much publicised oil products. Prior to 1973 the greatest percentage increases were for the iron and steel industry; since 1973 the greatest have been for the services sector. The domestic sector has experienced the smallest real increase. Not surprisingly, consumption has fallen during this period although an increase in 1979 suggests this trend may be reversed.

By 1978, the real price of industrial steam coal in France and Germany had increased about as much as in Britain (although the rise came somewhat later in France) but in Japan it had increased still more (chart 3). The real price of domestic coal increased

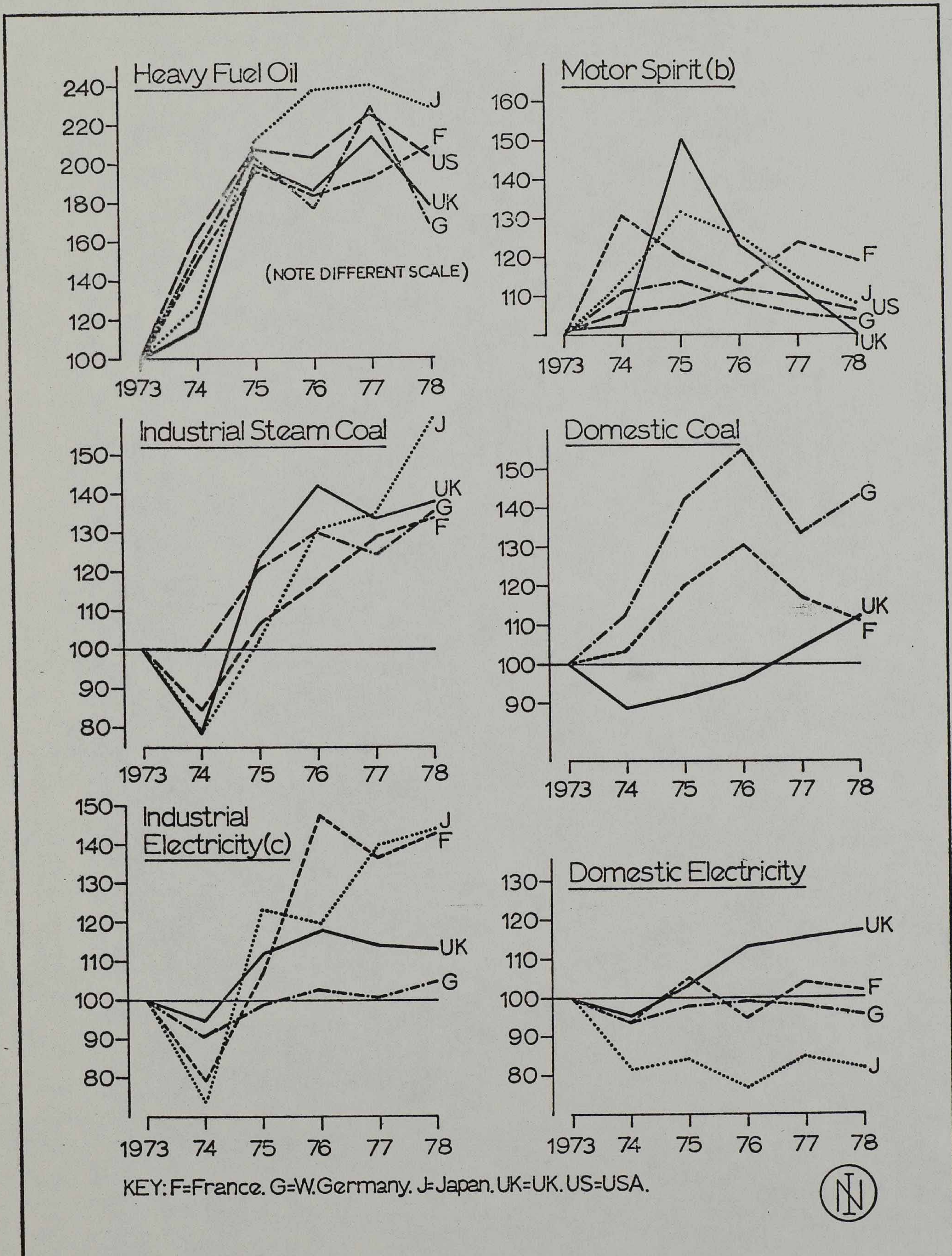
[1] Derived from the *Digest of UK Energy Statistics* table 'Commodity analysis of purchases in the energy sector', and the expenditure and consumption by final user tables.

[2] Prices from OECD *Energy Statistics 1975–77* deflated by CPI or WPI (output) from IMF *International Financial Statistics* (1st quarter figures were used to deflate the January prices).

[3] Including coke and other solid manufactured fuel.

Chart 3. International comparison of real fuel prices, 1973–8

Index numbers, 1973=100(a)



Source: OECD *Energy Statistics*, with deflators from IMF, *International Financial Statistics*, NIESR calculations.
(a) All figures refer to January of the years shown.
(b) 'Super' quality for all countries except for the USA for which this is not available and 'regular' gasolene is used.
(c) 15 GWh.

more in both Germany and France than in the UK but in France it had fallen again by 1978.

Conclusions

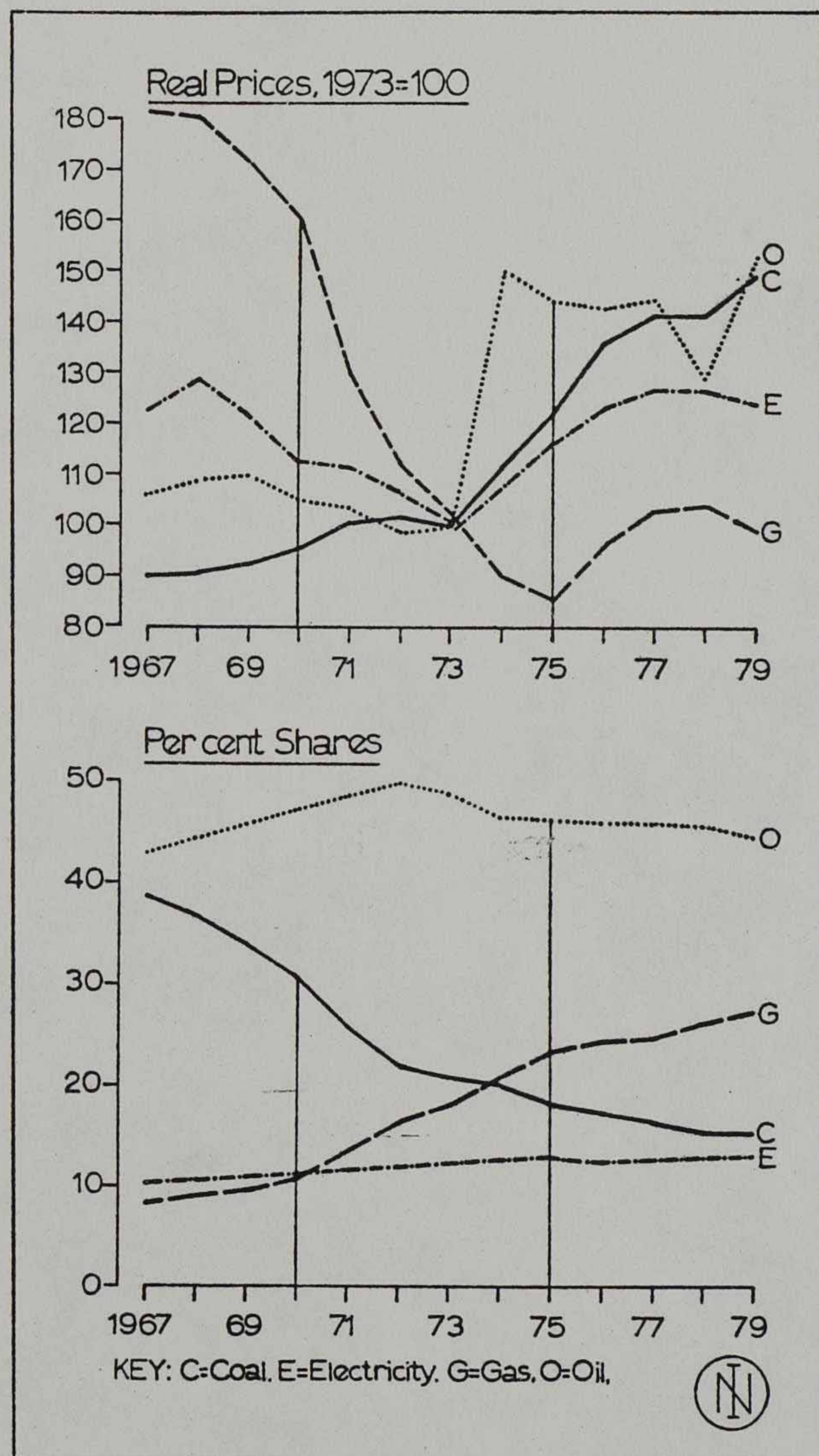
Chart 4 shows indices of the average real price paid by final consumers in the UK for the four major fuels between 1967 and 1979 and how the different fuels' shares of final energy consumption have changed over the same period. A relationship between relative prices and shares of the various fuels is clearly indicated. Since 1973 the average real prices of oil products and coal have both increased by about 50 per cent and the real price of electricity by about half this amount, whereas that of gas is back to its 1973 level.

The increase in the annual average real price of all energy has been 35 per cent—modest compared with the dramatic rises in the world price of crude oil described earlier in this note.

Within this overall pattern, there is a lot of variation in the real price changes of the same type of fuel in different sectors in the UK, providing different sectors with quite different financial incentives to conserve energy. Given the importance of oil products in the transport sector, accounting for 51 per cent of final consumption of oil products in 1979, it is particularly noteworthy that the real price of motor spirit had fallen back to its 1973 level in 1978 and in March 1980 was only 33 per cent above it.

Total energy consumption by all final consumers, which had been increasing quite steadily prior to 1973, fell from 61,034 million therms in 1973 to 55,876 million therms in 1975 (GDP also fell in these years) but then began to increase again to reach 61,701 million therms in 1979 (which was, however, an exceptionally cold year). As well as the effect of economic recession, it seems likely that some of this moderation in the growth of energy consumption can be attributed to conservation in response to the higher real price of energy. That there has not been a more dramatic reduction in energy use is not surprising given the relative weakness of the stimulus to conserve provided by increases in the real prices of fuels, especially motor spirit.

Chart 4. The real prices of fuel paid by all consumers and the shares of various fuels in final consumption, 1967–79



see the decline in gas ms

Source: *Digest of UK Energy Statistics*, NIESR estimates.

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cc IND POL : July 1980
Newsprint Production
Nationalised Industries

TWP

BF 29/8/80

See previous B/F

10 DOWNING STREET

From the Private Secretary

26 August 1980

On 11 August I wrote to you about international comparisons of energy prices to industry, and asked for briefing for the Prime Minister by the end of August.

The Prime Minister has now seen a copy of the letter of 18 August from Lord Trenchard's office about Bowater's Paper Mill at Ellesmere Port. She has commented that almost all commercial concerns sell some of their output at rock bottom prices, and sometimes below cost, to keep up the volume of sales and distribute their overheads. She has asked whether the Electricity Council does anything like this.

I should be grateful if you could take these comments into account in preparing the advice for which we have asked.

I am copying this letter to Ian Ellison (Department of Industry), John Wiggins (HM Treasury) and David Wright (Cabinet Office).

N. J. SANDERS

J.D. West, Esq.,
Department of Energy.

PRIME MINISTER

2

This is a series of first submissions on energy prices. I suspect that it will raise a lot of questions in your mind; if it does, they might best be answered by talking to Mr Howell (and officials) before the E meetings on energy matters?

MS 26/8

CONFIDENTIAL

DoE. Treasury + I Lad letter Leave a preliminary discussion. MS

PRIME MINISTER

ENERGY PRICES

In view of the strong lobbying from industries which feel hard-pressed by increases in energy prices generally over the past year, we clearly need to consider our present approach to energy pricing in the context of our economic strategy.

2. My Department is urgently reviewing our pricing policy and examining options for the immediate future. This work will take account both of gas pricing and the pricing of other forms of energy. There are important inter-relationships between the different fuels and these need to be looked at together. The Treasury, Department of Industry and CPRS will be associated with this review. I am suggesting to the Secretary of State for Industry and other colleagues concerned that the results of this work should be examined by the proposed inter-departmental working group which is being set up to scrutinise the evidence which the CBI are to collect, following the recent NEDC meeting, on international energy cost comparisons.

3. I aim to submit a paper on industrial energy pricing to colleagues in September. Meantime, in response to the request in your Private Secretary's letter of 4th August, I attach a preliminary note by my Department on energy prices to the chemical industry, with particular reference to gas pricing. This is a factual note based on the latest information available here and in Community countries. The note concludes that:

a) Average gas prices to British industry were not out of line with other EEC countries in January:

b) Electricity prices at that time for reasonably large industrial loads were generally in line with those elsewhere:

c) More recently our fuel oil prices have moved ahead:

CONFIDENTIAL/2.

d) Our coal prices were comparable to other Community-produced supplies.

This note is essentially a preliminary survey in somewhat generalised terms and with statistical matter of variable quality. The further studies we have in hand should produce a better basis for discussions with industry and for policy decisions.

3. I am copying this minute to members of E Committee and to Sir Robert Armstrong.

GH

21st August 1980.

ENERGY PRICES TO THE CHEMICAL INDUSTRY

1. There has been much concern expressed in recent weeks that the prices paid for energy by British industry may be higher than those paid by their European competitors. The Chemical Industries Association (CIA) has made much of the running though they would not argue that their industry is worse placed than British industry as a whole. The main emphasis of the CIA campaign has been on gas prices.

2. This note considers two questions:

i) is the price paid for gas by our chemical industry in fact higher than that paid by their Continental competitors?

ii) if it were, what would be the impact on our industry's competitiveness?

The Annexes B, C and D deal with the other fuels.

Are our prices higher?

3. Valid international comparisons of gas prices in particular are difficult. The gas market is the least transparent, and is subject to the longest lags, of any energy market. Prices to large consumers are often the subject of confidential contracts. Where tariffs apply these may be complex, involving escalation related to oil prices and regional variation. Gas prices are inevitably linked in one way or another to those of oil since for most users the two fuels are in principle interchangeable. But in practice gas prices tend to lag behind those for oil, particularly when the latter have increased sharply. For these reasons reliable, up-to-date figures for average prices paid by industry in other countries are not easily obtained.

4. The Department of Energy publish each quarter an average industrial gas price based on a survey of 900 large consumers. For the first quarter of 1980 (the most recent data available) the figure is 15.96 pence/therm. This includes a few old, low-priced contracts, in particular part of the very large supply to ICI. Omission of these would add up to two pence to the average price figure, i.e. bringing it up towards 18p/therm.

5. The most recent reliable data on industrial gas prices in the other EC countries are those compiled by the Statistical Office of the European Communities for January 1980. These are shown at Annex A for representative cities. It will be seen that the average price paid in Britain in January - mentioned above - was not out of line with those paid in the other countries, even if the old low-priced contracts mentioned above are omitted.

