PREM 19/852

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PART 6

CONFIDENTIAL FILING

GAS AND ELECTRICITY PRICING POLICY

GAS AND ELECTRICITY INDUSTRIES EFLS

INDUSTRIAL ENERGY POLICY

NATIONALISED INDUSTRIES

PART 1: SEPT 1979

PART 6: OCT 1981

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~19.4.82~~		~~4.8.82~~					
~~10.5.82~~		~~17.8.82~~					
~~18.5.82~~		~~8.9.82~~					
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PART 6 ends:-

S/S Energy to LPS 11.10.82

PART 7 begins:-

RTA to Sir D. Wass 14.10.82

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TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
E(81) 102	19.10.81
CCU(81) 17th Mtg Min 1	29.10.81
E(NI)(82) 17	11. 6. 82

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 R Pomman Date 25 Oct. 2012

PREM Records Team

cc JV

Next Fwd

Prime Minister (2)

MCS 11/10

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ
01 211 6402

The Rt Hon The Baroness Young
Lord Privy Seal
Management and Personnel Office
Whitehall
LONDON
SW1A 2AZ

11 October 1982

Dear Janet

GAS SAFETY ETC

Thank you for your letter of 9 August. I am also grateful for Nicholas Ridley's letter of 6 September and Norman Lamont's of 8 September, and for copies of Norman Tebbit's of 17 August and Arthur Cockfield's of 24 August.

I note that the proposal to transfer the safety work of the Gas Standards Branch to the Health and Safety Executive has been agreed by colleagues, subject to the Prime Minister's approval. My officials in consultation with other interested Departments are therefore working up the proposal.

I have noted the points raised by Nicholas Ridley and Norman Lamont on the metrology proposals and no doubt Arthur Cockfield will take these into account when considering the proposals in the light of the further work being done by his officials and ours, which I hope will be completed shortly.

I am anxious to make progress on the question of the safety regime, but I do see difficulties in the route proposed by Norman Tebbit. I hope soon to be in a position to put proposals to colleagues for dealing with the problem of BGC's gas appliance retailing activities. However, the Government is committed to maintaining gas safety standards at least as their present levels after the appliance retailing decision is implemented and therefore the question of how to control gas installers needs to be resolved before any decision on gas showrooms can be taken. If the Health and Safety Commission were to conduct formal consultations at this stage, the gas unions would inevitably see this as a sign that we were starting to take action on the highly contentious showrooms front. Since we would not have finalised our policy or announced our proposals, this would give them a golden opportunity to get in first with a damaging campaign against us. Quite apart from the adverse politics of this I need hardly stress the importance of not provoking industrial action in the gas industry at the beginning of the winter.

Thus while I accept that the HSC must conduct their formal consultations I would prefer these to take place after we have reached agreement in principle on some form of control of gas installers. I therefore propose that my officials, in consultation with HSE and other interested Departments, should as a matter of urgency prepare a paper on possible safety regimes with recommendations on which we can take a decision in principle. Once we have taken a view the HSC can begin their consultations and the gas safety work can then be transferred to HSE.

Copies of this letter go to the Prime Minister, Norman Tebbit, Arthur Cockfield, Patrick Jenkin and Nicholas Ridley.

Yours ever

Nigel

NIGEL LAWSON

Nat Ind

Gas x Elec

c/c JV

Prime Minister (2)

MS 11/10

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ
01 211 6402

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON SW1

11 October 1982

Dear Geoffrey

I wrote to you on 14 September setting out details of the British Gas Corporation's offer to the gas staffs and senior officers (GSSO) when they met on 9 September.

At a further meeting with the GSSO on 30 September the Corporation refused to table a revised offer. The unions - whose aspirations have been gradually whittled down during the negotiations - asked the Corporation to accept increases for senior staff ranging from 6.9% to 7.8% (compared with BGC's 6.5% to 7.4% offer). The Corporation refused. The unions then formally gave notice of their intention to refer the matter to conciliation and/or arbitration.

BGC suspect that the unions do not want to go to arbitration and are hoping to reach agreement during conciliation, which BGC would also prefer. Accordingly, they will be prepared marginally to increase their offer to secure agreement during conciliation. The cost of such an increase would be small.

I am copying this to the Prime Minister, other members of E Committee, George Younger, John Sparrow and Sir Robert Armstrong.

Yrs ever
Nigel

NIGEL LAWSON

Nat Ind

Gas & Elec

3 PPS c/c JV

JH 39

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 October 1982

Jeremy Clayton Esq
Private Secretary to the
Secretary of STate for Energy
Thames House South
Millbank
London SW1P 4QJ

Prime Minister (2)

MCS 11/10

Dear Jeremy

STANDING CHARGES FOR DOMESTIC CONSUMERS

Your Secretary of State copied to mine his minute to the Prime Minister suggesting that he would announce at the Party Conference that he had commissioned Price Waterhouse and Delottes to review the level of standing charges in the gas and electricity industries, and that he had asked the consultants to consider a proposal that no standing charge would exceed 50% of any bill.

2 My Secretary of State is concerned that the proposal to substantially reduce standing charges would be at the expense of heavy energy users in industry who are already suffering from a competitive disadvantage imposed by high energy charges. Moreover, there could be unwelcome repercussions for BT. Mr Lawson will remember that under pressure from this Department BT agreed to introduce a concession for very small telephone users in the form of a rebate related to the number of units charged in any quarter. This would have had the effect of reducing the total bill for eligible subscribers (the concession has been postponed as it was part of the package of increased charges which BT postponed from 1 November). My Secretary of State fears that if BT came under pressure from Parliament to adopt Mr Lawson's "50%" formula, it could prove very costly for BT. Tariffs on heavier users would have to be increased and the concession could prejudice a successful flotation.

3 These issues should be taken into account before any particular course of action on standing charges is finally agreed.

4 I am sending copies of this letter to Michael Scholar (No

10), Margaret O'Mara (HM Treasury), John Gieve (Chief Secretary's Office), John Lyon (Northern Ireland Office), David Edmonds (Department of the Environment), Muir Russell (Scottish Office), Adam Peat (Welsh Office), David Clark (Department of Health and Social Security) and Richard Hatfield (Cabinet Office).

Yours sincerely
David Saunders

DAVID SAUNDERS
Private Secretary

11 OCT 1985

Not Incl
Gas & Elec

CONFIDENTIAL

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Not Ind

(2)

PRIME MINISTER

Electricity Prices

Electricity prices are going to be one of the subjects of the next few weeks. As you will know from other papers in the box, the Chief Secretary is suggesting a small meeting under your chairmanship on this subject before E committee takes it the week after next. At the same time, we now have the CPRS report which the Chancellor commissioned some months ago. It is attached; there is a summary at the beginning and, at greater length, in Chapter 6.

The CPRS note that electricity prices in France are significantly lower than ours; that in Germany and Italy they are broadly comparable with ours except for large users; and that Japanese prices are higher than ours. They argue that the reason for this is not mainly inefficiency in our industry, but rather the exchange rate, and differences in the cost-base of the industries concerned (for example the French with their larger nuclear capacity have systematically lower supply costs). They argue (unremarkably) for a substantial increase in our nuclear plant, that NCB coal prices to the CEGB should be related to import prices and not to their net realised export prices. There are also proposals for extending private sector generation and the sale or lease of CEGB plant.

The CPRS basically endorse, with a few detailed proposals for change, the present electricity tariff structure (noting that the Cooper and Lybrand proposals would lower CEGB prices by 5-10 per cent, but would do little to help large users). They conclude firmly against subsidies for electricity prices. So that the considerable difference between French prices and ours is forecast to persist, and to widen, until we match their nuclear capability, and the gap between our prices and German prices is forecast to narrow in time.