6. The Chemical Industries Association have collected and published information from their own industry and their European counterparts for new and renewed contract prices (see Annex A). In Britain such prices tend to be higher than average prices because annual fixed price contracts are the rule; when gas renewal prices increase rapidly during or following a period of rising oil prices, the gap between the average price paid across the board and the renewal price on some particular date may be appreciable. For instance, in the first quarter of this year the mean price realised by BGC in new and renewed contracts was 22p/therm. This may be compared with the average price of 15.96p/therm mentioned in paragraph 4. For other EC countries, when more frequent escalation against oil is usual, new and renewed contract prices tend to be closer to average prices.

7. Average prices provide the best measure of the impact of gas purchases on industry's overall costs. On this basis Britain was not out of line with other EC countries in January. No more up-to-date and reliable information is as yet available, either to the Department of Energy or generally. On the other hand, contract renewal prices provide industry with an indication of rising energy costs and perhaps for this reason the CIA have paid most attention to them, and their own figures show lower prices on the Continent (see Annex A).

Gas costs and competitiveness

8. For most industrial sectors energy costs comprise only a few per cent of total costs and gas costs less than one per cent, though the latter will vary from firm to firm, depending on the plant in use. Therefore any gas price differential between Britain and the Continent would in itself have only a very small effect on the competitiveness of our industry.

9. For the chemical industry all fuel purchases amount to about 6 per cent of total costs and gas purchases to about 1½ per cent. The CIA have recently argued that the British chemical industry as a whole is paying more for gas as a fuel than its W German or French counterparts - £130m and £70m respectively this year for the equivalent volume of gas. But the UK prices underlying this conclusion appear to be renewal prices rather than average prices, which would make the calculation inadmissible. We expect that our average price is unlikely to be very different over the course of this year from that of the French and there is the prospect of big price rises in Germany later in the year.

Their posn. is valid. What is what they are paying compd. with whether competitors are paying.

Conclusions

10. The following conclusions may be drawn from available information on energy prices:

No - you have to look at specific industries. Averages are no good.

(i) Average prices provide the best measure of the impact of gas purchases on industry's overall costs. The latest available data on average gas prices to industry do not show Britain to be out of line with the other EC countries in January. Even if our prices were to move ahead faster in the course of this year than Continental prices the effect on the competitive position of the chemical industry would be very small.

(ii) The CIA, in their representations on gas, have been careful to refer only to the fuel use of gas by the chemical industry. In fact about 60 per cent of that industry's gas supply is taken by ICI on a 15 year contract at a very low price and used substantially for feedstock. The average price of all gas purchased by the UK chemical industry for all purposes was probably less than 11p/therm last year.

(iii) As regards the other fuels, our fuel oil prices have recently moved rather ahead of those in most of the other EC countries (see Annex B). Our electricity prices in January for reasonably large industrial loads were in line with those elsewhere though the discounts available to very large users in France, in particular, are greater (see Annex C). Coal prices were comparable to other Community-produced supplies (see Annex D).

Department of Energy
14 August 1980

ANNEX A

GAS PRICES TO INDUSTRY: JANUARY 1980

pence/therm

	Eurostat average prices (1)		Chemical Industries Association: new and renewed contracts (2)
	4m.therms/year	40m.therms/year	20m.therms/year
Dusseldorf	24.3	n.a.	15.8
Paris	19.5	19.3	19.3
Rome	19.5	18.9	19.6
Rotterdam	18.3	17.2	17.5
Brussels	17.3	16.8	n.a.
UK D/Energy	15.96		26-28 (3)

(1) The Eurostat data are in general actual or average prices paid in selected cities, compiled by the Statistical Office of the European Communities.

(2) The CIA figures are for new and renewed contract prices for the respective countries.

(3) The CIA figure for Britain is higher than BGC's estimate both of the mean price for firm contract renewal in January (23.5p/therm) and that for all contracts - firm and interruptible (22p/therm).

D Energy say that the CIA figure of 26-28p/therm is the level BGC have now got to in renewing contracts. For new contracts to brand new customers, they are quoting the full oil-related price of 38-40 p/therm.

The market splits roughly 50% domestic / 10% non-domestic tariff / 40% non-domestic contract - including ICI with a huge contract at something like 6½p/therm.

ANNEX B

OIL

1. Liquid fuels comprised 31 per cent of the chemical industry's fuel purchases last year.

2. The CIA have argued that UK heavy fuel oil prices are higher than in other EC countries and that the difference is exacerbated by the high level of excise duty here. In the past UK fuel oil prices have broadly moved in line with those in other EC countries although the relativities have fluctuated somewhat, particularly in 1979. The CIA's data, while not statistically satisfactory, are nevertheless consistent with other information available to the Department of Energy which suggest that on some measures UK prices for heavy fuel oil have recently moved ahead:

	$/tonne	
	EC: Consumer prices(1)	OPAL: Net market realisations (2)
Belgium	187	166.3
Denmark	201	-
France	185	189.6
F R Germany	182	182.5
Ireland	214	-
Italy	187	184.9
Netherlands	194	189.9
UK	206	196.3
EC weighted average	191	-

Notes:

(1) Bulletin of 17 July; net of taxes and duties; small consumers.

(2) Private consultants' end June 1980 market survey of large consumers; net of taxes and duties.

3. There are significant statistical problems in establishing valid price comparisons. Several factors may be involved in this recent movement. Some other EC countries have selective price controls linked to spot prices of certain petroleum products; recently these have moved down with possible repercussive effects. Moreover, countries such as Germany and

Benelux can benefit from such a movement more rapidly through their greater dependence on supplies from the spot market. In contrast the UK tends to be self sufficient in fuel oil production and we believe a higher proportion of sales are on a contractual basis. The UK oil companies have also told the Department that they seek to recover a higher proportion of their overall costs from heavy products. The question of relative oil product prices is under current examination in the Department of Energy, particularly whether there is any evidence that their level and distribution do not properly reflect market pressures.

4. Our level of duty on heavy fuel oil is effectively the highest in Europe* but even so this contributes only a relatively small percentage (8-9%) to the overall fuel oil cost. Moreover, the UK has been above the general EC level for many years. On the other hand our level of duty on petrol is amongst the lowest in Europe.

* (Ireland alone excepted)

ANNEX C

ELECTRICITY

1. International comparisons of electricity prices are difficult because of the lack of information about the terms and conditions of supply, particularly to large users. Nevertheless, available data for reasonably large industrial loads in January 1980 do not show Britain to be generally out of line:

	pence/kWh
UK	1.866 - 2.298
F R Germany	1.984 - 2.401
France	1.770 - 1.920
Italy	2.133
Netherlands	2.833

2. However, the discounts offered to very large, high load factor users, typical for some chemical processes, are not as great in the UK as they are in France or Germany. France, in particular, offers a markedly lower price for such loads which are especially suitable for its large nuclear programme.

3. UK prices to industry could rise by about 30 per cent by the end of this financial year, depending on the size of future coal and oil price increases. This is likely to be higher than increases in other EC countries and could result in some cost disadvantage to our chemical industry for whom electricity comprises about 36 per cent of all fuel purchases.

ANNEX D

COAL

1. Steam coal is only a minor direct fuel input for the UK chemical industry ($3\frac{1}{2}$ per cent by value in 1979). Although prices to industry vary widely throughout the EC estimates from various sources show that NCB prices are not out of line with other Community-produced supplies.

Source	France	F R Germany	UK
		£ per tonne	
CIA (July 1980, pithead prices)	-	55	40
European Commission (April 1980, pithead prices)	43	50	38-45

2. However, coal supplies from third countries with more favourable geological conditions (e.g. USA, Australia, S Africa) do at present undercut Community coal at locations close to port facilities and distant from coalfields.

Source	Rotterdam	Thamesside Ports
	£ per tonne	
Coal Week (June 1980, Cif. port)	22-24	27

OA

CABINET OFFICE

① MAP

② CAW (OR)

③ DPL (OR)

to see

MJS 15/8

With the compliments of
Sir Robert Armstrong KCB, CVO
Secretary of the Cabinet

N.J. Sanders, Esq.

70 Whitehall, London SW1A 2AS
Telephone: 01-233 8319

CONFIDENTIAL

CABINET OFFICE

70 Whitehall, London SW1A 2AS Telephone 01-233 8319

From the Secretary of the Cabinet: Sir Robert Armstrong KCB, CVO

15th August, 1980

Ref. A02899

Gas Prices

Before leaving London on 13th August, the Prime Minister said that she would like to see a study made of the possibility of a change in strategy on gas prices.

She is conscious that, with a combination of recession of domestic demand and high exchange rates affecting competitiveness in world markets, the cost of energy is creating severe difficulties for energy-intensive industries, such as the chemical industry; and she is also conscious of the impact of increases in gas prices on the retail price index. She would like consideration to be given to the possibility of relating gas prices to consumers, domestic as well as industrial, not to the prices of other fuels but to the costs of producing and distributing gas (including costs of production, transmission and distribution, exploration and development). She recognises that, if this resulted in gas prices to consumers relatively lower than prices of other fuels, there would be likely to be a continuing switch of demand from other fuels to gas, with implications for expenditure on transmission and distribution and for the rate of depletion of natural gas reserves. The immediate benefits would, however, include not only lower prices to consumers but also a stronger element of competition in the energy business which could have beneficial effects upon costs and prices of other fuels (notably electricity and coal). Admittedly offshore gas reserves would be depleted faster than would otherwise be the case; but, apart from the possibilities of new offshore discoveries in the North Sea and of increased imports from other sources of gas, the loss by earlier depletion would be occurring when nuclear power would be expanding to fill the gap.

You will clearly need to discuss this with the Treasury and the Department of Industry - and, I suggest, the CPRS - and it may be a little time before you are in a position to report to Ministers, perhaps in the form of a paper by your Secretary of State for the Ministerial Committee on Economic Strategy. I think that it would be useful if your Secretary of State could send the Prime Minister a progress report on her return, indicating when he expects to be able to report the conclusions of the study and his recommendations on them.

/I am

Sir Donald Maitland, GCMG, OBE

CONFIDENTIAL

I am sending copies of this letter to Douglas Wass, Peter Carey, Robin Ibbs and Nick Sanders.

ROBERT ARMSTRONG

Nationalised Industries

NBPM
MJS
15/8

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon David Howell MP
Secretary of State
Department of Energy
Thames House South
Millbank
London SW1

15 August 1980

Dear David,

GAS LEVY

I am replying to your letter of 8 August to the Chancellor of the Exchequer about the consultations with BGC on the gas levy.

First, I agree that it is entirely sensible to consult BGC as you propose and we will need to pay close attention to their views about the practical operation of the levy. But I assume from your letter that your approach is that while consulting the Corporation about the size of the levy we should in no way set out to negotiate about it with the Corporation. The decision on the size of the levy is essentially a political one which as you say will have to be decided in consultation with colleagues.

Turning to your Department's note and the particular proposals in your letter, I am in general agreement with your approach, subject to the following points. As you say, the main objective of the levy is to reduce BGC's profits to publicly acceptable levels. I rather wonder whether the post-levy profits of £400 million and £500 million in 1981-82 and 1982-83 respectively are low enough to reduce public criticism as much as we would like. I would feel happier with somewhat lower figures of £300 million and £350 million for those two years with perhaps an increase in the 1980-81 profit to say £250 million giving some £900 million spread over the three years. I therefore propose that we should regard the lower figures for 1981-82 and 1982-83 as the overall target for the discussion with BGC but that, as you suggest, we should not tie ourselves finally at this stage to specific figures nor to their distribution over the three-year period. The Chancellor has not yet had the opportunity to come to a view on desirable profit levels and his position must be reserved until our later discussions.

For the rest, I agree with your proposals and the approach set out in the officials' paper. I agree that we will need to take particular care about the presentation of the levy and I suggest we discuss this when we take final decisions.

I am sending a copy of this letter to members of E Committee and to Sir Robert Armstrong.

Tim

John Biffen

JOHN BIFFEN

RH

Nat Inds

11 August, 1980

BF 29.8.80

Peter Stredder send us a copy of his letter of 8 August about comparisons of energy prices. I am disturbed to see that it is suggested that there should be a delay, and apparently possibly a substantial delay, in meeting our request for advice.

I hope that it will be possible for you to let us have as full a report as possible by the end of this month.

I am copying this letter to Ian Ellison (Department of Industry) and John Wiggins (HM Treasury).

N. J. SANDERS

J D West, Esq
Department of Energy

GB

X 1

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

Secretary of State for Industry

8 August 1980

Rt Hon David Howell MP
Secretary of State for Energy
Thames House South
Millbank
London SW1

SECRETARY OF STATE FOR ENERGY
RECEIVED
11 AUG 1980

Dear David.

Yesterday at NEDC the CBI said they would be examining evidence on the price of energy to industry in this country and its effect on our competitiveness. This is a very worrying subject. We have received a mass of evidence from major industrial energy users, many of whom are well placed to make international cost comparisons, that they are operating at a significant disadvantage in comparison to their overseas competitors in respect of gas, electricity and heavy fuel oil costs.

2 Industry's sense of grievance over what it sees as a paradoxical and damaging situation is understandable. Our favourable energy position unavoidably weakens industrial competitiveness through its exchange rate consequences, yet our policies for managing our energy resources appear to them to compound rather than offset these effects.

3 I think it would be desirable for a joint working party drawn from our Departments and the Treasury to scrutinise the evidence in co-operation with the CBI and/establish agreed comparisons against which we can discuss our energy pricing policies.

/to

3 I am copying this to Geoffrey Howe.

Yours Keith

SECRETARY OF STATE'S OFFICE

TO: Mr E. Price

FOR ADVICE (AND DRAFT REPLY IF APPROPRIATE)

PLEASE BY: ASAP

Copies to
MoS
PUSS
PUSS
PUS
Mr Tucker
Mr T. P. Jones
Mr U. Jones
Mr Campbell
Mr Guinness
Mr Kelly
Mr Spain
Mr Morchet
Mr Priddle
Mr Monger
Mr Whaley
Dr Metz

108/8

SM

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

Secretary of State for Industry

Julian West Esq
Department of Energy
Thames House South
Millbank
London
SW1P 4QJ

8 August 1980

Dear Julian,

ENERGY PRICES

I have seen a copy of Tim Lankester's letter of 4 August to you.

will request if required

2 My Secretary of State has now gone on holiday, but before he left he wrote to your Secretary of State and the Chancellor suggesting that a joint working group of officials should consider the whole question of the prices industry is expected to pay for energy, given the wide range of representations he has received and the discussion at NEDC on 6 August. In view of this, I hope it will be possible to defer a substantive reply to the Prime Minister until we have agreed comparisons. We should also like any interim reply to reflect the views in the second paragraph of my Secretary of State's letter proposing the prior study.