If you have time you might read Chapter 6 of the report, in view of the importance of this issue in the coming weeks.

MCS

8 October 1982

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With the Compliments of

G. B. SPENCE

CENTRAL POLICY REVIEW STAFF

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cc JL

ml

CABINET OFFICE

Central Policy Review Staff

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

From: John Sparrow

Qa 06074

CONFIDENTIAL

8 October 1982

John Kerr Esq
Principal Private Secretary to the
Chancellor of the Exchequer
HM TREASURY
S W 1

Dear John

CPRS Report on Electricity Prices for Industry

Earlier this year the Chancellor proposed that the CPRS should make a study of electricity prices for industry. The correspondence closed with the Chancellor's letter of 8 March to the Secretary of State for Energy, and John Sparrow's letter of 7 April to the Chancellor.

see attached folder

Our report is enclosed. The conclusions are set out in Chapter 6 and, in a more abbreviated way, in a summary at the beginning of the report.

The issues are complex and have been the subject of much argument and discussion over the last two years. We have examined the facts and arguments carefully, and our conclusions do not point to any special measures to help industry to cope with the impact of electricity prices. In our view the report, (Chapter 6 in particular), provides Ministers with a full justification of these conclusions.

I should make it clear that in this report we are considering only the questions raised by electricity prices. We have not considered the wider question of whether the Government should act to lighten the burden on industry. If Ministers think that they should act, in our view they should not use the impact of electricity prices as the criterion for relief, nor the electricity pricing system as the means of giving industrial support.

I am sending copies of this letter and of the report to Michael Scholar, to the Private Secretaries to the Secretaries of State for Energy, Industry, Scotland and Wales, and to Richard Hatfield.

Yours ever

Gerry

G B Spence

Enc

Nat Ind, Gas & Elect, PT6

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PREM 19/852, 8.10.82

COPY NO 2

ELECTRICITY PRICES FOR INDUSTRY

A Report by CPRS

October 1982

CONFIDENTIAL

CONTENTS

SUMMARY

1. In recent years industrialists have complained bitterly about United Kingdom electricity prices; and the NEDC Task Force in 1981 confirmed that some heavy users of electricity were paying more than some overseas competitors. The Government responded to the pressures in both the 1981 and 1982 Budgets with measures which are costing £100 million this year.

2. For most industrial consumers price differentials between the United Kingdom and overseas are not significant. Price comparisons are however generally less favourable than 5 years ago because of changes in the exchange rate and our general decline in competitiveness.

3. United Kingdom electricity intensive industries face a higher sterling electricity price than their main competitors in France, Germany and Italy. The reasons are primarily cost based, with pricing policies and industrial susbsidies playing a role.

4. For manufacturing industry as a whole electricity accounts for about 2½ per cent of costs. For the bulk of manufacturing firms electricity costs are not a major factor in their competitive position.

5. A few sectors of industry are seriously affected by electricity prices, notably -

i. aluminium, and integrated pulp and paper mills. These are so electricity-intensive that they have no long term future in the United Kingdom without large and permanent subsidies;

ii. chlorine and its derivatives. The United Kingdom could in time lose 4,000 jobs, possibly more;

iii. electric arc steel making - but electricity is only one of its many problems.

6. There is no systematic bias against heavy industrial users in current electricity tariffs and the CPRS considers the marginal cost approach to pricing to be sound. The Coopers and Lybrand Study suggests that CEGB's prices are some 5-10 per cent too high. Most firms would profit from the changes they propose but ironically electricity intensive users on load management terms would not benefit much if at all.

7. Assuming that NCB coal prices remain broadly in line with the price of imported coal the propspects to 1990 are that current price disparities will persist with France, but narrow with Germany as most special contracts for electricity-intensive industries are renegotiated. There is room for improvement in the electricity industry's operational performance but this cannot have a very great impact on total system costs.

8. The CPRS sees no case for subsidising industry's electricity costs; such assistance would not be short lived, only part of the present price disparities reflect subsidies by foreign governments, there is no guarantee that state aid would do more than delay job losses, and there are more cost effective ways of reducing burdens on industry. Depending on the outcome of the current review of the Bulk Supply Tariff and developments abroad, the existing support for large users should be phased out in due course.

9. Maintaining competitive electricity prices in the longer term rests essentially on keeping NCB coal prices to CEGB aligned with the cost of imports to it and on establishing a successful nuclear programme with construction performance markedly better than has been achieved so far.

INTRODUCTION

1. This Government has been subjected to sustained lobbying from industrialists about high energy prices. The facts were carefully explored in a study by the NEDC Energy Task Force in February 1981 (updated in November 1981). As regards electricity, the Task Force concluded that prices in the UK were generally comparable with those in Belgium, Italy and the Netherlands. Prices in France were consistently and significantly lower than in the UK. In Germany most industrial consumers paid as much as or more than their UK equivalents, but those with high load factors* paid up to 16 per cent less than their UK counterparts and up to 30 per cent less in some cases where German utilities operated special contracts. Industrialists in the chemical and iron and steel sectors have been particularly active lobbyists, although not all their members are high load-factor users.

2. Ministers have already taken some action to alleviate the problem. In the 1981 Budget statement, the Chancellor of the Exchequer announced the introduction of an improved load management scheme (Category C) and a 3 per cent flexibility allowance for Area Boards to use in negotiating with large industrial consumers. In the forum of MISC 56 last summer, Ministers concentrated on industrial users of electricity (rather than energy in general), and considered what could be done, short of a subsidy, to mitigate the effect of the cheaper prices enjoyed by their competitors abroad. Considerable efforts were devoted to the design and development of schemes to help those industrial users who were most at a competitive disadvantage. The 1982 Budget included the contracted consumer load (CCL) scheme, which has a life of 3 years. The help given to electricity consumers in the 1981 Budget amounted to £45 million in 1981/82; and in the 1982 Budget to £100 million for 1982/83 (which includes the cost of continuing the 1981 Budget measures.)

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*This term is explained in Chapter 1, paragraph 4.

3. Since then the pressure on Government to do something about energy prices has eased somewhat. Complaints about electricity prices are less frequent, but as it is known that the Secretary of State for Energy is still considering the Bulk Supply Tariff (BST) Review submitted by the Electricity Council in January 1982, industrialists may simply be waiting to see what action he decides to take. The appointment of the consultants, Coopers and Lybrand, to advise on the BST Review has not been announced publicly, but pressure for some kind of Government statement on electricity prices is likely to build up towards the end of this year. In addition, the Government is committed to discuss electricity prices at NEDC before the end of the year. The forthcoming announcement of the electricity industry's EFL for 1983/4 is also likely to raise questions about prices. This is because the industry's financial target expires at the end of 1982/83, and the new one, which will clearly have to be compatible with the EFL, has not yet been announced.