3 I am copying this letter to Tim Lankester.

Yours ever,
Peter Stredder

PETER STREDDER
Private Secretary

11 AUG 1980

File be
AMT
IND

C.F.

cc Econ Pol: May 79 BF 11.8.80
Corr. with John Sparrow

ds

Econ Pol

4 August 1980

The Prime Minister has become increasingly concerned at recent reports that our chemical industry are having to pay much higher energy prices, particularly in respect of gas, than our competitors in Europe. I would be grateful for an early factual report on the situation; and if it is the case that energy prices being paid by our chemical industry are higher, for an explanation.

TIM LANKESTER

Julian West, Esq.,
Department of Energy.

Top copy in Econ Pol : May 79.
Corr. with John Sparrow.

4

23 GREAT WINCHESTER STREET
LONDON EC2P 2AX
01-588 4545

From: JOHN SPARROW

Prime Minister

I will get a report on the energy price problem mentioned at the end of this letter

T. 1/8

1st August, 1980.

Dear Mrs. Thatcher,

Your speech in the no confidence debate has attracted a quite remarkable degree of approval; in my experience it is unusual for a speech in Parliament to attract as much attention as this one did, let alone the degree of unanimity in what have been entirely spontaneous reactions. It is an indication of the success you are having in changing people's minds, because I am quite sure that opinions would have been much more divided even a year ago.

In the financial markets, the dollar has shown some strength this week in response to the view that the fall in dollar interest rates has now come to an end. Quite separately, the gilt market has weakened, although a more accurate description might perhaps be that it has ceased to discount quite so much of the decline in U.K. interest rates that is expected.

There has been some premature discussion this week of the conclusions likely to be drawn by the Ryrie Committee. This has coincided with a batch of price increases by the nationalised industries which have demonstrated yet again that the control exercised by cash limits is both incomplete and potentially dangerous. It is incomplete because a monopolist can always expect to increase his prices without losing sales: even this proposition is beginning to look doubtful in such cases as the commuter traffic on British Rail, where there is now tangible evidence of a decline. It is also ineffective in that it fails to distinguish between capital and revenue items and therefore allows (one might even say encourages) the by now traditional sacrifice of capital expenditure in order to preserve current expenditure. This leads to the potentially damaging conclusion, that capital expenditure which is necessary and economically justifiable, is being postponed to the detriment of the country.

Ahead of the Ryrie report, it seems to me that what is needed is a more commercial approach, in which nationalised industries are required to adopt pricing policies which maximise their revenues, as opposed to cover their costs, whilst at the same time having every incentive to control their costs effectively. Quite separately, capital projects should be appraised on their merits, bearing in mind that if they have sufficient merits there is every reason to believe that they could be financed by the private sector instead of having to fund themselves through the Treasury. If, for example, British Rail follow the pattern of the Post Office and the Electricity authorities in putting up their prices in order to finance their capital expenditure without having any pressure brought upon them to reduce their costs (and perhaps without regard to the optimum pricing structure that is currently within their capacity) then we will still be some way from mastering the art of financial control.

/2.

Tim - please enquire. MT.

Going off at a tangent, I have spent some time recently with people prominent in the chemical industry, who have convinced me that they do genuinely believe that their subsidiaries in France and Spain are able to buy gas originally imported from this country at prices anything up to 33% below those being paid by their subsidiaries here. I do not pretend to know the ins and outs of this particular story, but I hope you will not mind my mentioning that I am personally totally satisfied that the chemical industry believes what it is saying, a view which covers the conclusions they draw as well as their premises.

Yours sincerely,

John Sparrow.

The Rt. Hon. Mrs. Margaret Thatcher, M.P.,
10 Downing Street,
London, S.W.1.

cc. Adam Ridley, Esq.

Nat. Inds.

cc A. Duguid

CONFIDENTIAL

Ref. A02799

PRIME MINISTER

CEGB Winter Fuel Stocks; and NCB and CEGB External Financing Limits in 1980-81

(E(80) 76 and 86)

BACKGROUND

In E(80) 76 the Secretary of State for Energy explains that there is a risk that the electricity (England and Wales) EFL for 1980-81 of £187 million could be overrun because of higher than expected fuel stock holdings following reductions in demand forecasts.

2. There are considerable uncertainties over the likely rundown of stock over the winter. But if they take no action on stocks the CEGB could overrun the EFL by up to £200 million.

3. The Secretary of State advises against action to reduce NCB deliveries of coal to the CEGB. This would simply shift the problem on to the NCB's EFL. Moreover it would break the CEGB/NCB understanding that the CEGB will take coal at the rate of 75 million tonnes a year provided the price does not rise in real terms. He argues that the ending of this agreement would remove an important restraint, through the price condition, on the miners and so have an adverse effect on the coming pay settlement. In his second paper (E(80) 86) the Secretary of State advises that, provided the coal sales agreement with the CEGB is maintained, the NCB should find the necessary economies to stay within their 1980-81 EFL of £834 million, though he admits that the prospects for 1981-82 are much more uncertain.

4. He also advises against asking the CEGB to reduce their coal imports. This would give the wrong message to the miners; it would reduce sources of supply; and it would lose the CEGB cheaper coal. He similarly advises against reducing oil deliveries.

5. The Secretary of State recommends that, while at this stage fuel deliveries should not be reduced, the situation should be reviewed later in the year when the outcome of the miners' settlement is known. He recognises that this involves a risk that the Electricity Industry's EFL would be breached by £100 million or more. He recommends that in no circumstances should the CEGB be allowed to reduce their winter peak endurance below six weeks of stocks.

HANDLING

6. After the Secretary of State for Energy has introduced his paper you will wish to invite the Chief Secretary to comment on the risks of overrunning the EFL. The Secretaries of State for Scotland and for Wales may also wish to comment.

7. The Chief Secretary recorded in his minute of 15th July to you that he and the Secretary of State for Energy are firmly against dealing with this problem by setting up special financing arrangements outside the EFL to cover contingency coal stocks. The financing of adequate stocks should be a normal responsibility of the industry, and one for which the consumer pays.

8. The Committee may feel however that this particular problem is different from the general run of difficulties over nationalised industries' EFLs. It would be possible for the CEGB to take action now - by cutting coal and oil purchases - to keep within their EFL. But, quite apart from the effect on the NCB's EFL, it would not be in the national interest if they were to run down their stocks unduly or if there were to be adverse repercussions on the miners' pay negotiations.

£187m

9. The Committee will wish to consider therefore whether in these circumstances it might be right to accept the Secretary of State for Energy's recommendations and to run the risk of an overrun of the Electricity EFL. This could however be on the understanding that the CEGB took all possible steps to stay within their EFL; that the position would be kept under review; and, possibly, that it should be made a condition that the maximum overrun which would be acceptable would be, say, £100 million.

10. The Committee will have an opportunity to return to this subject in September when the Secretary of State for Energy will be putting forward a paper on the investment and the financing of the NCB up to 1983-84. It will then be possible to look at the 1981-82 EFL and to consider in more detail the tactical questions raised in Mr. Hoskyns' minute to you of 25th July.

CONCLUSIONS

11. In the light of the discussion you will wish to record conclusions on:-

(i) whether the Committee accepts the recommendations of the Secretary of State for Energy in paragraph 13 of E(80) 76 that for the time being the CEGB should not reduce fuel deliveries and that in no circumstances should they allow winter peak endurance stocks to drop below six weeks;

(ii) any points on the limits to overrunning the EFL which might be acceptable;

(iii) taking note of the assessment in E(80) 86 that, provided the CEGB take their 75 million tonnes, the NCB should keep within their 1980-81 EFL;

(iv) agreeing to resume discussion of these questions when the Committee discusses the Secretary of State's further paper on the coal industry in September.

D J Wright

(Robert Armstrong)

(approved by Sir R Armstrong and signed on his behalf).

1st August 1980

CONFIDENTIAL

Qa 05095

To: MR LANKESTER

From: J R IBBS

CEGB Winter Fuel Stocks

1. The CPRS sees no satisfactory alternative to the proposal that the unavoidable stockbuilding takes place at power stations rather than at pitheads.

2. There appears to be no alternative to allowing the increased stock-building to be reflected by an increase in the Electricity Industry's EFL.

3. It would be very undesirable if this increase were left as an unspecified amount so that overall financial discipline on the electricity industry was relaxed.

4. The CPRS suggests that the value of the increased stock should be estimated as the difference between a rate of supply of 75 million tonnes per annum (as proposed by Mr Howell in E(80)86) and the rate of supply which the CEGB would otherwise have taken. This value should be added to the Electricity Industry's EFL. The adjustment would be subject to review if for any reason the understanding between the NCB and the CEGB, on which the rate of 75 million tonnes per annum is based, is significantly varied, or not kept to.

5. I am sending a copy of this minute to Sir Robert Armstrong.

JRI

1 August 1980

CONFIDENTIAL

Nat Ind

MBPM

Have already told

him strongly about x

R. 30/7

PRIME MINISTER

PUBLIC PARTICIPATION IN BRITISH GAS: MONOPOLIES AND MERGERS COMMISSION REPORT ON GAS APPLIANCES

In their minutes of 24 and 25 July Geoffrey Howe and David Howell commented on my minute of 14 July about the Monopolies and Mergers Commission Report on the supply of certain domestic gas appliances.

This Report is published today. As I have said the recommendations are extremely interesting, and, as they are controversial, can be expected to provoke a good deal of public debate. I agree with David Howell that my Department and his should co-operate closely, together with the Office of Fair Trading and other interested Departments, in putting in hand consultations with those affected by the Report and in considering the best options for implementing it. Proposals for measures pursuant to the Report can then be circulated this Autumn. x

I am copying this minute to Members of E, E(DL) and to Sir Robert Armstrong.

JN

J N

Department of Trade
1 Victoria Street
London, SW1H OET

29 July 1980

25 July 1980

Policy Unit

1

Original returned to J. Hoskyns 19/8

PRIME MINISTER

E COMMITTEE (4 AUGUST ~~28 JULY~~): CEGB WINTER FUEL STOCKS

1. E Committee is due to discuss coal stocks next week. The discussion on 16 July showed an uneasy feeling that big problems were looming in the coal industry over the next few years.

2. The Policy Unit has done some thinking about the crucial position occupied by the miners in the next and future pay rounds. Quite apart from the direct costs that excessive pay settlements for the miners can inflict on the community (bearing especially heavily on pensioners and the under-privileged), the miners' bargaining power can exert an unhealthy influence on the pay round (especially at the start). Their power makes responsible pay bargaining, elsewhere, less likely, as others either try to imitate them or feel aggrieved by their behaviour. In the end, society can't function properly if powerful groups are not inhibited by some countervailing forces.

3. For these reasons, the attached paper suggests that it is essential for the miners themselves and the public at large to see that irresponsible behaviour will not always be rewarded. We don't know if it would be possible to "win" a strike, but we do think that measures are available, and need to be taken, to deter one. Some of the obvious measures - on secondary picketing, secondary blacking, SB for strikers' families - have already been taken, although their effectiveness has yet to be tested.

4. We think that the key short-term factor in deterring a strike is the level of coal stocks on non-NCB premises. In the longer-term, other key factors will be the Electricity Industry's capacity to import coal, and perhaps the structure of the UK coal industry.

5. Although this paper is written in terms of the miners' power in pay bargaining, the arguments apply also to their power to insulate themselves from other market forces, notably the need to close uneconomic pits. Obviously it would be bad tactics to push the miners into a corner from which (like the steel workers) they felt they had to attack in order to defend themselves on both closures and pay at the same time. From the point of view of the repercussions on the

rest of society, pay may be the more important of the two issues in the short-term. But any measures to deter strikes and strengthen our bargaining position should eventually be beneficial in both respects.

6. I am copying this minute and attachment to members of E Committee, Robin Ibbs, and to Sir Robert Armstrong.

JOHN HOSKHNS

22 July 1980
Policy Unit

MINERS AND FUTURE PAY ROUNDS

1. INTRODUCTION

1.1 The next wages round is critical to our economic strategy. Miners' pay increases have been used before as a reference point by both the public and private sectors. We shall be trying hard to discourage this, but the tendency to compare is deep-rooted and will not disappear because we want it to. A moderate miners' settlement this year would bring dividends far beyond the savings to the NCB and the effect on the cost of coal (both important in themselves). Although it is likely that the settlement will be higher than average, there is no obvious rationale for this, since:

- improved productivity is reflected in pay through the incentive scheme;

- there is no shortage of new entrants;

- although oil prices are higher, the sterling value of imported coal has hardly increased at all since last year's settlement.

1.2 The sheer bargaining power of the NUM needs to be counterbalanced to ensure that the settlement is as low as the market will permit - not as high as NUM muscle can make it. This paper discusses what can be done to achieve this next time and in future years.

2. PERSONALITIES AND TIMING

2.1 This year's settlement was for a 10-month period ending 31 December. It has already been agreed that the next settlement will run for 10 months from 1 January to 31 October 1981, thus restoring the miners' pre-1971 bargaining date of 1 November.

2.2 Negotiations are likely to take place during September/October while Mr Gormley remains President. The behaviour of the NUM's National Executive will be affected by the succession in prospect when Mr Gormley eventually retires. Last year, the moderates on the NEC took the lead in rejecting the Board's offer and calling for a ballot.

2.3 Sir Derek Ezra has already conceded that the settlement should be high enough to maintain coalminers' position at the top of the wage league table. But this could be done with a quite modest settlement. He says the Board will also be guided by the need to "safeguard the future of the industry" - ie keep prices within reasonable bounds.

2.4 The NUM Conference in July voted to pursue increases of 35% on basic pay (= 43% on an annual basis). However, the NEC will not formulate its claim - which may be different - until September.

3. AVERTING A STRIKE

3.1 Experience suggests that a long strike by this powerful group would end eventually in a high settlement with great economic damage to the country. Two elements of our strategy must therefore be to make sure that:

(1) the miners know that a strike would be costly to them as well as to the rest of us;

(2) the miners believe in our willingness to face a strike if necessary.

3.2 Although miners think they can "win" a strike in the end, they also know it will take time and cost something. Our most important weapon in deterring a strike is keeping that time long, expensive and uncomfortable. This involves a variety of measures:

(1) level and location of coal stocks;

(2) amount of non-coal generating capacity;

(3) level of oil stocks;

(4) timing of strike action;

(5) plan for rationing electricity;

(6) cost to strikers (influenced by rules on supplementary benefit for strikers' families etc);

(7) post-strike outlook for coal industry. (It must be made clear that this would be bleaker not better if a strike took place.)

3.3 The most important single factor would be the level and location of coal stocks (discussed at Section 4.2 below).

4. SOME NEW FACTORS

4.1 There are several new factors which should each work to make a strike less likely or more costly to the participants:

(1) Overtime and the incentive scheme together provide over 30% of coalminers' earnings, compared with 15% in 1970. This should make an overtime ban, designed to reduce stocks before a strike, much less attractive than on previous occasions.

(2) The Employment Act will restrict immunity for picketing by the NUM to NCB premises.

(3) Non-coal power stations could produce about a third of average winter demand, given a supply of oil (about the same as 1974). The Employment Act withdraws immunity for tanker drivers refusing to deliver oil to power stations not supplied by pipeline.