4. In April 1982 it was agreed that the CPRS should undertake a study of the effect of electricity prices on UK industry and its competitors, and make recommendations. The terms of reference (attached to John Sparrow's letter of 7 April 1982 to the Chancellor of the Exchequer) were -

i. To examine the extent to which the price of electricity is more expensive for industrial customers in the UK than in other major industrial countries; and to advise on the reasons, considering in particular whether this is due to unavoidably high costs, such as efficiency, or to pricing policies.

ii. To examine how the cost of electricity in the UK is likely to move relative to costs in other major industrial countries; and to consider how we could react to lower prices in those countries.

iii. To examine the effects on industry of the continuation of the international price differentials foreseen under ii, assuming also continuation of present UK costs and tariff structures; to consider, in particular, which industries or processes may be adversely affected to a significant extent and to advise on the consequences for the economy as a whole.

iv. To advise on the costs, practicability and desirability of changes in the electricity pricing structure which would have the effect of reducing charges to the consumers identified in iii, including the possibility of legislative change; and on other possible forms of assistance.

v. To consider, in the light of i, ii, iii, and iv the case for reducing electricity prices to industry at the expense of other customers or the PSBR.

5. This paper follows the same logical thread as the terms of reference. Chapters 1 to 5 deal with sections i, ii and iii. Each of the first five chapters ends with a summary of the main conclusions that can be draw from the material in it. In Chapter 6 we discuss the results of the analysis and propose an approach to the problem.

6. In the preparation of this Report, we have discussed the issues involved with officials of the Departments of Energy and Industry and the Treasury and, as far as possible without revealing that we were involved in such a study, with the electricity supply industry, industrialists and industry federations. We have also conducted a series of off-the-record discussions in Germany.

CHAPTER 1 - INTERNATIONAL COMPARISON OF PRICES

Electricity prices to large industrial users

1.1. Any attempts to compare industrial electricity prices for different countries are fraught with difficulties. Figures are available in many cases, but are not perfectly reliable - they are quite adequate to give an indication of how prices vary from one country to another but they do not always represent the exact price an industrialist would face in each place. In general, the figures are based on what the "average" user, with an average pattern of demand, would pay according to the published tariff. Large users, however, are often on special contracts whose details are kept secret for commercial reasons, and their load patterns may differ from the average; for example, a user may choose to concentrate his demand in the cheaper off-peak periods. In addition, exchange rate fluctuation can cause rapid changes in price relativities. The figures in this chapter should therefore be taken as indications only and used with care.

1.2. The NEDC Energy Task Force Study of February 1981, updated in November 1981, showed that the most important disparities faced by the UK in Europe were against France and Germany. For certain groups of consumers, prices in Italy also were very favourable. In this report we will concentrate mainly on these three countries, both because of the disparities and because between them they account for a quarter of our exports of manufactures and are therefore important in terms of the competition they provide.

1.3. A second group of countries (accounting for a further quarter of manufactured UK exports) is also considered, but in a little less detail, partly because less information on them is available on a comparable basis. It includes -

USA and Japan	- these countries are important general trading competitors
Canada	- important in the paper and board sector
Sweden	- important in paper
Norway	- important for chemicals and paper
Netherlands	- important in chemicals and steel
Belgium	- important for steel
Austria	- important for special steels.

1.4. The Task Force work concluded that large high load factor* users - those who used large but fairly steady quantities of electricity for much of the time - were at a particular disadvantage in the UK. We give below some more up to date figures for users of 10 MW maximum demand. These are very large users; only 191 out of the total of 3125 industrial consumers considered in the NEDC report used 10 MW or more in 1980/1. Very few of these are at high load factors - there are only 29 at 70 per cent load factor or more.

Table 1A - Industrial Electricity Tariff Prices** - 10 MW users
(prices as at 30 July 1982, at current market exchange rates)

	Annual Load Factor			p/kWh
	40%	60%	80%	
UK (England and Wales)+	3.29	3.12	3.03	
France	2.55	2.30	2.12	
Germany (RWE++)	3.43	2.85	2.48	
Italy	3.32	3.05	1.80	

** Including all non-recoverable taxes, ie excluding VAT which is recoverable where electricity is an input to VAT rated goods.
+ Based on a load pattern representative of the chemical industry at 10 MW demand, and including Area Board flexibility allowance, but excluding load management. (However most consumers at these loads or above in the chemical industry are now on CCL.)
++ Germany has many electricity utilities each with different tariffs. RWE is the largest.

Source: The Electricity Council.

*The "load factor" relates the average electricity demand to the peak demand. For example, a consumer using roughly the same amount of electricity almost all the time would have a high load factor. A user whose demand fluctuates widely, very occasionally reaching a high peak, would have a low load factor.

1.5. Table 1A shows how, at low load factors, prices in the United Kingdom are competitive with those in Germany and Italy, but at high load factors they are well above the others. Prices in France are well below those in other countries except in Italy at 80 per cent load factor. There are, however, qualifications for each figure -

i. The United Kingdom prices can be reduced by around 20 per cent if the consumer is able to take advantage of load management terms. 107 consumers (mainly in the steel and chemical sectors) have elected to join the recently introduced Contracted Consumer Load Scheme. Users on CCL at 10 MW and 80 per cent load factor could get their price down from the 3.03 p/kWh shown in the table to 2.42 p/kWh. Other large consumers are on other forms of load management, giving smaller price reductions. The reductions in electricity costs from using load management terms may be partly offset by the higher costs incurred as a result of rescheduling production.

ii. The continued weakening of the French franc against the £ means that the gap between prices in France and the United Kingdom identified by NEDC has widened. French prices are now generally around 25 per cent lower than ours (not allowing for the effect of load management on United Kingdom prices).

iii. At 80 per cent load factor, the German (RWE) tariff price is 2.48 p/kWh -18 per cent cheaper than the British price (excluding load management). Germany has many electricity utilities each with different tariffs. RWE is the largest and offers prices and tariffs near the bottom of the range. The prices given here are based on RWE's published tariffs, but some industrial users pay significantly less than this under their special contracts.

iv. The Italian price at 80 per cent load factor is low, and much lower than at other load factors, because there is a specific price subsidy in Italy for users with load factors of 80 per cent or more.

1.6. Compared with the NEDC findings in November 1981 (showing differences of up to 28 per cent for France and 16 per cent for Germany), the discrepancies at higher load factors between the United Kingdom and France and Germany shown in Table 1A are up to 30 per cent and up to 18 per cent respectively. This is the net outcome of price increases in all three countries and movement in exchange rates. The disparity is of course reduced for many large consumers in the United Kingdom by load management terms.

1.7. Turning now to the second group of countries that were identified in paragraph 3 as of interest, Table 1B demonstrates that some of these countries enjoy electricity prices well below ours, especially at high load-factors (although figures as up to date as Table 1A are not available for this group).

Table 1B - Industrial Electricity Tariff Prices* - 10 MW users
(prices as at August 1981, at current market exchange rates)

	Annual Load Factor			p/kWh
	20%	40%	60%	80%
UK				
England and Wales**	3.29-4.37	2.90-3.55	2.76-3.30	2.66-3.17
Scotland	3.73-3.97	3.05-3.21	2.80-2.91	2.64-2.75
N. Ireland	4.37	3.62	3.32	3.15
USA	3.43-10.51	2.69-7.38	2.40-6.23	1.99-5.57
Japan	5.48-5.92	4.20-4.74	3.77-4.34	3.56-4.15
Canada	2.23-2.44	1.46-1.78	1.17-1.20	1.00-1.05
Sweden	2.32-2.47	1.86-2.02	1.70-1.86	1.69-1.76
Netherlands	3.17-4.43	2.81-3.78	2.63-3.52	2.53-3.38
Belgium	n/a	n/a	2.68	2.52

* Including all non-recoverable taxes, ie excluding VAT which is recoverable where electricity is an input to VAT rated goods.
** Excluding load management.
Source: An International Comparison of Electricity Prices, The Electricity Council.

1.8. Within the UK, prices in England and Wales are broadly comparable with those in Scotland. Prices in N Ireland are subsidised down to the top end of the United Kingdom price range. Comparing the UK with the others, at 80 per cent load factor and taking the lower end of the price ranges, all the countries except the Netherlands and Japan have lower prices. Prices are particularly low in Sweden and Canada largely because much of their power is hydro-electric. Prices range widely in the US, but some utilities with large quantities of nuclear and hydro power are able to offer prices comparable to those in Sweden and Canada. Netherlands, Japan and some parts of the USA are more expensive than the UK because of their dependence on gas and oil for generation. The Netherlands are, however, introducing a scheme to help large users (over 6 MW and 50 per cent load factor). This is expected to reduce prices for 10 MW users to levels similar to those in the United Kingdom, but prices paid by very large users could fall below ours.

Exchange Rates and Competitiveness

1.9. The picture presented above is materially different from that of 10 or even 5 years ago. Table 2 below shows that in 1973 UK industrial electricity prices were generally half those in Germany, by up to a third lower than in France, and by 12-25 per cent below Italian levels. In 1978 the UK's industrial electricity prices were generally about a third below German levels, very much the same as in France, and up to 15-20 per cent below Italian levels. The preceding paragraphs have shown that French industrial electricity consumers now enjoy a substantial advantage over their English counterparts; the same is true for industrial users in Germany and Italy if they maintain a high load factor. Why has the balance of advantage tilted so decisively against UK industrial consumers in recent years? We shall discuss in succeeding Chapters the main factors which affect electricity costs and prices. But there is one factor which deserves separate treatment - the effect of exchange rates on all international comparisons.

Table 2 - European Comparison of Industrial Electricity Tariffs*-2.5 MW users

	Load Factor 20%	40%	60%	p**/kWh 80%
1 August 1973				
United Kingdom	0.92-1.25	0.72-0.90	0.61-0.77	0.56-0.70
France+	1.28	1.00	0.83	0.71
Germany	1.90-2.35	1.42-1.72	1.14-1.37	0.99-1.22
Italy	1.02	0.80	0.69	0.64
1 August 1978				
United Kingdom	2.42-2.97	2.07-2.41	1.82-2.16	1.69-2.04
France+	2.70-2.84	2.21-2.31	1.92-1.99	1.70-1.76
Germany	3.78-5.43	3.12-3.65	2.51-3.10	2.18-2.84
Italy	2.72-2.73	2.36-2.37	2.18-2.19	2.10-2.11

* Excluding VAT
** Converted at prevailing market exchange rates
\+ Cheapest zone
Source: A Comparison of Electricity Prices in the Countries of The European Community 1973-78. Electricity Council.

1.10. Table 3 below illuminates what happened in the 1970s. Column 1 shows that between 1975 and 1980 the rise in industrial electricity prices relative to the general domestic cost level in the UK was not very markedly out of line with that in other major countries. The real price of industrial electricity in the UK rose by roughly the same amount as in France, and considerably less than in Italy and the United States in this period. It rose more than in Germany, where in fact the real price of industrial electricity remained virtually unchanged. But in general the UK's deterioration in relative sterling electricity prices does not reflect a deterioration in the real costs or productivity of the UK's electricity industry relative to those in our main competitors. (This is not to say that the absolute level of productivity and efficiency in our electricity supply industry (esi) is satisfactory, a subject to which we turn later.)

Table 3 - Increase in industrial electricity prices during the 1970s

	% increase in real price of electricity*	% increase in price expressed in Sterling**	
	1975-1980	1970-1975	1975-1980
United Kingdom	16	90	121
France	15	77	82
Germany	-1	94	26
Italy	27	97	136
United States	26	98	75

* Electricity price deflated by GDP deflator.

** Nominal prices converted into Sterling at prevailing market exchange rate.

Source: Energy Price Indices 1960-1980, Eurostat 1982.
1981 Annual Report to Congress, US Department of Energy.

1.11. Looking at price rises between 1975 and 1980 in sterling terms, however, (column 3 of Table 3) shows a very different picture. On that basis United Kingdom prices rose much more than in the other countries except Italy. This is in marked contrast with the experience between 1970 and 1975 (column 2 of Table 3). The deterioration in relative sterling industrial electricity prices over recent years reflects movements in the exchange rate. Since the mid-70s the exchange rate and the general cost/price level in the United Kingdom have become de-coupled. In 1975 and 1980 sterling's effective ("trade weighted") exchange rate was much the same, yet the domestic cost level had virtually doubled. The divergence between the exchange rate and domestic costs since the mid 70s reflects the anti-inflationary stance of macro-economic policy, the impact of North Sea Oil production and higher world oil prices on the exchange rate, and the slowness (relative to the speed of adjustment in the exchange market) of the deceleration of domestic cost inflation, especially wages.

1.12. The disparities between United Kingdom and competitors' industrial electricity prices which have become apparent in recent years, do therefore, essentially reflect British industry's general loss of competitiveness. Whilst the NEDC Energy Task Force studies mentioned the exchange rate, they concentrated on snap-shot price comparisons in the 1980s and did not make clear its full importance and implications.

Conclusions

1.13. In summary, the main conclusions of this chapter are -

i. French prices are well below ours for all industrial consumers.

ii. German tariff prices are much the same as ours, except at very high load factors. At these load factors the German tariffs are considerably cheaper than ours, although a United Kingdom firm taking full advantage of the CCL scheme could get down to RWE's tariff prices. But German consumers enjoy yet lower prices through special contracts.

iii. Italian prices are comparable with ours except at 80 per cent load factor where they are subsidised and much cheaper.

iv. Some countries eg Sweden and Canada have large hydro-electric resources and enjoy much lower prices than ours.

v. Japan, Netherlands and parts of the USA have higher prices than ours.

vi. Exchange rate movements account for much of the changing disparities between United Kingdom and European electricity prices over recent years, reflecting the United Kingdom's general loss of competitiveness.

1.14. But why do utilities in different countries charge the prices they do? Undoubtedly among the most important factors governing electricity prices are the mix of generating plant and variations in feedstock prices. Another factor is of course pricing policies, and the extent to which Governments are prepared to require consumers to pay the full cost of generating the electricity they use and of investing for their future needs. Tariff structures can place more of the burden on some consumers than others and subsidies can switch it from the electricity consumer to the taxpayer. But countries with plenty of low cost nuclear and hydro-electric power have a head start. These are points we shall explore in Chapters 2 and 3.

CHAPTER 2 - THE COSTS OF SUPPLYING ELECTRICITY

2.1. A utility's costs mainly depend on the proportions of different types of plant it uses; the prices it pays for the fuels it uses; and on the efficiency with which it both operates existing plant and builds new plant.

Plant Mix

2.2. The cheapest power is obtained from hydro-electric stations and from nuclear plant, provided that the stations are built efficiently and plant availability is kept at reasonable levels. Next, but much dearer, are large modern plants burning fossil fuels (with coal being cheaper than oil). Then come the smaller, less efficient coal and oil plants; and finally gas turbines (used in the United Kingdom only to meet peak demand). Costs depend on the mix of plant the utility runs to meet demand. The choice will depend on availability, fuel input price, response time and other factors. Some plant, particularly more efficient and lower cost base load plant, will be more intensively used than other types and will therefore have a larger influence on the price of electricity than the plant mix alone indicates.

2.3. Tables 4A and 4B below show the proportion of electricity actually generated by each type of plant in the UK and the countries chosen for comparison.