(4) More cheap coal is available on world markets than in previous years. The Employment Act withdraws immunity for dockers or the NUR refusing to supply imported coal to non-coastal stations.

NUR?

(5) Supplementary benefits for strikers' families will be £12 less per week. SB is not the main source of income to strikers, but its importance increases with the duration of a strike. In the 6½ week 1972 strike, 50% of miners claimed it - though the proportion was much lower in the shorter 1974 strike. If the NUM were to make up the £12 to everyone, it would cost over £2m per week.

4.2 Decisions needed on stocks

4.2.1 Stock location. The proportion of coal stocks held by CEGB and the NCB has fluctuated over recent years. At present, 14.5 million tons are held by CEGB, while 13.3 million tons are held at pit-heads. NCB stocks can be picketed by the NUM, but there will be no immunity for picketing CEGB stocks in future. (Nor would picketing the Gas Board's Saltley coke depot have immunity.) If there was any need to move CEGB coal stocks or imports during a dispute (is there likely to be?) blacking action by ASLEF, NUR or TGWU would not retain immunity either - since the action would not be aimed at the employer in dispute. A coal strike would obviously put the effectiveness of the Employment Act changes to the test in a dramatic way. In principle, the changes in the law mean that as high a proportion of stocks as possible should be located on non-NCB premises.

4.2.2 Level and cost of stocks. Ministers have already decided (at E on 24 April) that the Electricity Council should not seek further savings by reducing their fuel stocks. The industry's normal objective is to meet 5-6 weeks' endurance during the winter peak. But should stocks be higher? If so, who should be seen to pay? What are the real costs involved in transferring some of the NCB's high stocks to the Electricity Industry? How would this show up in the accounts of the Coal and Electricity industries?

4.2.3 Extra CEGB stocks could be paid for by customers through higher prices or by taxpayers as a whole, through a grant. Pricing decisions have already been made, but a grant would still be possible. It would dramatise to the public the cost of an insurance against smash-and-grab tactics. At the same time, it would ensure maximum publicity for the Government's determination to make strike action long and expensive.

4.2.4 Such a policy might be described as provocative. But it seems very unlikely that the miners would respond by striking. Given the importance of incentive and overtime earnings, it also seems unlikely that miners would be prepared to respond to a build-up of stocks with an overtime ban.

2.5 Pithead stocks are already higher than average for July. With the prospect of overproduction, the NCB - and probably the NUM - would welcome a decision by the Electricity Industry to build up stocks.

5. IMPORTS AS A CHECK

5.1 We are destined to rely primarily on UK-produced coal for power generation for many years to come. In the timescale of a strike, or an overtime ban, extra imports of coal and extra oil could have a limited effect on the duration, provided that secondary blacking (no longer immune) was not widespread.

5.2 We suspect that a capacity to import around 10-20% of requirements could be very helpful in bringing some competitive pressure, at the margin, on the NCB. If the price gap between foreign and domestic coal is large enough to justify importing 10%, ie around 8 million tons per year, this would mean reduced UK coal output which would have a big impact on overtime and incentive earnings and the economics of the NCB. So a relatively small investment in importing capacity could pay big dividends in restraining the wage claims of the miners - not necessarily by deterring strikes, but by introducing an element of price responsiveness on the part of the customer, which would be normal for other markets. Of course, the miners would be fiercely opposed to this. But what would they do?

5.3 At present, there is an understanding whereby CEGB will use its best endeavours to take 75 million tons from NCB, provided NCB can keep their price increase no greater than the RPI.

5.4 The CEGB did have plans for a large new deep-water import facility at Killingholme on Humberside. This would have roughly doubled the present importing capacity from 8 million tons (including Thameside power stations currently using UK coal) to 16-18 million tons. It would also have allowed bulk delivery, at rather lower prices than are possible using present facilities.

5.5 We understand this facility would cost £11m and take 5 years to complete. (There are some other modest plans to increase importing capacity further - to 10 million tons.) The Electricity Council have cut out this expenditure in their economy drive to meet our EFL. We think the benefits of this facility should be looked at again.

The Electricity Industry may be relatively unconcerned about taking out an insurance policy against excessive wage demands by the miners; they can pass the costs on to the customer. From the Government's point of view, the position looks quite different. If a large and powerful group of public sector workers like the miners have a big influence on the whole pay round, any measure which subjects them to normal market forces has especially high returns.

6. MORE COMPETITION

6.1 Another element in the longer-term strategy to reduce the miners' monopoly power could be the introduction of a competitive structure to the supply of UK coal. A modest step in this direction could be achieved by raising the maximum size of the private sector mines, but it would take a very big increase to have a significant effect. (This is being considered by Energy - when might it happen?) More radically, would it be possible to break the NCB up into competing regional units? Obviously, it would be fiercely resisted by the NUM, who would do their best to maintain national pay bargaining.

No. they are all members of the NUM

6.2 While it might be difficult to break up the NCB, it might be worth moving further towards regionally differentiated pay. Already there is a modest gap between earnings in the most and least productive pits. Could we move closer to a position where pay reflected productivity - providing some further incentive to movement from low to high productivity pits, and eventually lowering resistance to the closure of uneconomic pits?

6.3 Whether or not pay is varied, would breaking down the single pricing policy offer a way forward to greater competition between pits or regions?

7. SUMMARY OF QUESTIONS

7.1 (1) Should we be aiming for more than 5-6 weeks' endurance this winter?

(2) If so, who should pay for it - consumers or taxpayers?

(3) Could increased use of alternative fuels plus coal imports during an overtime ban provide longer endurance than previously - if the Employment Act makes some difference?

(4) Should we draw the attention of the public and the miners to the cost of the insurance policy?

(5) Should we explain to miners that a strike and overtime ban would cost them at least £1,500 each, or should we ensure it is more - eg £2,000?

(6) Would the effectiveness of the deterrent be increased by letting it be known that the Government is quite prepared to face a strike - even though it would be a "negative sum game"?

(7) Would the ability to vary imports from zero to 20% be a restraining factor in miners' demands?

(8) Should we re-examine the cost for a new import facility on Humberside? Are there other measures which could increase our capacity to import, sooner?

(9) How much impact is raising the maximum size for private coal mines likely to have?

(10) Could Energy examine the scope for a change in NCB's structure to force more internal competition? Perhaps a first step would be greater variation in wages or a differential pricing policy?

cc Mr Hodgson

2pps

Prime Minister

To note: Mr Howell and the Chancellor (Flag B) are in favour of BGC's reducing its retailing function (or stopping it altogether). There will be a paper (to E?) in the autumn.

MS,

PRIME MINISTER

Flag A The Secretary of State for Trade sent to you a minute on 14 July about the Report of the Monopolies and Mergers Commission on gas appliances which is to be published next week.

The dominant position of British Gas in the retail appliance market has been of concern to me for some time but I had delayed putting forward proposals until the MMC Report became available. One of the alternative recommendations of the Report is that BGC should cease to retail appliances. Such a radical proposal undoubtedly has its attractions though I gather that the Director General of Fair Trading has advised Sally Oppenheim of his doubts about this route. We shall obviously need to consider all the possible courses of action open to us - not only those mentioned in the Report - and their implications before settling our policy.

I hope that John Nott and I may be able to put a joint paper on this to you and our colleagues in the autumn once we have had an opportunity to consider the implications of the Report properly.

I am copying this minute to Members of E, E(DL) and to Sir Robert Armstrong.

DA

Secretary of State for Energy

25 July 1980

cc. A. Duguid.

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

PUBLIC PARTICIPATION IN BRITISH GAS

I have seen John Nott's minute to you of 14 July, discussing the Monopolies and Mergers Commission report on the Supply of Certain Domestic Gas Appliances.

2. There is much to think about in the MMC report, which makes out a strong case for concluding that BGC should leave the retailing sector. If that does turn out to be our final view, we could all welcome this reduction in the public sector and the sales proceeds which I hope would arise from disposing of retail sites.

3. However, it is clear that John Nott's and David Howell's Departments will have some work to do before coming to a final conclusion, and it seems inconceivable that any significant proceeds could arise this financial year. There can therefore be no let-up in the pursuit of BGC disposals bringing proceeds this year, as outlined in Keith Joseph's minute of 26 June.

4. I am copying this minute to members of E, E(DL) and to Sir Robert Armstrong.

(G.H.)

24 July 1980

CONFIDENTIAL

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon David Howell MP
Secretary of State
Department of Energy
Thames House South
Millbank
London SW1

24 July 1980

Dear David,

CEGB WINTER FUEL STOCKS AND THE NCB

My minute of 15 July to the Prime Minister on contingency fuel stocks mentioned that you would shortly be putting a paper to E Committee on the electricity supply industry's(ESI)stock position and their EFL. I understand that you are proposing to circulate a paper for a discussion next week, in which you say that there is a risk that the ESI will overshoot their EFL unless they cut back on stock building for the coming winter.

This is the first indication we will have had that the ESI could be in serious difficulty with its EFL. I understand from my officials that it coincides with news that the NCB expect to put more coal to stock this year than planned putting their EFL at risk by £100 million or more. It is clear that anything the CEGB do to reduce stocks to help them stay within their EFL will directly affect the NCB. I do not therefore think we can sensibly discuss either industry in isolation. We need to know the full extent of the threat for both industries, and the scope for off-setting action by each. I therefore think it will be desirable to postpone the discussion of the electricity industry's stocks and EFL until you can bring forward a parallel paper on the position of the NCB. I realise that this will mean deferring the discussion in E Committee until the week after next. But as the news concerning the NCB is so recent, I do not think there is any alternative. The industries may need to act quickly if the substantial claim on the contingency reserve this year is to be avoided. This issue therefore cannot wait until the autumn.

I am sending copies of this letter to members of E Committee, the Secretaries of State for Scotland and Wales and to Sir Robert Armstrong and Robin Ibbs.

John Biffen

JOHN BIFFEN

CONFIDENTIAL

25 JUL 1980

CONFIDENTIAL

E

HO Nat Ind
FCO
HMT
DOI
Ld. Pres.
D/EMP

FILE

10 DOWNING STREET

From the Private Secretary

16 July 1980

MAFF
DOT
D/ENERGY
(CSO, HMT)
+ SO
CO

DSG

CONTINGENCY FUEL STOCKS

The Prime Minister has read the Chief Secretary's minute of 15 July and agrees that there would be no point in proceeding with the idea of financing fuel stocks held by the electricity supply industry separately from the industry's external financing limit. She has noted that the Secretary of State for Energy will shortly be putting forward a paper to E Committee on the fuel stock position.

I am sending copies of this letter to the Private Secretaries to the members of E Committee, to Godfrey Robson (Scottish Office) and David Wright (Cabinet Office).

T. P. LANKESTER

Alastair Pirie, Esq.,
Chief Secretary's Office,
H.M. Treasury.

CONFIDENTIAL

Prime Minister 1

Agree that we should not finance coal stocks separately from the EFL? (The arguments against seem overwhelming.) On the size of fuel stocks, Mr Howell will be bringing forward a paper. But it is worth remembering that it would be pointless (and costly) to build up stocks if we have decided we can't take the miners on anyway.

TL 15/7

Yes

MT

cc Mr Hoskyns
Mr Wolfson

CHIEF SECRETARY TO THE TREASURY

PRIME MINISTER

CONTINGENCY FUEL STOCKS

E Committee invited me, in consultation with the Secretary of State for Energy, to consider whether fuel stocks held by the electricity supply industry for contingency purposes could and should be financed separately from the industry's external financing limit (E(80) 8th Meeting, Item 3). Uncertainties on the EFL position this year have delayed a reply.

We think that it would be possible to devise a scheme whereby contingency stocks could be financed separately from the industry's external financing limit. But there could be considerable problems with such a scheme. It would draw attention to the contingency stocks and could provoke the miners and stimulate the power workers to black the stocks concerned. Moreover, financing contingency stocks separately from the EFL would almost certainly increase public expenditure since the industries would no longer be under pressure to make savings elsewhere to compensate for any higher stocks. And perhaps most important of all, the exemption of such a major part of the electricity supply industry's cash requirements form the control of the EFL system would be inconsistent with our policy on EFLs generally. Once special arrangements had been conceded for the EFL of the electricity supply industry, we would be under intense pressure to agree to similar arrangements for the other nationalised industries. If the scheme was applied to the NCB which is now running into a period when production will be in excess of demand, it could reduce the incentive to close uneconomic capacity. Thus, a scheme to insulate the EFL of the electricity supply industry from variations in stock levels would raise the issues which are now being considered in the Ministerial Group E(NF) under the Chancellor of the Exchequer.

It would, of course, be possible, if we took a policy decision to that effect, simply to increase the industry's EFL so that it could build up a special coal stock for contingency purposes above the stock level it would normally plan to hold. But the problem here is finance. The electricity supply industry's EFL for 1980-81 is likely to imply a winter endurance for the CEGB of some 5-6 weeks assuming average weather. We decided when we discussed the industry's EFL in E Committee that in formulating proposals for further savings in 1980-81 that they should not seek savings by reducing their fuel stocks. David Howell is discussing the fuel stock position with the industry and is proposing to put a paper to E Committee shortly setting out the position on the most up to date information available. To extend endurance by two weeks (or more if electricity demand was restricted) would give rise to an initial cost of some £140 million in 1980 survey prices (in the year the stocks were built up) with storage and interest costs perhaps amounting to £25 million a year thereafter (with perhaps increased working capital requirements for the industry as coal prices rise).

?

These extra costs could be financed by higher electricity tariffs. But a 1 per cent increase in tariffs raises only some £70 million in the full 12 months following the increase and there are already significant tariff increases in prospect for the year - 17% in April and 10% in August. If not financed from tariffs and compensating savings were unavoidable, the costs would represent a substantial claim on the Contingency Reserve. Some 4 million tonnes of extra coal would cost some £140 million in 1980 Survey prices and would represent almost one-eighth of the Reserve.

So to sum up, our conclusion is firmly against special financing arrangements outside EFLs for contingency coal stocks at this stage. The financing of adequate stocks should be a normal responsibility of the industry for which the consumer pays. Beyond that, it would be possible to raise the industry's EFL if we were to take a policy decision that the industry should hold stocks at a higher level than it would normally. But such a decision would pre-empt about one-eighth of the Contingency Reserve as originally constituted and more now that some claims on the Reserve have had to be accepted. You are already aware of our great difficulties with the Contingency Reserve this year. I would see very considerable problems with this course. David Howell tells me that he cannot at this stage exclude the possibility that the fuel stocks which the industry can provide for within the terms of the proposed tariff increases and the EFL may not constitute adequate endurance for the winter. He is of course continuing to encourage the industry to hold adequate stocks while remaining within the EFL.

I am sending copies of this minute to members of E Committee, the Secretary of State for Scotland and to Sir Robert Armstrong.

WJB

JOHN BIFFEN
15 July 1980

2

Prime Minister

You will want to see other Ministers' comments on the proposal at X.

PRIME MINISTER

PUBLIC PARTICIPATION IN BRITISH GAS

I have seen a copy of the Secretary of State for Industry's minute to you of 26 June reporting the discussion in E(DL) on the possibility of obtaining a contribution from the British Gas Corporation towards the target for public sector disposals.

In this context you may be interested to learn of the very interesting Monopolies and Mergers Commission Report on the Supply of Certain Domestic Gas Appliances, which is due to be published shortly. The monopoly enjoyed by the British Gas Corporation in cookers, space heaters and water heaters was found to operate against the public interest, and the more radical of the Report's main alternative recommendations is that BGC should cease to retail these gas appliances. If that were acted on it would probably mean that they would leave retailing altogether and probably divest themselves of a good many of their retail gas appliance outlets.

The Government have yet to decide on action on the Report's findings. The Commission's recommendations will be controversial; and there can be expected to be public debate on them. But, subject to the necessary consultations, both Sally Oppenheim and I tend to favour the

X recommendation that the BGC should leave retailing. True, the mechanics of any transfer have still to be worked out, and it is unlikely to be an immediate step. It would probably need to be phased. But, over a period, it would allow private sector outlets to expand their operations with a concomitant reduction in the number of BGC outlets. To the extent that these outlets were sold, there could be a worthwhile reduction to the PSBR.

I am copying this minute to Members of E, E(DL) and to Sir Robert Armstrong.

Department of Trade
1 Victoria Street
Lodnon, SW1H OET

J N

14 July 1980

Nat Ind

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon David Howell MP
Secretary of State
Department of Energy
Thames House South
Millbank
London SW1

PL
8/7

9 July 1980

Dear David,

BGC: EXTERNAL FINANCING LIMIT 1980-81

Thank you for your letter of 7 July in which you report the action BGC intend to take to deal with the prospective excess of £110 million in their EFL.

I would much prefer that BGC would have identified the £30 million 'unspecified savings' since this would give a greater confidence that the savings will actually be made. But in the circumstances I am prepared to accept the Corporation's assurances about their plans to work within the EFL of minus £400 million.

I entirely agree that our acceptance of the Corporation's assurances must be on the basis that they must give us the maximum possible warning if they see themselves being further blown off course. This is essential. The recent reduction by the CEGB in their demand forecasts shows the effects of lower economic activity on that industry and similar factors could be affecting gas sales. It is therefore most important that there is the closest monitoring of the industry's EFL.

I agree that our officials should consider BGC's plans to secure the so-far unidentified £30 million saving when BGC submit their next monthly statement.

I am sending a copy of this letter to the Prime Minister and to Members of E Committee, the Secretary of State for Scotland and Sir Robert Armstrong.

Yours
John Biffen

JOHN BIFFEN

Nat Ind

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

01 211 6402

R 7/7

The Rt Hon John Biffen MP
Chief Secretary to the Treasury
Treasury Chambers

7 July 1980

Dear John

BGC: EXTERNAL FINANCING LIMIT 1980-81

not copied to us. - will request if req'd.

I have delayed replying to your letter of 27 May until the position regarding the British Gas Corporation's EFL had become clearer. As you were aware, in March BGC foresaw an excess over their EFL of £110m. During initial discussions the Corporation agreed that £25m might be cut from their capital programme. More recently, following my meeting with the Deputy Chairman, they have agreed to make further cuts in capital and revenue expenditure to the tune of £25m.

They have also decided to increase contract renewal prices by 2 to 3 p a therm above the levels previously proposed (eg 26p/therm at present); implemented by quarterly escalation from September. This will bring in £30m this year. Although gas prices to industry after these increases will still be significantly below the price of the comparable oil products, British Gas observe that there could be further adverse reaction from industry, not to mention public sector bodies operating within tight cash limits.

This leaves a balance of £30m to be found though where this is to come from is not yet clear. The Corporation have, nevertheless, undertaken to use their best endeavours to reach the figure of minus £400m (the EFL as set). In their judgement they stand a good chance of hitting the target, in the absence of further adverse shifts. Our understanding is that BGC will in fact be budgeting to a bottom line of minus £400m.

I think we can accept the Corporation's assurances, on the basis that they must give us the maximum possible warning if they see themselves being further blown off course. We should be able to see how they plan to find the remaining £30m when we received their next monthly statement. Our officials can pursue this in detail, as necessary.

In the circumstances I suggest we should now regard the BGC position as having been satisfactorily resolved.

I am sending a copy of this letter to the Prime Minister and the other recipients of your letter.

Yours ever

David

D A R Howell

Nat Inds.

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

01 211 6402

12 May 5

The Rt Hon John Nott MP
Secretary of State for Trade
1 Victoria Street
London SW1

15 May 1980

Dear John

ELECTRICITY (ENGLAND AND WALES): REFERENCE TO THE MMC

Various comments have been made on the draft note attached to my letter to you of 7 May, setting out my proposals for referring the efficiency and cost control of the CEGB to the MMC. We are, I believe, agreed that this reference be confined to CEGB as the industry's major cost centre.

I entirely agree with Geoffrey Howe on the need to ensure that all the Board's costs are included in the investigation and that the effectiveness of the cost control systems rather than the systems themselves is of prime importance. I also agree that the terms of reference should enable the MMC to examine labour productivity.

I can also accept Robin Ibbs' suggested amendment. I did, of course, insert "project control" in my original draft with power station construction in mind.

The attached terms of reference, prepared in your Department accommodate these points. (I am advised that the revision of the second paragraph of the preamble will enable the MMC to consider labour productivity.)

Now that the reference has been announced I am sure that we should press ahead with communicating these terms to the CEGB. We shall, of course, need to consider any comments the Board may have before the terms are formally announced.

I am sending a copy of this letter to the Prime Minister, members of E Committee and Sir Robert Armstrong.

Yours ever

David

D A R Howell

The Secretary of State, in exercise of his powers under section 11(1)(a) of the Competition Act 1980, hereby refers to the Monopolies and Mergers Commission the questions set out below relating to the efficiency and costs of the Central Electricity Generating Board in operating its system for the generation and supply of electricity in bulk.

The Commission shall upon this reference investigate and report on the question whether, in operating the said system, the Board could, without reducing the standard of service provided, improve its efficiency, so as to be able to reduce its costs or mitigate the effect of any increases in its costs, with particular reference to -

(a) its internal cost control and project control systems,

(b) its management information systems,

(c) its purchasing policies and methods of stock control,

(d) its management of plant maintenance and the effect of programmes for plant maintenance on plant availability,

(e) the planning and appraisal of new investment, and its ability to carry out its proposals for such investment within the cost and the time estimated;

and on the question whether, in relation to any matter falling within the question set out above, the Board is pursuing a course of conduct which operates against the public interest.

The Commission shall report on this reference within a period of six months beginning with the date hereof.

Nat Ind.

2 Pl's

R

13/8

01 211 6402

The Rt Hon John Biffen MP
Chief Secretary to the Treasury
H M Treasury
Parliament Street
London
SW1

13 May 1980

Dear John

ELECTRICITY (ENGLAND AND WALES) EFL 1980-81

When we discussed this at E Committee on 24 April, mention was made of the desirability of bringing forward the proposed 10% tariff increase to July; it was pointed out however that this might well not be possible, because of the need for discussion with Consultative Councils. I should record that when I took the matter up with Sir Francis Tombs, he confirmed that an increase before August would not be practicable.

I am sending copies of this letter to E Committee colleagues and to George Younger.

Yours ever

David

D A R HOWELL

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

13 May 1980

The Rt. Hon. David Howell MP
Secretary of State for Energy

Dear David

ELECTRICITY (ENGLAND AND WALES): REFERENCE TO MMC

I have three comments on the proposed coverage of the MMC enquiry into the CEGB which were attached to your letter of 7 May to John Nott.

First, I think the reference correctly reflects our aim of ensuring that the Board operates efficiently so that its costs and hence its price increases are minimised consistent with financial targets and EFLs. Section 11 of the Competition Act 1980 explicitly excludes financial targets for the Commission's scope. We decided this so that the nationalised industry chairmen could not then accuse us of impeding them from meeting their financial targets set by the Government by the action of a statutory agency. The industries should be given no excuse for not meeting their financial targets in view of the vast sums of public expenditure involved.

Second, the reference asks the Commission to examine, among other matters:

> "Internal cost control systems including project control."

I suggest that this should be amended so as to make clear that our concern is not so much about techniques for controlling costs as about the effective control of the costs themselves. This point could be met by amending the passage so that it reads:

> "all the Board's costs, and the systems for controlling those costs, including the systems for project control."

I think it important to specify that all the Board's costs are to be examined by the Commission. I say this so that the Commission have the opportunity to consider labour productivity. Indeed there may be some references where we will need to direct the Commission to labour costs.

I am sending a copy of this letter to the Prime Minister, members of E Committee and Sir Robert Armstrong.

GEOFFREY HOWE

CONFIDENTIAL

cc/ A Duguid
Nat Ind

Caxton House Tothill Street London SW1H 9NA

Telephone Direct Line 01-213 6400

Switchboard 01-213 3000

Rt Hon David Howell MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
LONDON SW1

R 12/5

12 May 1980

Dear David

ELECTRICITY SUPPLY INDUSTRY : REFERENCE TO MMC

In your letter to John Nott of 7 May you proposed an early enquiry by the Monopolies and Mergers Commission into the efficiency of the electricity supply industry in England and Wales.

My only comment on this is that, if only because the coverage of the enquiry would include the CEGB's "internal cost control systems, including project control", it would be bound to go into the labour troubles that have beset the building of large power stations. It is perhaps no bad thing that this subject should be given an objective examination, with the results being made public, by an independent body, though there have of course been a number of earlier studies of general industrial relations problems affecting large sites. In any case, the more restricted problem of the laggers at the Isle of Grain site is I understand to be examined by the Commons Select Committee on Energy.

I am copying this letter to the Prime Minister, the other members of E Committee and Sir Robert Armstrong.

Yours

Jim

CONFIDENTIAL

CABINET OFFICE

Central Policy Review Staff

70 Whitehall, London SW1A 2AS Telephone 01-233 7765

From: J. R. Ibbs

Qa 05017

9 May 1980

Dear Secretary of State,

Electricity (England and Wales): Reference to MMC

May I offer one comment on your letter dated 7 May to the Secretary of State for Trade? Although I agree with the emphasis you place on directing the Commission to examine the CEGB's internal cost control and information systems, I do wonder whether the terms of reference as drafted ensure adequate examination of the performance in planning the investment programme and bringing new generating plant on line within budget and on time. In some respects this is the area of greatest weakness that was clearly revealed during recent meetings.

If you agree you may like to consider modifying item (v) of the terms of reference to read as follows:

> "(v) effectiveness in planning the capital investment programme, in capacity and financial terms, and performance in bringing new generating plant on line within budget and on time".

I am sending a copy of this letter to the Prime Minister, the other members of E Committee, and to Sir Robert Armstrong.

Yours sincerely,

J R Ibbs

The Rt Hon David Howell MP
Secretary of State for Energy
THAMES HOUSE SOUTH
S W 1

CONFIDENTIAL

cc A. Duguid

CONFIDENTIAL

DEPARTMENT OF TRADE
1 VICTORIA STREET
LONDON SW1H OET

TELEPHONE DIRECT LINE 01 215 5662
SWITCHBOARD 01 215 7877

From the
Minister of State
for Consumer Affairs

The Rt Hon Sally Oppenheim MP

The Rt Hon David Howell MP
Secretary of State for Energy
Thames House South
Millbank
London SW1

9 May 1980

Dear Secretary of State,

ELECTRICITY (ENGLAND AND WALES) REFERENCE TO MMC

Thank you for your letter of 7 May, to which I am replying in John Nott's absence abroad.

My overall concern is that the proposed inquiry should remain a six month efficiency audit and should not include matters of major policy which the Commission will be unable to consider properly in the time available. Subject to that caveat, I am broadly content with the terms of reference you suggest. They will obviously require some legal redrafting before they can be sent to the Commission. They may also require some amendment in the light of any comments from the CEGB or the Electricity Consumers Council, whom I propose should be consulted urgently, as soon as the reference is announced in principle.

In view of John Nott's responsibilities under the Competition Act, I think it would be appropriate if I made the formal announcement about the intended reference. I therefore propose to issue a press notice on Monday morning (if necessary embargoed until the afternoon). You will be able to draw on my announcement during the debate on gas and electricity prices. I enclose a copy of the press notice which has been agreed with your officials.

The decision to refer the CEGB to the MMC now means that the proposed reference of the Severn-Trent Water Authority (and two private water companies) will have to be postponed until later this year. However, I do not think that this need cause any major problems.

I am copying this letter to the Prime Minister, to members of E Committee and to Sir Robert Armstrong.

Yours sincerely,

Peter McCarthy

for SALLY OPPENHEIM (approved by the Minister and signed in her absence)

CONFIDENTIAL

PRESS NOTICE: MMC TO LOOK AT CEGB'S COSTS AND EFFICIENCY

Mrs Sally Oppenheim, Minister of State for Consumer Affairs today announced that the Monopolies & Mergers Commission is to investigate the efficiency and costs of the Central Electricity Generating Board.

Making the announcement, Mrs Oppenheim said:-

"The cost of electricity supplied in bulk to area boards by the CEGB is a very large element in the final bill to the consumer, which has risen substantially in recent years. It is important to establish that everything possible is being done by the CEGB to absorb costs and to increase efficiency in order to keep prices as low as possible.

The terms of reference will be announced shortly."

NOTES FOR EDITORS

1 Section 11 of the Competition Act enables the Secretary of State to refer to the Monopolies & Mergers Commission questions about the efficiency and costs of, the service provided by, and the possible abuse of monopoly power by nationalised industries and other bodies (including water authorities) that posses a statutory national or local monopoly.

2 The Commission will be required to report back to the Secretary of State within six months, although it may ask for one extension of three months.

3 The Commission has already begun an investigation into British Rail's London and South East Commuter Services, referred to it under Section 11 of the Competition Act on 8 April 1980. It is due to report on this by 3 September 1980. It was announced on 29 April that the Commission is also to be required to investigate the Severn-Trent Water Authority and two private water companies.

-9 MAY 1980

Prime Minister 2

For announcement on Monday. Mr Oppenheim will also announce the reference to the Monopolies Commission on Monday - which should help a little. (Also see Neville Gaffin's note at Flag A). The Press Statement is at Flag B.

TL 9/5

01 211 6402

R E S Prescott Esq
Privy Council Office
Whitehall
LONDON SW1A 2AT

9 May 1980

Dear Richard,

ELECTRICITY PRICES

Ministers accepted at E Committee on 24 April (E(80)14th) that the second phased electricity price increase in 1980/81 would average 10% and would take effect from 1 August. (Mr Howell tried to get it brought forward to July as agreed at E; but this proved impossible) TL

Area Electricity Boards are starting the required statutory consultations with their Consultative Councils on Monday 12 May. North Eastern Consultative Council which meets in public with the press invited will consider its Board's proposals on that date. The details are therefore likely to be made public.