Table 4A - Electricity Generation in 1980

per cent

	Nuclear	Hydro and Other	Coal	Oil	Gas	Total*
UK	12.5	1.7	73.6	11.4	0.8	100
France	23	30	25	21	-	100
Germany	11.9	5.1	63.5	6.2	13.3	100
Italy	1.2	27.0	12.2	54.9	4.8	100

* Figures may not add to totals because of rounding.

Source: Energy Policies and Programmes of IEA Countries, IEA, 1982, and EdF figures for France.

2.4. France clearly has much more nuclear than the others, and like Italy enjoys a substantial amount of hydro-electric power. The UK and Germany, while having relatively little nuclear, depend most heavily on coal, which is cheaper than the oil on which Italy is so dependent. It should be noted that 45 per cent of the coal used in Germany is brown coal (lignite), which is cheaper than the steam coal which makes up the balance. However, German brown coal deposits are declining rapidly. France therefore has the advantage with so much nuclear and hydro, UK and Germany are broadly comparable and the cost to Italy of generating much of its electricity from costly oil is only partly offset by hydro-electric power.

2.5. The fuels used for electricity generation in the second group of countries demonstrate clearly why some of their prices are very low.

Table 4B - Electricity Generation in 1980

per cent

	Nuclear	Hydro and other	Coal	Oil	Gas	Total*
UK	12.5	1.7	73.6	11.4	0.8	100
USA	10.9	11.7	52.6	10.4	14.4	100
Japan	16.1	18.4	11.7	41.1	12.7	100
Canada	9.7	68.3	16.5	3.5	2.0	100
Sweden	27.5	59.8	1.3	11.8	0	100
Norway	0	100	0	0	0	100
Netherlands	6.6	0	13.9	37.2	43.1	100
Belgium	23.1	1.5	35.4	30.0	10.0	100
Austria	0	70.8	8.3	15.6	5.2	100

* Figures may not add to totals because of rounding.

Source: Energy Policies and Programmes of IEA countries, IEA, 1982.

2.6. Canada, Sweden, Norway and Austria all produce over 70 per cent of their electricity from the cheapest sources, nuclear and hydro. By contrast, Japan and the Netherlands depend for over half of theirs on the more expensive sources, oil and gas. The national average figures for the USA mask significant differences between individual utilities, which account for their wide range of prices. Belgium lies between the two extremes, with a good proportion of nuclear generated electricity, but the benefits of this are offset by the need to depend for a substantial amount of the remainder on oil and gas.

2.7. Thus the United Kingdom does not enjoy the natural advantage which some countries have of large hydroelectric resources. Nor do we have a particularly large nuclear capacity: some of our competitors, most notably France, are now beginning to reap the benefits of a vigorous and successful nuclear programme. On the other hand things could be far worse: for example our proportion of oil fired plant is quite low.

The Cost of Fossil Fuels

2.8. For thermal power stations, fuel costs represent a very significant element in the overall cost structure.

2.9. The electricity supply industry (esi) in the United Kingdom has so much coal-fired plant that coal is by far the most important factor in the esi's costs. In 1981-82 it accounted for 46 per cent of the CEGB's total costs (on a CCA basis). For high load factor industrialists taking full advantage of load management, and not therefore paying any capacity charges, coal accounts for approaching 60 per cent of their electricity bills.

2.10. We have therefore considered whether the price paid by the esi for power station coal is at the right economic level. If it is too low, electricity prices are being subsidised below the economic price. But if it is too high, electricity consumers are carrying some of the burden of supporting NCB. The CPRS considers that, to the extent that the coal industry is to be supported at all, the cost of that support should be clearly defined (making it easier to control) and should be borne by the taxpayer through central Government.

2.11. So what is the right price? The CPRS considers that the volume of coal traded on the world market is adequate to establish a world traded price, and that the economic level of coal prices in the UK should be determined by reference to the world traded coal price. Our argument is that it is the world price for coal that represents the opportunity cost of coal to this country and indeed to other countries including our major competitors, and that given our future supply potential (small and invariable relative to the rest of the world's) we have little impact on the world's price. This argument is analogous to the reasoning underlying the pricing of UK produced crude oil.

2.12. At present the world (Rotterdam) price of coal is about £34/tonne. Trans-shipment to the United Kingdom involves additional costs of some £5/tonne, and transport to inland power stations - which account for four-fifths of the CEGB's coal burn - would add a further £5/tonne, giving a delivered cost at the CEGB's central power stations of £44/tonne. This is somewhat higher than the delivered price of NCB coal - £42/tonne. In the case of power stations on the Thames, the costs must be adjusted to allow for the higher transport cost of NCB coal and the lower transport costs of coal imports; the result is that at these Thames stations imports are substantially (about 15 per cent) cheaper than NCB coal. But overall the CEGB's total coal bill is aligned with the price to it of imported coal.

2.13. However these calculations assume existing import facilities which involve trans-shipment from the Continent. If efficient deepwater coal ports were developed in the UK there would be a net saving in import costs of £3/tonne. If imports are to be used as the competitive economic benchmark price, it is sensible to do the costing on the basis that imports are handled in the most efficient way. On this basis the delivered cost at inland power stations of imported coal could be about £41/tonne, slightly below the current NCB price. Taking into account also the prices at coastal stations, this would reduce the CEGB's total coal bill overall by about 5 per cent.

2.14. The NEDC's February and November 1981 Energy Task Force reports both concluded that UK coal prices were competitive with imports and prices being paid in Europe. Given current circumstances we agree that for the bulk of the CEGB's coal burn NCB coal prices are broadly in line with imports. This means that the costs of today's uneconomic level of coal output are borne not by the coal consumer, but by the taxpayer. However, developments in prospect may lead to a widening divergence. This November, under the terms of the NCB-CEGB agreement which runs until 1984, the NCB will raise their prices in line with inflation ie by about 6 to 7 per cent, and presumably they will increase them again in November 1983. Although the prospects for world coal prices over the same period are uncertain, dollar prices are unlikely to rise, and may even show some decline. Currently there are a number of distress sales by Poland and South Africa below the level of £34/tonne, and trans-Atlantic freight rates have tumbled. It is possible that these pressures may over the coming months tend to reduce the term price for new (long term) contracts.

2.15. The danger therefore exists that a gap between domestic and world coal prices will start to open up. In November 1982 NCB coal delivered to the CEGB's central power stations could cost about £45/tonne, a level some 10 per cent above the notional cost of imports (assuming, as in paragraph 13, the development of deepwater ports in the UK).

2.16. It is worth noting that the CEGB's case that coal is too expensive is only in part based on their lack of access to imports and the lower price of traded coal on the world market. Many of the CEGB's power stations are sited next to efficient inland pits with production costs below the price of imports. The CEGB has therefore suggested that NCB coal should be priced on a direct cost basis related to individual pits, which would significantly reduce its total coal bill. We cannot accept such a cost-based argument, which is one that the CEGB rejects in its own marginal cost pricing policy and which does not have the economic justification of a policy related to the world market in coal. Part of the reason why the CEGB feels aggrieved is that the NCB is known to low prices to secure export orders. This is simply because NCB production is too high for the present level of demand, and the NCB has to slash prices in order to dispose at all of the last tonnage of coal. By contrast, electricity production is flexible and can be matched to demand.

2.17. As the United Kingdom is currently a net exporter of coal, it has been argued that, to reflect the opportunity cost, NCB coal prices should be related to the world market, less the costs of transport. This would give a very substantially lower price. But the United Kingdom is only an exporter because of its excessive level of uneconomic production. United Kingdom coal usage exceeds the level of production justified at or near current coal prices, and on an economic basis the United Kingdom would definitely be a net importer of coal. For this reason we consider that the relevant opportunity cost is based on the world market, plus the costs of transport.