I attach a brief the Paymaster General may wish to circulate to Ministers setting out the background and a line to take in response to the points most likely to be made in any media comment.

We are still uncertain whether or not the Electricity Council will issue a statement on Monday covering these proposals in general terms, and the reasons for them and announcing that the process of consultation by Area Boards with their Consultative Council is now beginning. This, if issued, could forestall repeated press comment and speculation from further leaks that may be made as the consultative process proceeds over the next few weeks. If the Council decides to issue a statement, I shall send you a copy as soon as it is available.

I am copying this letter and its attachment ~~as~~ to Nick Sanders at No. 10.

Yours sincerely,

Denis Walker

~~Denis Walker~~
Private Secretary

ELECTRICITY PRICES

The Secretary of State for Energy announced on 16 January, (in the context of his statement on financial targets for the gas and electricity industries) that the Government had asked the industries to phase this year's increases in two stages, one in April and another in October.

2 The first stage electricity price increase (averaging 17%) was announced by Area Electricity Boards in March, and took effect from 1 April. The second stage (an increase averaging 10% from 1 August)* is not likely to be <u>formally</u> announced until mid July and must first be subject to statutory consultation by the twelve Area Boards with their Consultative Councils.

3 This consultation process will be spread over a period of weeks; it starts on Monday, 12 May, when the North Eastern Board meets its Consultative Council. This is one of a small minority of Council's that holds its meetings in public with the Press invited. Details of the size and timing of the proposed increase are, therefore, likely to be made public.

4 The proposals may well be criticised because they take effect earlier (August <u>not</u> October). It may also be claimed that they are larger than anticipated. (No figure for the second increase has, however, been formally published. The size of the second increase was, of course, always dependent on movements in the industry's costs. There were, however, press reports (in January/February) based on informal discussions between some of the Boards and their Consultative Councils that the second increase might be of the

*but first payable by domestic consumers in November order of 5%: and this was indeed the industry's assumption at the beginning of the year).

5 The second stage electricity price increase is larger and earlier than anticipated mostly because its industry has to meet larger than expected adverse effects in its costs from:

(i) fuel prices

(ii) higher wage and other costs (including LA rates)

Its revenues have also suffered from reduced sales.

LINE TO TAKE

6 Detailed tariff increases are a matter for the industry. The Government asked the industry to phase the increase in two stages. It has always been made clear that the size of the second increase would depend on movement in the industry's costs.

7 The industry's costs have recently increased substantially - notably the coal price increase in February was higher than anticipated and crude oil prices rose by over 100% in 1979. Fuel now accounts for half the final price of electricity.

8 The Government does not accept that cost increases should automatically be passed on to consumers in higher prices. This risks creating a vicious circle of rising prices and falling demand. The industry recognises this and is continuing to cut its costs.

?

[9 (Confidential until announced - probably on Monday) The Government has decided to refer the industry's major cost centre - the Central Electricity Generating Board - to the

Monopolies and Mergers Commission under the Competition Act for an early inquiry into its efficiency with particular reference to cost control. The detailed terms of reference will be announced shortly.]

10 The Government believes in realistic energy pricing. Energy is a scarce and finite commodity. It would be a short term folly to allow it to be underpriced. Unpopular though it is, electricity prices will have to continue to reflect real costs of production. Realistic pricing is essential if we are to make the best use of our energy resources and avoid bringing forward the time when we have to turn to even more expensive and less secure alternative sources.

11 At the same time the Government is urging the industry vigorously to pursue economies [and the MMC reference is designed to check on the effectiveness of its cost control.]

12 The Government has also recognised that a realistic approach to energy pricing must go hand in glove with effective measures to help those who are hardest hit, and least able to help themselves. A package of measures of help have already been announced for next winter, (the attached statement by the Secretary of State for Energy on 27 March, can be drawn on for details).

DEPARTMENT OF ENERGY

Thames House South, Millbank, London SW1P 4QJ. Telephone: 01-211 3000
Press Office Direct Line: 01-211 4545 (10 lines) (Out of hours: 01-215 7877)

Mr Pash

Reference No 63

March 27, 1980

PRESS NOTICE

FUEL PRICES AND ASSISTANCE TO POOR CONSUMERS

Commenting in London today, Thursday, March 27 1980 on Mr Patrick Jenkin's, Secretary of State for Social Services, announcement of the Government's new measures to help poor consumers with their fuel costs, Mr David Howell, Secretary of State for Energy said:

"Today's announcement by Mr Jenkin fulfills the Government's commitment to provide extra help for poor consumers with their fuel costs, which I promised at the time of my statement on financial targets for the gas and electricity industries on 16 January.

"The Government has always recognised that a realistic approach to energy pricing must be accompanied by effective measures to help those hardest hit. The two go hand in hand. Realistic energy pricing is essential if we are to make the best use of our energy resources and avoid bringing forward the time when we have to turn to even more expensive and less secure alternatives. It is in everyone's longer term interests - indeed, in a world of rising energy costs, there is really no alternative.

"But at the same time, the Government has always recognised that energy price increases bear hardest on elderly and poor households. We have accepted our responsibility to develop social policies which respond to these pressures. We made a start last October and introduced a new scheme which has operated this winter, providing worthwhile sums to those groups likely to be in most need.

"For next winter, we accept that the rises in prospect for all fuel prices have to be taken into account - as on 16 January I promised they would - in our social policies. The package of measures Patrick Jenkin has today announced develops and considerably expands the approach we initiated last winter. We have aimed to tackle the problems across a broad front, including both worthwhile cash help with fuel costs and extra help with insulation for those at present not able to afford to invest in energy saving.

"Patrick Jenkin has given full details of the new package. In summary, there are five elements:

- First, the extra heating additions - available under the supplementary benefits system for those with particular heating needs including the elderly, the disabled and the housebound - will be given a special boost. The additions, received by some $1\frac{1}{2}$ million poor people, will be worth from £72.80 to £176.80 a year, once the new rates come in, in November.

- Second, the entitlement to a heating addition, at the new standard rate of £1.40 per week, will be automatic from November for supplementary pensioner householders over 70. Last year's scheme gave automatic entitlement to the over 75s; extension to the over 70s next November further reflects the Government's special concern for the heating needs of the elderly.

- Third, automatic entitlement to a heating addition is retained for supplementary benefit householders with children under 5. This continues the approach adopted last winter, and ensures that such families with young children gain from the special boost to the additions.

- Fourth, a special addition of £1 per week from November, on top of the £1 already added for fuel this winter, for those on Family Income Supplement, to help poor working families.

- Fifth, help with home insulation. As announced by Mr John Stanley, Minister for Housing and Construction today, extra provision has been made to make 90% grants up to a maximum of £70 available under the Homes Insulation Scheme for poor pensioners (those on Supplementary Benefit or in receipt of housing allowances). Because this will reduce the share of insulation costs to be borne by the poor pensioner, in many cases to a very modest level, this measure will increase the numbers of those able to benefit from the scheme through lower heating bills or better standards of warmth.

"The Government are also examining the prospect of other ways of helping the old and disabled with insulation improvement , for example, involving the voluntary bodies.

"Overall, the package will provide a generous amount of help next winter to some 2 million people. It also provides the basis of protection against future fuel price increases, and so will complement the longer term approach of our pricing policy for the gas and electricity industries. This year's special boost to heating additions will create a generous basis for future upratings, in line with energy prices.

"The Government also recognises the role the fuel industries can and must play in responding sensitively to the needs of poor consumers, while at the same time having regard to their wider responsibilities to all their customers. The industries already operate a variety of easy payments methods to help spread the burden of high winter bills. With my encouragement they have been considering the development and extension of these schemes and, as recently announced, are negotiating with the National Federation of Sub-Postmasters for the sale of their stamps through sub-post offices. Success of these negotiations would greatly extend the number of outlets through which consumers could buy these stamps and I hope this welcome development will prove possible.

"I believe that these measures offer a well rounded and effective arrangement. They demonstrate the Government's intention to combine realism in energy pricing policy with full acceptance of the responsibility to protect those least able to protect themselves."

MR. INGHAM

Electricity Prices

The attached papers about the next electricity price increase.

The essential problem is that prices will go up at an average of 10 per cent from 1 August rather than an expected 5 per cent in October. The news could start oozing out from next Monday, 12 May, when the first regional board (North East) meets its Consumer Council.

D/Energy is well geared up. Presentational elements likely to include:

I. Statement from Electricy Council on 12 May explaining why increase necessary;

II. D/Energy to announce that gas and electricity savings stamps will from now on be available from sub post offices (as well as show-rooms).

III. D/Trade announcemnt of Monopolies Commission's reference to look at CEGB costs;

IV. D/Energy Minister to speak in H/C on Private Member's Motion about fuel prices (thus giving opportunity to elaborate the whole of the defensive argument);

V. D/Energy is providing PMG with draft defensive speaking note.

D/Energy will also explore possibility of co-ordinating counter-attacks by backbenchers as each regional board meets its consultative council; and repeting the counter-attack exercise when the new tariffs are advertised in local and regional papers later.

NG

9 May, 1980

NEVILLE GAFFIN

Tel: 211 6402

R E Prescott Esq
Private Secretary to the
Paymaster General
Privy Council Office
Whitehall
London SW1A 2AT

9 May 1980

Dear Richard,

ELECTRICITY PRICES

Further to my letter to you earlier today on electricity prices, I am now attaching a copy of the statement which the Electricity Council will be making on Monday.

I am also copying this letter with its attachment to Nick Sanders at No 10.

Yours ever,

Denis

Denis Walker
Private Secretary

PRESS STATEMENT - FOR ISSUE AT 12 NOON ON 12 MAY

Earlier this year it was announced that the Area Electricity Boards would arrange the increases in electricity prices that are needed this year in two stages: a 17% increase from 1 April with a further increase, possibly in October. Since costs are somewhat higher than anticipated earlier the Area Electricity Boards are considering increases in electricity tariffs in August. They will soon be discussing their proposals with the Area Electricity Consultative Councils. The tariff increases are likely to vary from Board to Board, but the national average increases will be about 10 per cent (including the expected effect of fuel cost adjustment which applies to monthly tariffs - applicable to larger industrial and commercial consumers).

The industry very much regrets the need for these increases, the main reason for which is the continuing rise in the cost of fuel used to generate electricity, which accounts for about half of the industry's total costs. During the last financial year, oil doubled in price and coal prices increased by 35 per cent. This means that substantial increases in electricity prices are required in 1980/81.

As well as the increased fuel costs, other costs such as capital charges, salaries, goods and services have risen in spite of very real economy efforts. The industry also has to have regard to the financial target agreed with the Government and to the need to keep within its borrowing limit for 1980/81.

On the basis of a 10 per cent increase in tariffs, the national average price for a unit of electricity from meter readings after

1 August will be 4.2 (domestic) and 3.0p (industrial). Domestic Economy 7 prices per unit, day rate, would be 4.5 and it is expected that the night rate, which is closely-related to fuel costs, will be 1.69p.

Mr. Peter Rees: My right hon. Friend will be aware that the valuation officer is required by law to arrive at rating assessments in accordance with the relevant statutory provisions. It would not be appropriate for me to give him guidance as to how he should carry out these duties.

School Journey Costs (Value Added Tax)

Mr. Freud asked the Chancellor of the Exchequer whether a school journey to a youth hostel is or is not eligible for value added tax refund.

Mr. Peter Rees: I shall let the hon. Member have a reply as soon as possible.

Short-term Bonds

Mr. Chapman asked the Chancellor of the Exchequer, further to his Budget Statement, *Official Report,* 26 March, column 1481, whether a short-term bond proposal accepted by letter from an insurance company dated 25 March 1980 will be affected by the new life assurance premium proposals.

Mr. Peter Rees: I shall let my hon. Friend have a reply as soon as possible.

Coinage (Designation)

Mr. Wheeler asked the Chancellor of the Exchequer if, pursuant to his answer to the hon. Member of 24 May 1979, he has now had time to prepare the necessary legislation for the removal of the word "new" from the coinage as recommended in the report "Decimal Currency in the United Kingdom", Cmnd. 3164, 1966, paragraph 20.

Mr. Lawson: The necessary legislation will be introduced as soon as the parliamentary timetable permits.

British Gas Corporation

Mr. Skeet asked the Chancellor of the Exchequer why he decided not to impose a windfall profits tax on the future earnings of the British Gas Corporation; and if he will make a statement.

Mr. David Howell: The Government have decided in principle to impose a levy on the British Gas Corporation in respect of gas purchased from the United Kingdom continental shelf, and sold to the corporation under contracts not subject to petroleum revenue tax (PRT). The corporation's financial target set for three years will be modified to compensate for it. The North Sea gas levy will therefore have no effect on gas prices during the target period.

This will mean that some of the financial benefits which would otherwise accrue to the corporation will be permanently transferred to the benefit of the nation as a whole.

Legislation will be required and this will be introduced as soon as possible.

INDUSTRY

Mr. Ian MacGregor

Mr. Dobson asked the Secretary of State for Industry (1) how much is to be paid to Russell Reynolds for helping recruit Mr. Ian MacGregor; and who will pay it;

(2) whether the payment or payments to Russell Reynolds for helping recruit Mr. Ian MacGregor will be related to his pay to the payments to be made to Lazard Frères, or to any other factors.

Sir Keith Joseph: Russell Reynolds Associates Inc. was engaged on standard terms, namely a fee calculated on the basis of a proportion of the first year's remuneration received by the new BSC chairman, if he was appointed with its assistance. Russell Reynolds is also being reimbursed for its expenses incurred during the search for a new chairman. The payments are made by the Department of Industry.

Mr. Dobson asked the Secretary of State for Industry how many people Russell Reynolds interviewed in the course of its efforts to recruit a new chairman of the British Steel Corporation.

Sir Keith Joseph: Russell Reynolds supplied a list of 31 people whom it had approached or considered for the BSC chairmanship.

Mr. Dobson asked the Secretary of State for Industry how many people Russell Reynolds recommended to him as possible candidates for chairmanship of the British Steel Corporation; and how many of them were British.

Sir Keith Joseph: Russell Reynolds presented seven possible candidates, of whom five were British.

Mr. Dobson a
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PRIME MINISTER

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THE PRICE OF FUEL

It is hoped that this brief will be of use to Members in the debate on the private member's motion on fuel prices on Monday 12th May 1980.

Contents

MT.

Conservative Research Dept.,
32 Smith Square, London SW1

LMR/STR
7.5.80

Background

The issues surrounding the rising price of fuel have been well-rehearsed over recent months. The fundamental case is that:

- in future energy will be increasingly hard to win. Prices must reflect long-term replacement cost.
- massive investment in gas, coal and electricity, and in the longer term in alternatives, is needed. This investment must be serviced, again putting pressure on prices.
- subsidies to the old and to poor families are necessary, and a continuing element in the Government's energy policy. Wider subsidies would simply bear heavily on taxation, public borrowing and general inflation, and discourage investment of money and effort on conservation.