2.18. Meanwhile the NCB exports 8 million tonnes or so of coal in order to clear its excess production at net realised prices far below those paid by the CEGB. If for a period the benefit of similar prices could be passed through to the final electricity prices payable by electricity-intensive UK industry this would make a substantial difference to their competitive position. This course is particularly attractive when considering a marginal case, such as an aluminium smelter, which will close without the benefit of such prices, thereby requiring more coal to be exported or stocked. However it is clear that selective price discounting to existing coal users would not materially increase the total demand for NCB coal. To remove the need to export NCB coal would require widespread and large cuts in UK coal prices at great cost to the Exchequer. Furthermore, since the Government's policy is that the NCB should achieve a demand/supply balance, price discounting in the UK would not be sustainable in the medium-term. It is therefore important that electricity-intensive industry continues to take its strategic decisions on the basis of the full price of coal. In short, the cash-flow advantages to particular industries would be paid for by substantial cash-flow disadvantages to Government, without materially affecting the long-run position.

Efficiency

2.19. The Monopolies and Mergers Commission (MMC) investigated the CEGB and reported last year. It gave the CEGB a comparatively clean bill of health as far as its operational efficiency was concerned, but was critical of power station construction costs and system development planning.

Operational Efficiency

2.20. The statistical problems of comparing operational efficiency between different utilities are severe. There are the usual problems of definition and measurement involved in international comparisons, and in addition, operational efficiency is affected by other factors that are not equal between countries eg the age and size of plant and the way the system is operated. Thermal efficiency, plant availability, system load factor, and labour productivity are all aspects of operational efficiency.

2.21. Thermal efficiency is a measure of the proportion of the energy content of the fuels used in electricity generation that is converted into electricity. The NEDC Task Force Report of February 1981 gave the following table. It covers all plant burning fossil fuels (but not nuclear or hydro plant for which a thermal efficiency comparison is not relevant).

Table 5 - Thermal Efficiency in 1977

	per cent
France	37.0
Italy	36.8
West Germany	35.1
United Kingdom	33.2
EEC Nine	35.2

Source: NEDC Energy Task Force Report, February 1981, based on Eurostat.

2.22. Not all plant in the system is, however, available for use at any particular time. Breakdowns and plant maintenance, for example, cause reductions in the amount of capacity available for use. Only the CEGB and EdF publish availability data regularly. The February 1981 NEDC report included the following comparison.

Table 6 - Availability of Large Conventional Units

	1970/1	1974/5	1978/9
UK (England and Wales)*	62.8	75.2	84.6
France**	66.5	83.0	73.1

* CEGB, 500-660 MW units

** EdF, 600 MW units

Source: NEDC Energy Task Force Report, February 1981.

2.23. The National Institute for Economic and Social Research have recently calculated estimates of labour productivity in the esi. Their estimates are shown in Table 7.

Table 7 - US and German Labour Productivity in the esi compared with the UK

UK = 1

	1968	1977 for US 1976 for Germany
US/UK	4.06	3.47
Germany/UK	1.93	2.25

Source: NIESR, 1982.

They suggest a significant shortfall of labour productivity in the UK esi and this shortfall is larger than that of the UK economy as a whole. As however labour accounts for only 9 per cent of CEGB costs and 16 per cent of all esi costs, improvements in productivity can make only a limited difference to total costs.

2.24. The efficiency of a system is related to the system load factor. In general the higher the system load factor, the higher the percentage of total electricity demand that is generated by base load plant and the higher is thermal efficiency and labour productivity. System load factors in the UK, France and Germany are 56 per cent, 67 per cent and 66 per cent respectively. The system load factor reflects the mix of electricity consumers and the pattern of their demands. The utility can influence it by tariff design only to a limited extent. The United Kingdom's lower system load factor weakens its comparative performance. Overall, however, the room for improvement in operational efficiency is not large enough to make an appreciable impact on the price disparities faced by high load factor industrialists.

Capacity cost efficiency

2.25. The poor performance of the British construction industry at large sites has caused concern for many years. The NEDO Report of 1976 "Engineering Construction Performance" looked at large sites, including power stations in the UK, USA, Germany and Italy. The report found that projects took longer to design and build in the UK than abroad, and involved more man hours and larger numbers employed on the site. Among the causes that were identified were the tendency to require more rigorous operating standards than foreign clients, an inability to catch up once time had been lost, less effective project planning and hard pressed industrial relations management. The recommendations included measures to improve morale and labour relations on site.

2.26. More recent experience corroborates these findings. Although comparable figures are not available, the problems encountered by the CEGB are well known. We shall not dwell on their disastrous experiences with, for example, most of the AGR programme and the Isle of Grain. But at best (eg Dinorwic and Drax), construction times have been about 8 years. Foreign experience is variable. France's performance has been impressive, with construction times averaging under 6 years in its current nuclear programme. Germany too has constructed stations in about 6 years. America has suffered slippage in recent years with construction averaging about 8 years but this masks a wide range.

2.27. France also comes out well in the following comparison of the costs of building power stations in different countries.

Table 8 - Construction Cost

(Cost per kWh in constant prices, excluding taxes, discounted at 5 per cent)

pence per kWh at 1.1.81

	Nuclear Plant	Coal Fired Plant
UK	1.57	0.82
France	0.56	0.45
Germany	0.86	0.43
Italy	0.54	0.31

Source: Generating costs - assessment made in 1981 for plant to be commissioned in 1990, Unipede, 1982.

It is important to bear in mind that the figures in the table above reflect each country's views of the cost it would face in building a station to be commissioned in 1990, not necessarily the results it has already achieved. They are therefore far more likely to be optimistic than pessimistic. Nevertheless the main message is clear and stark - it is significantly more expensive to build either type of plant in the UK than elsewhere. The CEGB however strongly believes that the PWR will be substantially cheaper than the AGR which forms the basis for the UK nuclear figure in the above table.

2.28. A degree of reserve capacity, to ensure against the risk of normal plant breakdown, weather variability, and errors in demand forecasting, is required and is known as the planning margin. In the 1950s the CEGB's planning margin was 14 per cent. It was increased to 17 per cent, then 20 per cent in 1968 and 28 per cent in 1977. The rise reflects the increased uncertainty in forecasting demand, and the deterioration through time in plant reliability - a problem associated with the introduction of the large 500 and 660-MW sets. A recent report by the Electricity Consumers Council found that, although an international comparison of security of supply standards was difficult, the CEGB's standard appeared to be higher than those of other utilities. In addition, supply interruptions were rarely the result of generating failures - the main cause of failure had been the distribution system, because of factors like bad weather and strikes. The report concluded that a lower security standard could yield significant long term savings.

Conclusions

2.29. The main conclusions of this chapter are -

i. Only France, with a large amount of nuclear power, and Canada, Sweden, Norway and Austria, with a dominant share of hydro-electric power, have generating mixes with significantly lower cost structures than the UK. Germany is broadly comparable with the UK and the cost to Italy of a large share of oil-fired thermal plant is only partly offset by hydro-electric power.

ii. Fuel costs are a major cost component for electricity generation. In the UK we conclude that although the current coal bill paid by the CEGB to the NCB is about right, the immediate prospect is that NCB prices will rise above import related prices.

iii. In terms of operational efficiency, the UK is at a disadvantage compared with France and Germany. Partly this results from a different pattern of demand which the utilities can only influence to a limited extent. There is certainly room for the esi to improve its operational efficiency but the impact on its overall cost structure would be small.

iv. Construction costs are significantly higher for both coal and nuclear plant in the UK than elsewhere.

CHAPTER 3 - PRICING POLICIES

3.1. The price of electricity to consumers is dependent not only on cost but on the financial regime within which the utility operates and the way in which, via the tariffs, it shares out the costs between consumers.

UK pricing policy

3.2. In the United Kingdom the esi is required to meet a financial target set by Government. The Government's general policy is that consumers should pay economic prices for energy, as established by the international market. For electricity, in which there is no international market, pricing policies have been based on long run marginal costs in order to give the correct economic signals to users and the supply industry. The financial target for the electricity supply industry for the three years from 1980/81 to 1982/83 was based on estimates of marginal costs made by the CEGB in 1979. These suggested that in 1979 the CEGB's Bulk Supply Tariff was on average some 5 to 10 per cent below marginal costs. The financial target was set on the basis that this under-pricing would be progressively phased out. It was expressed as an average 1.8 per cent (subsequently reduced to 1.7 per cent) return on net assets over the three years.

3.3. In England and Wales the electricity produced by the CEGB is sold wholesale at a price determined by a published Bulk Supply Tariff (BST) to Area Boards, who then distribute electricity to consumers. The CEGB accounts for approximately 4/5ths of the electricity supply industry's costs, but for large industrial consumers Area Board distribution costs are low, and their prices are very largely determined by the BST alone.

3.4. The 1967 White Paper on the Nationalised Industries (Cmnd 3437) argued that if national resources were to be allocated efficiently, nationalised industry prices should be reasonably related to costs at the margin. Although it was acknowledged that when there was spare capacity, short run marginal costs (variable costs) would be relevant, it gave more emphasis to the need to cover long run marginal costs (including the capacity element). In the 1978 White Paper (Cmnd 7131) Government re-affirmed that for industries where there was sufficient scope for setting prices, these should take account of the need to cover costs, including the opportunity costs of capital. It further said that these costs should be reflected in the industry's medium term financial target. Of course, appropriate pricing principles do not of themselves ensure efficiency.

3.5. Marginal cost pricing in the electricity industry has two main components -

i. the variable costs of producing electricity. These are mainly fuel, but also associated fuel handling and labour costs. Because of the varied range of power stations (using different fuels - coal, oil, nuclear, gas turbines - and of different ages), a merit order exists and power stations are brought onto the system in order of increasing cost to meet increases in demand. Electricity demand varies significantly both during each day and on a seasonal basis. As a consequence marginal costs vary; different power stations are being brought on to meet increments of demand at different times. This is why the BST has different energy charges over the 8 hour night, 14½ hour day and 1½ hour peak periods.

ii. The element that gives marginal cost its longer term dimension is the cost of adding capacity to the system. Given the variation in demand just referred to, capacity costs essentially arise from extra peak demand. The BST therefore levies capacity charges at times of peak demand in the winter. The net cost of adding to capacity is the capital cost of plant, plus, through its impact on the merit order, its effect on generating costs. New capacity will have lower generating costs, be used as intensively as possible, and therefore displace more costly plant at the margin. If the electricity supply system is in balance - in the sense that demand and cost assessments turn out to be broadly correct and the plant mix is such as to minimise costs - the net cost of each type of capacity, whether new nuclear or fossil plant or the costs of delaying the retirement of existing plant, will be the same. If this were not so, costs could be lowered by rearranging the plant mix.

3.6. As mentioned above, the esi's financial target for 1980/81 to 1982/83 was set so as to phase out underpricing. Some spare capacity was expected but it was assumed that by the middle 1980s demand and capacity would be in broad balance. The marginal cost estimates therefore included the full net cost of adding new capacity to the system. But since then the environment facing the industry has changed significantly. Two elements stand out -

i. the recession has been more severe than expected and expectations of growth in the United Kingdom have fallen. In addition higher energy prices have led to greater reductions in energy use than was thought likely during the 1970s. As a consequence estimates of future demands for electricity have been revised downwards substantially on a number of occasions, so that the period of excess capacity is likely to be prolonged until well into the 1990s.

ii. oil prices rose sharply in 1979 and 1980, although they have since fallen back somewhat. The prospect is of very much higher prices for fossil fuels than was thought likely in the late 1970s. The result is that the economic case for investment in nuclear electricity is now based on cost saving and the advantages of diversifying sources of supply, rather than on expansion of capacity.

3.7. Indeed since the electricity supply industry has excess capacity extending well into the 1990s, there is no present case on grounds of capacity for building new plant. A substantial amount of new investment in nuclear plant would apparently be justifiable on the grounds of cost saving and diversification of supply but this would effectively prolong the period of excess capacity even further. This makes it even harder to pursue the nuclear programme in the face of public and political opposition. The existence of excess capacity also has important implications for marginal costs. Because of the comparatively low fixed costs of retaining relatively modern and efficient existing plant on the system and the absence of any need to build new plant to meet additional demand in the next decade, the marginal capacity cost of meeting additional demands is low.

The Bulk Supply Tariff

3.8. Earlier this year the Secretary of State for Energy commissioned Coopers and Lybrand Associates to report on the Review of the BST which the Electricity Council had carried out. In their report Coopers have investigated the BST's structure thoroughly, including the implications of the current imbalance in capacity for prices. We do not propose to adjudicate on the many detailed and important points raised by Coopers' investigation. However their conclusions do have implications for this current CPRS study.

3.9. The thrust of Coopers' work is, first, that the BST's capacity charges (which account for one fifth of CEGB's revenues) are too high. This is partly because inadequate weight is given to excess capacity (which lowers the cost of meeting additional demand), but also for more detailed methodological reasons. Secondly, the BST's structure may not adequately reflect the variation in costs during the day or over the year. The questions and problems posed by Coopers' investigation require further follow-up work by the Department of Energy with the CEGB. Assessments of the quantitative impact of Coopers' conclusions are therefore inevitably very uncertain at this stage. Nonetheless, it appears reasonable to suppose that too high a level of capacity charges results in the overall BST average selling price being at least 5 per cent and perhaps as much as 10 per cent too high. However the BST incorporates various load management schemes, arrangements under which large users reduce their demands for electricity at times of likely system peak, in return for reductions in capacity charges. By virtue of these load management schemes many of the larger intensive users already pay reduced capacity charges or are able to escape paying them entirely, so avoiding any element of overcharging contained in them. But industrialists would be affected by the introduction of a more sophisticated reflection of costs in the BST as Coopers recommended. Some, by concentrating their demand in the cheaper time periods, would benefit. For others it may not be practicable or worthwhile to re-schedule their demands and they might end up worse off than they are now.

3.10. The Coopers report indicates that there is a large degree of averaging within the existing BST, which averages the cost of generation into four time of day rates. This is taken even further by Area Boards in their taiffs and the types of contracts and special arrangements they make with industrialists. Coopers' report suggests that weekend rates and perhaps a sub-division of the standard day rate may be appropriate. This, combined with explicit charging by Area Boards for the existing 1½ hour peak period surcharge, could for some industrialists lower their electricity bills - but it would not be enough to remove more than a small part of the price disparities with France and Germany. Steel producers are among the more vociferous lobbyists, and many of them would be in a position to make use of more sophisticated day rates in particular, because their process is interruptible. Not only would a more sophisticated tariff be justified in its own right, but industrialists have shown through the various load management schemes that they can respond to appropriate price signals.