Gas prices

The Price Commission report (June 1979) showed domestic gas to be 30% underpriced. The price had been falling in real terms under Labour (Govt. interference!) and extraction costs had been rising.

The new financial target of 9% pa. return on real assets (ave. for 3 years) implies a 10% pa. real price increase for domestic gas. (Recent estimates of a 130% increase over three years, made by the Southern Gas Consumers Council, conceal ridiculous assumptions on the level of future inflation).

The BGC would have preferred a 10% increase this year, but smaller increases in subsequent years. They accepted the Price Commission figure of 30% underpricing but felt that since this was a result of Labour's interference, the consumer should not have to catch up too quickly. The Government felt 3 years was a reasonable period for the adjustment, balancing the interests of the gas consumer on the one hand with those of the taxpayer on the other.

BGC does not make 'huge profits'. Domestic gas broke even in 1979-80 and would have moved into deficit thereafter, had the price remained unchanged. (Price Commission - June 1979). The 1979/80 profit derived exclusively from sales to industry at oil related prices.

In any case, BGC is a huge monopoly; it has £8 billion assets and the 1979/80 profit represented a return of less than 5% on these.

The new target (9% pa.) used to be of the order routinely achieved throughout British industry. Recently few companies can perform so well, but then BGC has the advantages of being a monopoly buyer and seller of gas.

Even after the three years period, gas will still be the cheapest fuel in the UK, and cheaper here than anywhere else in Europe.

BGC's profits go to the Exchequer, thereby relieving pressure on the PSBR and hence on the general level of inflation. At present BGC has first call on these funds. A levy is under consideration which would convert some of the surplus into general Exchequer revenue (without affecting prices).

Electricity prices

Electricity is a secondary fuel, and therefore prices are greatly influenced by the movement in oil and coal prices.

The target set for the industry is 1.8% pa. return on assets at current cost.

The implication is that, over the next three years, prices will rise by about 5% more than the industry's own costs.

Price increases announced in April 1980 relate entirely to increases in the cost of fuel bought by the industry. They had nothing to do with the abnormally low demand experienced last winter.

Falling demand does put pressure on prices in the short term - power stations still have to be maintained and repaired. However in the longer term consumers can only benefit from reduced demand;

a) their own bills are lower.
b) future overheads for the industry are lower.

There is no desire on the part of the Government to tamper with prices so that electricity competes more readily with gas. Each fuel is priced at a level consistent with the continuing cost of its supply.

Coal prices

The Government is investing heavily in new and highly productive coal capacity in order to keep future prices down. Further, the new Coal Bill would allow deferred payment of interest so that the cash-flow of the industry is not prejudiced before the investment starts to bring a return. This will help keep prices down.

The industry will, however, be required to operate within a sound financial framework. Grants to fund deficits are to be phased out over the next three years. This is entirely consistent with the Government's intention that consumers should pay the true price of the fuel they use.

Help with fuel bills

Worthwhile help has been concentrated on those recipients of supplementary benefit who have special heating needs (the old, the sick, and those with young children) and on the working poor (FIS recipients).

All supplementary benefit recipients over 70 now receive heating additions, and these have recently been increased. Levels paid are £1.40 per week (basic) and £3.40 at the higher level.

FIS was increased by £1 in November 1979, and a further £1 in November 1980, in order to keep pace with rising fuel costs.

Increased grants are now available to help poor pensioners with home insulation - they need only make a very modest contribution themselves to the cost.

We are spending £85 million on this package in 1980/81. Had we retained Labour's Electricity Discount Scheme the cost would have been only £50 million. Our scheme includes those using fuels other than electricity - they would largely have fallen outside Labour's scheme. Our scheme excludes housing allowance beneficiaries. This is a matter of priority. These are not the poorest section of the community. It is preferred to concentrate help where it is most needed.

Conservation

Increased efficiency in fuel use is essential, particularly in industry where price competitiveness is all-important. Realistic pricing is the key.

Since 1973, consumption of fuel has fallen only when real prices have been rising. In the 1975-8 period of Labour's 'Save it' campaign, real prices were falling and this prejudiced the success of the campaign. Consumption rose until prices again started to rise in the wake of the Iranian Revolution.

Price is one aspect of the Government's conservation policy. Expenditure on advice and information has been increased from £2½ million to £3¼ million this year, and the expected demand for home insulation grants (now available to tenants of local authorities and housing associations) will be met. £200 million was spent on home insulation last year. The Government will not duplicate the conservation programmes run by the energy supply industries; nor will it spend taxpayers' money helping those able to help themselves, to their own financial advantage. The commitment to conservation remains strong, and the programme is working.

In the last quarter of 1979, petrol consumption was down by 5%, as prices started to rise. Mr. John Moore, Under Secretary of State with responsibility for conservation, has pointed out that this success "baffles the critics who think that nothing can work unless it involves state spending and more officialdom". (1.4.80).

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2

Prime Minister

You will be glad to see that Energy are getting ahead with the CEGB reference to the Monopolies Commission. The terms of reference seem OK, but we can have Trade and Treasury to comment.

Trade have now replied to Mr Howell's letter - at flag A. TL 8/5

01 211 6402

Rt Hon John Nott MP
Secretary of State for Trade
1 Victoria St
LONDON SW1

7 May 1980

Dear John

ELECTRICITY (ENGLAND AND WALES): REFERENCE TO MMC

As requested at E(80)14th meeting I am consulting you on the terms of reference and coverage for an early MMC inquiry into the efficiency of the electricity supply industry in England and Wales, with particular reference to cost control.

In view of the fact that the majority of the industry's costs, and its major investment programmes, fall to generation I propose that the investigation be confined to the CEGB. (It is also relevant that the Area Electricity Boards were investigated in some detail by the Price Commission as recently as last year). I am particularly concerned to know whether the Board really are, as they assure me, achieving efficiency increases through absorbing cost increases wherever possible; and to have a general audit of the Board's managerial efficiency. To that end I propose, as you will see from the attached note, that the Commission should be specifically directed to examine the Board's internal cost control and information systems.

Under the first head I have specifically included project control in view of the very large expenditure involved in power station construction.

An investigation of purchasing and stocking policies will of course take the Commission into the area of strategic fuel stocking. This will need careful handling. But since fuel constitutes 60% of the Baord's costs I do not think it can reasonably be excluded from the scope of the inquiry. Plant maintenance and plant availability are obvious areas for investigation in view of the considerable financial benefits to be obtained from greater efficiency in fuel use. Finally, I should like the Commission to look at new investment, and in particular how scrupulously the Board appraises new projects, and the need for them. Under this heading I would envisage, for instance, inquiry into the adequacy of the Board's forecasting; and the extent to which it keeps abreast of technological developments, including load control.

I should be grateful for your early agreement, and that of colleagues, to the coverage I propose.

The twelve Area Boards will shortly start the statutory consultation with their respective Consultative Councils on the second tariff increase - due to be implemented on 1 August. The first such meeting is on 12 May. Publicity can be expected. Also on 12 May a Private Member's Motion on fuel price increases, disconnections and debt is due to be debated. Although the precise terms of reference may not be settled by then I should like to announce in general terms that we have decided to refer the industry's efficiency and cost control for inquiry by the MMC.

I am copying this letter to the Prime Minister, Members of E Committee and Sir R Armstrong.

Yours ever

David

D A R Howell

PROPOSED COVERAGE OF MMC INQUIRY INTO CEGB

To examine the efficiency of the CEGB in operating its generating and transmission system with particular reference to the action open to the Board to absorb increases in costs through increased efficiency and specifically to examine

(i) internal cost control systems, including project control;

(ii) management information systems;

(iii) purchasing policies and stock control;

(iv) plant maintenance and plant availability;

(v) the procedures used by the Board in planning and appraising new investments.

B/f for Hansard d 8/5

2

10 DOWNING STREET

Prime Minister

Mr Howell intends to announce the gas levy by Written Answer on Thursday. The draft incorporates amendments from the Chancellor and Mr St John Stevas: it seems O.K.

TL

6/5

CONFIDENTIAL

Hold.

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

01 211 6402

CF.

Prime Minister 2
~~This draft Written Answer seems alright. I think we can leave it to the Chancellor to clear.~~
T 29/4

cc Mr Ingham

Rt Hon Sir Geoffrey Howe QC MP
Treasury Chambers
Parliament Street
London
SW1P 3HE

MO

28th April 1980

Dear Geoffrey

GAS LEVY

It was agreed at 'E' Committee on 26th February that we should consult together about the announcement of the Government's intention to impose a levy on the purchase of PRT-exempt gas by BGC. I attach a draft accordingly.

The draft is deliberately brief, avoiding detail, which I think is consistent with an announcement in principle. My Department is working on the details of the levy on which I hope to consult you fairly soon ahead of discussions with BGC.

I would like to announce the levy as early as possible this week. There will be a background Press Notice which will stress in particular the point that the levy will have no effect on gas prices during the financial target period.

I am copying this letter to members of 'E' and Sir Robert Armstrong.

Yours ever

David

D A R Howell

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WRITTEN ANSWER

Q. TO ASK THE SECRETARY OF STATE FOR ENERGY WHETHER HE HAS REACHED A DECISION ABOUT A TAX OR LEVY ON THE BRITISH GAS CORPORATION?

A. The Government have decided in principle to impose a levy on the British Gas Corporation in respect of gas purchased from the United Kingdom Continental Shelf, and sold to the Corporation under contracts not subject to petroleum revenue tax (PRT). The Corporation's financial target will be modified accordingly to take account of it. The N. Sea gas levy will therefore have no effect on gas prices during the target period.

This will mean that some of the ~~profits~~ financial benefits which would otherwise accrue to the Corporation will be permanently transferred to the benefit of the nation as a whole.

Legislation will be required and this will be introduced ~~introduced next session~~ as soon as possible.

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Nat Inds

Ref. A02004

PRIME MINISTER

Electricity (England and Wales) EFL, 1980-81

(E(80) 34)

BACKGROUND

The External Financing Limit (EFL) for 1980-81 is £187 million. When this was set last November it was thought that it would involve domestic tariff increases of 17 per cent in April and 5 per cent in October. Since then costs have risen substantially, and the possibility was floated of making the second price rise larger than 5 per cent and earlier than October - 10 per cent in July. You said that before agreeing to this increase you wished Mr. Howell to prepare a paper on all the options, including the possibility of reducing working capital requirements for stock-building.

2. On 17th April the Electricity Council decided that there should be an increase of 10 per cent in August together with capital investment cuts and other cost savings. This increase would first affect bills in November. The full RPI effects of 0.29 per cent would be reached in December.

3. The increases in costs since last November total £290 million - mainly higher fuel costs, higher salary settlements, and less sales revenue. This sum will be met by:

(i) £150 million yield from the 10 per cent tariff increase;

(ii) £52 million capital investment cuts; and

(iii) £88 million savings yet to be identified.

One element in the £88 million savings may be stocks (paragraph 5 of the paper). But Mr. Howell warns against significant reductions here. It would be risky to reduce stocks substantially. Any significant reduction could have an adverse effect on the NCB's financial position, as well as affecting endurance in times of difficulty.

4. Although this package should mean that the EFL can be held, it is not entirely satisfactory in terms of the financial target or, therefore, of public expenditure plans in later years. The financial target is to achieve a return on net assets, in current cost accounting terms, of an average of 1.8 per cent a year over the next three years. Achievement of this is assumed in the public expenditure projections to 1983-84; and any failure to meet it would, therefore, be a major setback in the effort to turn round the finances of the nationalised industries as a whole. As it is, even with the proposed increases, the CCA return in 1980-81 will be about 0.5 per cent compared with the 0.9 per cent desirable if the target is to be met over the period. Further substantial price increases, and cost savings, are likely to prove inevitable in later years.

5. If approved, the August increases will first become public knowledge in June. That is when the Electricity Council will be obliged to go to their Consumer Consultative Council.

HANDLING

6. You will wish to ask Mr. Howell to introduce his paper. Mr. Biffen could then comment on the public expenditure implications for the current and later years. I understand that he may wish to argue for advancing the increase to July (so getting another £40 million) with the objective of getting nearer to course for the financial target. The points to establish in subsequent discussion are:

(i) Are there any further practical options for 1980-81?

Because of the uncertainties of costs to, and sales by, the industry, an increase smaller than 10 per cent could well risk failure to meet the EFL. This would be a setback to public expenditure plans. Looking at the alternatives, you will wish to satisfy yourself on the proposed approach to stocks. This is, however, being examined further and may well contribute to the £88 million savings proposed. Little is said in the paper on disposals and this may be worth questioning. But in practice there may not be much in it. The industry owns spare land but needs to retain some of it as sites for future power stations. Sale of showrooms has often been considered. It could be looked at again if the Committee thought it worthwhile; but if changes were to be made they would probably not have effect this year. Capital investment has already been cut by £52 million. Anything more could lead to substantial nugatory expenditure, put the financial target at risk in later years, and also be damaging to the plant industry.

(ii) If the 10 per cent increase is approved can the £187 million EFL be held?

The Electricity Council have undertaken to make the necessary savings. However, they have yet to identify £88 million of them. You may wish to ask Mr. Howell to satisfy himself in, say, two months' time that they have produced firm proposals for these savings. Otherwise there is a risk that the package could burst too late in the year to do anything about it.

(iii) Should the 10 per cent increase be brought forward to July?

This would yield £40 million more and so make achievement of the EFL more certain. It would get the industry nearer to the path for their 3 year financial target, and so reinforce public expenditure objectives. But the Electricity Council themselves now favour August.

(iv) Should there be an inquiry into the efficiency of the industry?

The Committee may feel that, while there may be little option but to agree to the proposed price increase if the EFL for 1980-81 is to be held, they would like to see an in depth inquiry into the efficiency of this industry. One possibility would be a reference to the Monopolies and Mergers Commission. I suggest you do not take a firm decision on this at the meeting. Mr. Nott is considering the possible candidates for references to the Commission. If the Committee so wished, the electricity industry could be put on the list which, at a later stage, Mr. Nott could put to the Committee for consideration. It would then be possible to judge what priority should be given to an inquiry into electricity.

(v) Are there other longer-term measures to be considered?

One possibility might be to reintroduce the fuel cost adjustment clauses for domestic tariffs which were withdrawn in January 1979, but which still apply to industrial tariffs. These allowed for increases in coal and oil costs to be passed on automatically in quarterly bills. The advantage was that they were a flexible instrument for dealing with the major uncertain element in the costs to the industry (fuel accounts for over half of the industry's running costs); brought in extra revenue quickly and, because they were automatic, small and obscurely represented on customer's bills, did not attract the same odium as main tariff increases. On the other hand they were controversial and open to criticism as a means of passing on inflationary costs automatically. With two increases already scheduled for this year they probably offer little increased revenue in the short term, but they could be a helpful device for later years.

(vi) Are there any implications for the EFL regime generally?

The discussion may well lead to questions and proposals on the operation of EFLs for nationalised industries generally, and on financial targets. You will recall that you recently set up a Committee under the Chancellor to look at the financing of the nationalised industries (E(NF)). This Committee will be meeting shortly to discuss papers on the EFL system by the Treasury and the CPRS. You could, therefore, ask the Chancellor to ensure that E(NF) considers any new points raised in the present discussion. But any such points are likely to take time to resolve and should not be a reason for delaying decision on the electricity increase.

(vii) What are the implications for Scotland?

I understand that Mr. Younger now expects that an increase in the order of 10 per cent will be necessary for the Scottish industry in August. Because of this Mr. Howell's proposals are unlikely to be embarrassing to him. You will wish to ask him to report further when he has firm proposals for his industries. This will probably be in May.

CONCLUSIONS

7. Subject to the discussion, the Committee might be guided -

(i) either to approve now the proposed 10 per cent increase in August; or to invite Mr. Howell to raise any further proposals either on timing levels or other options with the Electricity Council urgently and to report back in sufficient time not to jeopardise the EFL, should a 10 per cent price increase in August prove to be an essential element in the package.

(ii) If the increases are approved, to invite Mr. Howell to satisfy himself in two months' time that the Electricity Council has formulated firm proposals for their proposed £88 million of additional cost savings.

(iii) If the Committee wants a longer-term investigation into the efficiency of the industry, to invite Mr. Nott to consider it as one of the candidates for a reference to the Monopolies Commission and to make further recommendations to the Committee.

(iv) To invite Sir Geoffrey Howe to take account, in the further work of the new Committee on the Financing of the Nationalised Industries (E(NF)), of any general points raised on the EFL system; and

(v) To invite Mr. Younger to report further when he has firm proposals for tariff increases by the Scottish industries.

RTA

(Robert Armstrong)

23rd April, 1980

Original returned to Mr Hoskyns

23 April 1980

PRIME MINISTER

ELECTRICITY INDUSTRY AND COAL STOCKS

1. E Committee will be discussing the EFL for the electricity industry on 24 April.

2. One element that we must not lose sight of is the risk of a miners' strike. In 1979/80, a large part of the electricity industry's overrun was the £161m they spent on providing extra coal and oil stocks against this contingency. (You may remember we discussed this briefly in the context of "Nationalised Industry Policy" the day after the Bournemouth speech.)

3. David Howell's paper (paragraph 5) anticipates that one way in which the industry will propose savings is likely to be a reduction in stocks. Coal stocks now are well below normal, though coal and oil together are about normal. David Howell argues that it would be unwise to aim much below the normal 5-6 weeks' endurance margin in the peak winter months.

4. We think Ministers should ask themselves whether there is a case for aiming substantially higher. High coal stocks are likely to act as a deterrent to strike action. Unusually low stocks will be an invitation. Jim and David could probably give colleagues a reading of the NUM mood and internal politics.

5. The insurance premium is expensive. But there is no doubt that other public sector employees have been influenced in this pay round - as in others - by what the miners have achieved. In announcing the ISTC strike decision on 7 December, Bill Sirs referred to his members' wish for the same 20% treatment as miners had just voted to accept.

6. Because of its pivotal importance in the pay round, Ministers may think it worthwhile making special provision for the necessary insurance premium. It might be worth considering whether this could be achieved covertly - by asking the electricity industry to build up stocks and then subsequently financing their cash overrun. (This is what happened this year, except that they acted on their own initiative.) But the importance we have attached to cash limit disciplines makes this approach very difficult. Alternatively, we could make explicit provision for higher stocks in one of three ways:

(a) increasing the cash limit;

(b) allowing a still greater price rise than proposed (ie putting the insurance costs onto the consumer of electricity);

(c) making a special grant (ie to share the cost of the premium among all taxpayers - rather like the "steel levy" idea).

7. Each course is unwelcome. But the problem is not of our making. With a determined effort, it might be possible to pin the responsibility for the insurance costs where it belongs: on the source of the risk.

8. There is an extra dimension to this question of the right level of coal stocks: higher purchases by the electricity industry would probably ease the cash position of the NCB, which faces the possibility of surplus coal production. So it could be that the cost of financing extra coal stocks is partially offset by savings on the NCB's cash requirements. While this may be convenient, it is in principle objectionable if the miners are the main beneficiaries from the act of taking out an insurance policy. This would be the case if the extra production was simply maintained through high overtime. But there may be an alternative. The other route to higher coal production is to accelerate pit closures, thereby transferring redundant miners to pits with higher productivity.

9. Coal stocks are normally divided between those held by the CEGB and those held by the NCB itself. Picketing of the NCB's own stocks will retain immunity in the event of a coal strike during the coming winter. But picketing <u>by the NUM</u> of CEGB stocks would not. Blacking the movement of CEGB coal stocks (by the NUR, TGWU or others) would not retain immunity either - since the action would clearly not be aimed at the employer in dispute, the NCB. We do not know in practice how much extra flexibility the new laws might provide to the electricity industry, especially as there may be problems of enforcement. The Department of Energy could be asked to advise on this.

10. In the longer term, one of the main checks on the power of the NUM must be the ability to import coal. David Howell's paper (paragraph 3) says that the industry is "deleting expenditure on a coal import facility". At the very least, you could question the wisdom of this. What is the size of the cost saving? Should we be <u>increasing</u> expenditure on coal import facilities? Can they be used for other purposes (eg coal exporting) as well?

11. We just could be on the brink of making a "false economy" decision. The task of containing nationalised industry pay (and thus prices) and public sector pay generally, in the face of monopoly union power, is central for the next 3 years. A few percentage points adrift there could more than wipe out any notional savings on the electricity industry's EFL. The Department of Energy and Treasury could be asked to do some sums so that colleagues can assess the likely cost/benefit.

I am sending a personal copy of this note to the Chancellor and to Robin Ibbs.

JOHN HOSKYNS

cc A. Duguid

Nationalised Industries 2

Seen by the Prime Minister but not returned on the today

16.iv

PRIME MINISTER

This is the minute you were expecting from Mr Howell.

MS

PRIME MINISTER

ELECTRICITY (ENGLAND & WALES) EFL 1980-81

As I mentioned to you informally yesterday, I am continuing to press the electricity supply industry for maximum economies with a view to their meeting their 1980-81 EFL and projected financial return. I have told them it is imperative that they cut costs further.

The position which the industry have reported to me is that they have experienced considerable adverse movements in their costs (predominantly fuel) since the EFL and the financial target were set.

Despite every effort to make economies they foresee the need for their planned second tariff increase this year to be 10%, in July (or possibly August). They will be discussing this at a meeting of the Electricity Council on Thursday 17th April. This discussion, the outcome of which will be reported to me, is not expected to result in final decisions, or in any immediate publicity. But if the industry (whose prerogative it is to determine tariffs) were to wish to go for an increase in July, preliminary work would need to be set in hand immediately, with a view to approaching the industry's various Consultative Councils in early May, when any proposal could be expected to become public.

I shall be putting a paper to E Committee very shortly, discussing the inter-related questions of achieving the EFL, maintaining adequate progress towards the financial target and the size and timing of the second tariff increase. In addition to seeking full information about economies, I have asked the industry to indicate the effects on their tariff proposals of variations in the key fuel assumptions. (A difficulty here is that lower fuel price assumptions could put the EFL at risk if they proved over-optimistic). The Chairman of the Electricity Council is aware that we shall be considering these matters very soon, and that the Government will wish to be satisfied as to the need for both the size and timing of the eventual tariff increase proposed.

I am sending copies of this minute to E Committee colleagues, the Secretary of State for Scotland and Sir R Armstrong.

DCH

SECRETARY OF STATE FOR ENERGY
16th April 1980

PRIME MINISTER

This is not on the E agenda any more, but might be raised afterwards?

MS 15/4

CONFIDENTIAL

P.0240

MR LANKESTER

cc: Mr Ibbs
Mr Wright
Mr Moore

THE ELECTRICITY INDUSTRY'S EFL

As you know, we have had to drop the electricity EFL item from tomorrow's E agenda because Mr Howell did not like the draft E paper on this subject which his Department had prepared, and has asked for more work to be done. As this work involves getting more information from the Electricity Council, it may well be that the issue will not come to E Committee until the week after next.

2. You may find the following background useful:-

(a) The paper which Mr Howell rejected recommended that the existing EFL (£187 million) in 1980/81 for the electricity supply industry in England and Wales should be maintained. Its achievement required, on the paper's reasoning, a number of cuts in capital expenditure (including delaying a start on site at Heysham II until August of this year) and an increase in electricity prices of 10 per cent from July. Fuel stocks would be maintained.

(b) While the measures proposed were thought to be sufficient to achieve the EFL target (subject to the usual uncertainties about the weather, the state of the economy and so on) they were not thought to be wholly consistent with the achievement of the industry's financial objectives (the agreed objective is an average pre-interest rate of return on the industry assets, on a CCA basis, of 1.8 per cent over the 3 years 1980/81 to 1982/83. The rate of return envisaged in the first year was 0.9 per cent. The proposed 10 per cent price increase would lead to a CCA return of 0.6 per cent this year). From the Exchequer's point of view, however, such a shortfall is a lesser evil than an increase in the EFL.

(c) The Electricity Council are due to meet on Thursday, 17 April to consider a recommendation for tariff increases of 10 per cent in July. If they do not agree on a 10 per cent increase this week then, such is the timetable for implementation, the July date may slip and the same financial result require a larger increase at a later date.

3. When I heard yesterday of the delay in the production of the E paper I asked Mr Howell's office to ensure that at least he let the Prime Minister have a minute setting out the position against the possibility of leaks from the Electricity Council meeting on Thursday. Mr Howell has agreed to write such a minute but will not do so until first thing tomorrow morning because he is seeing Sir Francis Tombs tonight to discuss the situation. That discussion, and the subsequent minute, may render my information out of date. But I thought you would nevertheless find it useful to have it.

4. We will of course brief when we have Mr Howell's promised minute and again when we have his paper. But should the matter crop up in, or in the margins of, tomorrow's E discussion the obvious questions which might be asked are:-

(a) Will a delay in taking Ministerial decisions inevitably lose the July window for the price increase? How much bigger would the increase have to be if deferred until, say, August?

(b) What is the scope for selling assets or reducing working capital (other presumably than fuel)?

(c) Would a return to quarterly fuel adjustment clauses in domestic tariffs help (they still apply to industrial sales) and if so, by how much?

(d) Should action be taken to bring about an outside investigation into the efficiency of the industry, eg by the Monopolies Commission under the new legislation?

P Le CHEMINANT

15 April 1980

Original
LGR

C.F.
To see

CCD/N
JS

Natural Industries

10 DOWNING STREET

From the Private Secretary 31 March 1980

The Prime Minister has asked me to thank you for your letter of 14 March about the tariff structures of the gas and electricity industries. You enclosed a copy of a brochure from a firm of tariff consultants, who had suggested to you that the structure of the industries' tariffs was so complex that specialised expert knowledge was required for a consumer to obtain the best possible tariff terms.

I should explain first of all that gas and electricity tariffs are a matter for the industries themselves, and that any detailed questions on this matter should be put to them. There will inevitably be some variety in tariff structures given the need for the industries' tariffs to reflect the pattern of their costs, which vary according to the type of consumption involved, and geographical and other factors. However, I have no reason to believe that tariffs are unnecessarily complex or presented in a way which is difficult to understand. The industries publish full details of their tariffs (of which there are in fact only a limited number in each region) and will always offer advice to the consumer who is not sure which is the best for his own circumstances. Tariff rates differ as between different regions in the country, reflecting differences in costs, but this does not of course complicate the choice to be made by the individual consumer in each region.

The position of the individual industries is as follows. With gas, I understand that there is only one non-domestic tariff rate in each region (apart from a special rate for stand-by power generation, which affects very few consumers indeed). Under the terms of the Gas Act 1972, the industry also enters into special agreements for the supply of gas in cases where the tariffs in force are not appropriate owing to special circumstances. Such agreements are negotiated individually with large consumers, but they do not affect the vast majority of customers, and do not require a consumer to take the initiative, since they only apply where tariff rates are inappropriate. With electricity, there has been considerable simplification and rationalisation of tariff structures over the past few decades.

/Each Area Board

VLC

Each Area Board retains a number of different tariffs, reflecting the different costs imposed on the supply system by different kinds of demand. In the great majority of cases, a consumer can readily identify the appropriate tariff for his own situation, but if there is any doubt, advice is available from the relevant Area Board. In addition, as with gas, the industry may enter into special agreements where tariffs are not appropriate, but this again does not affect the vast majority of customers such as yourself.

I would just add, on one small point raised in your letter, that although there is a very considerable body of legislation applying to the gas and, in particular, the electricity industries, the main provisions relating to tariffs are set out in primary legislation - in the 1972 Gas Act, and the 1947 Electricity Act (updated to take account of the reorganisation of the industry, in the 1957 Electricity Act) - and these provisions have not, as suggested, been subject to constant change.

I hope you will find these comments helpful. It is, of course, for each individual consumer to make his own choice about whether he needs the guidance of tariff consultants. I would suggest, however, that in the first place the consumer would be well advised to approach his Area Electricity Board or Gas Region if he is in any doubt about the most appropriate tariff for his own circumstances.

N. J. SANDERS

R. Harris, Esq.

CONFIDENTIAL

2

Prime Minister

Mr Howell plans to announce the gas levy after the Easter recess.

TL 26/3

cc Mr Ingham

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ
211 6402

The Rt Hon Angus Maude TD MP
The Paymaster General
Privy Council Office
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MO

26 March 1980

Dear Angus

Earlier this month we discussed the timing of possible announcements of a levy on the British Gas Corporation, and of a package of assistance with fuel costs for poor consumers next winter. Both these subjects are of course linked to our pricing strategy for gas and electricity which I announced in January.

Further consideration of the tactics has convinced me that we were right to decide to separate the two announcements. Close association of the two would simply draw attention to the discrepancy between the apparently large revenues deriving from the gas levy, as compared with the much smaller sum available to help poor consumers. Patrick Jenkin will be announcing this Thursday the package agreed by Cabinet on 18 March of help for poor fuel consumers. I intend to issue a statement myself, supporting Patrick, and linking the new measures with fuel price increases to drive home the message that the Government accepts and understands that high and rising energy prices must be accompanied by some measure of protection for poorer households. As you know, the package also includes an insulation component to which I attach great importance.

I propose to announce our intention to impose a gas levy after the Easter recess, though I would not expect at that stage to be able to spell out the details which will need further discussion both with British Gas and within Government. There is of course a link with the pricing policy here too, but it is a rather different one, since the levy is intended to demonstrate that the large profits accruing to British Gas, which will be augmented as a result of our pricing policy and financial target, will benefit the nation as a whole.

I hope you will find helpful this indication of how I see the different parts of the strategy fitting together. I will of course be in touch over the details of the announcements.

I am sending copies of this letter to Michael Jopling, Patrick Jenkin and John Biffen.

Yours ever

David

D A R Howell

26 MAR 1980

PART 1 ends:-

CST's offr to Energy 21/3

PART 2 begins:-

S/S Energy to PMG 26/3