3.11. The CPRS draws the following conclusions from Coopers' report and its implications.

i. There is no systematic bias in the present BST against large high load factor industrialists. Indeed, the Contracted Consumer Load scheme, by going beyond what can strictly be justified on cost grounds, may be unduly generous. (This is because the number of hours in which users might be asked to reduce demand is less than the actual number of peak hours.) Additionally, under a scheme announced in the 1981 Budget, the Area Boards have 3 per cent flexibility in dealing with large industrial consumers. In effect this has allowed a reduction in electricity prices for large industrialists; again this has no rigorous cost basis to justify it. These two concessions cost £100 million in 1982/83, a figure which was specifically allowed for in setting the electricity industry's EFL. In principle these factors should be corrected when a more cost reflective BST is introduced.

ii. The great majority of industrial consumers would benefit from lower BST capacity charges if these were to be introduced as a result of further work following Coopers' recommendations.

iii. But, ironically, these same changes would give less benefit - in some cases, none - to high load factor industrialists who are already on load management terms; and this is the very group which contains most of the industrialists who are most affected by - and disaffected about - electricity prices.

iv. If a more sophisticated cost reflective tariff were introduced, some industrialists, by re-scheduling demand, would have the option of lowering their electricity bills by concentrating demand in the cheaper time periods offered.

v. The implementation of Coopers' proposals, which were inspired purely by resource allocation considerations, would have substantial costs in terms of additional public expenditure - perhaps of the order of £½ billion a year. Such a figure is of course not without wider macro-economic significance, but the balancing of these wider considerations is beyond our terms of reference.

3.12. Coopers' report suggested that coal prices are too high. They came to this conclusion because the NCB offers substantial discounts in order to sell additional tonnages in some markets (including to the CEGB for a coal take above 75 million tonnes a year), so as to keep stock levels under control. And, because of the effect on overall NCB costs of the loss making portion of the industry, and because of the comparatively low cost (relative to current prices) of developing some new reserves, Coopers presume that the excess costs come through in NCB prices. But as explained in Chapter 2, the CPRS considers a world related price to be the most appropriate economic yardstick. On this basis present coal prices are not too high; the costs of the uneconomic portion of the NCB's activities are borne by the taxpayer rather than by coal consumers.

Industry's arguments

3.13. The CPRS has considered the main complaints expressed by industrialists about electricity prices and contracts. These are discussed in more detail below, but they are in many cases based on misunderstandings. However the esi for their part have not made much effort to dispel these misunderstandings.

3.14. Underlying many of these arguments is industry's understandable fear that because of its monopoly position the esi is operating in an inefficient and non-market oriented manner and is able to pass on the cost consequences to its customers. The CPRS is considering the wider issues raised by this complaint in a forthcoming report on state monopolies. Inefficiency is very difficult to prove in a monopoly, but as discussed in Chapter 2, improvements in operational efficiency would not have a very significant impact on prices. Overcapacity and planning limitations are not confined to state monopolies. As far as the charge of non-market oriented behaviour is concerned, it is generally accepted that the current structure of the esi is unsatisfactory and that the separation of a centralised generation authority from regional distribution and supply boards does distance the consumer from the dominant sector of the esi, the CEGB. Our discussions in Germany have also indicated that a regionalised system, largely made up of separate power-boards, appears to allow a greater degree of market response and the potential for limited competition. Although we consider that these areas should be studied further, such structural changes would complement rather than replace the long run marginal cost pricing policy. It should be noted that German utilities stress the need to give correct cost-reflective price signals and reject the argument that they should phase price movements in sympathy with the economic cycle. We return to some of these points in Chapter 6 and concentrate below on some of the more technical criticisms raised by industry.

3.15. It is often alleged that the CEGB has got its marginal cost methodology badly wrong, especially with regard to the balance between energy and capacity charges. In part this can be attributed to a lack of clear and consistent public explanation and presentation of its methodology. Coopers, in considering this criticism, conclude 'although we have several reservations concerning the calculation of capacity and energy charges we are satisfied that the CEGB's approach is, in broad principle, consistent.' And we pointed out in paragraph 3.9 that although the BST is too high because of too high capacity charges, many large industrial users pay reduced capacity charges or avoid them altogether through load management.

3.16. Two additional arguments often raised are that electricity pricing should be on the basis of an optimal (rather than existing) system, and that base load plant (ie the more efficient and low cost plant) should be dedicated or allocated to high load factor industrialists. Pricing on the basis of an optimal plant mix could not be justified, given the size and speed of the United Kingdom's prospective nuclear programme (see chapter 4). EdF is, it is true, anticipating the benefits of low nuclear costs in its tariffs, but France's large scale successful nuclear programme is well on the way to fruition. In the United Kingdom the argument for pricing on the basis of optimal plant mix cannot be an economic argument based on the need to give consumers the right signals, since the timescale is too protracted for the signals to be relevant.

3.17. Industrialists have argued that efficient coal fired plant should be dedicated to meet their demands, so justifying cheaper prices. This argument is in fact misconceived as the BST does charge base load users the costs of marginal base load coal plant. Furthermore, for industrialists on load management terms, current prices are lower than would flow from the full costs of allocated coal plant. The same conclusion would not apply for dedicated nuclear plant. In the longer term, in a fully balanced system, nuclear would become the marginal base load plant and industrialists would receive no economic advantage from dedication. At present with an unbalanced system, dedicated nuclear stations already in operation <u>would</u> provide electricity at lower prices than those flowing from the BST.

3.18. Plant dedication can however prove to be very risky for the user. As the esi knows to its cost, expectations about such crucial factors as construction costs and fuel prices can be falsified; for example ten years ago industrialists might well have argued for dedicated oil-fired plant. Relying on the total system spreads the risk. And lowering electricity prices for some consumers now by giving them the benefit of what is at present the cheapest plant would result in higher prices for other consumers. We can see no economic justification for such a cross-subsidy.

3.19. Nevertheless large industrial electricity users have much to gain from more nuclear power stations within the esi. Efforts by industry to draw attention to the link between industrial competitiveness and nuclear power could play a significant part in persuading public opinion of the need for a more vigorous nuclear programme. It should also be noted that, with the proposed new legislation on private generation, there will be nothing in principle to prevent private industry from developing nuclear power within the private sector - perhaps in consortia using the national grid as a common carrier.

Communication between the esi and industry

3.20. It is however clear that much more could and should be done to explain and justify to industry the methodology of electricity pricing. The esi will have to make a major effort on this once changes in the tariff structure flowing from Coopers' Report have been agreed. Industry should be given a clear statement of the Area Boards' criteria and rules for contracts and special agreements. The Electricity Council have informed us that currently there is nothing stopping an industrialist being given BST terms. This should be made clear.

3.21. Industrialists have also complained that they should be able to deal direct with the CEGB. They say that Area Boards do not necessarily understand, or have any financial incentive to find out about, the underlying cost intricacies of the BST. Even if it does prove possible in future to revise the BST so as to give more sophisticated cost messages, there could still be cases where negotiation between large industrial users and the CEGB could lead to special tariffs which were more advantageous to both sides. Discussions with the CEGB could also help to dispel some of the misunderstandings which industrialists have about electricity tariffs and the costs of the esi, and might relieve some of their sense of frustration. We therefore recommend that large industrial users should be given a real opportunity to deal directly with the CEGB.

3.22. These recommendations will not result in markedly cheaper electricity for industrialists. But they should help to remove much of the misunderstanding, and allow industrialists to negotiate more effectively with the electricity industry, so that they can both arrange their affairs so as to minimise their costs.

International Comparisons

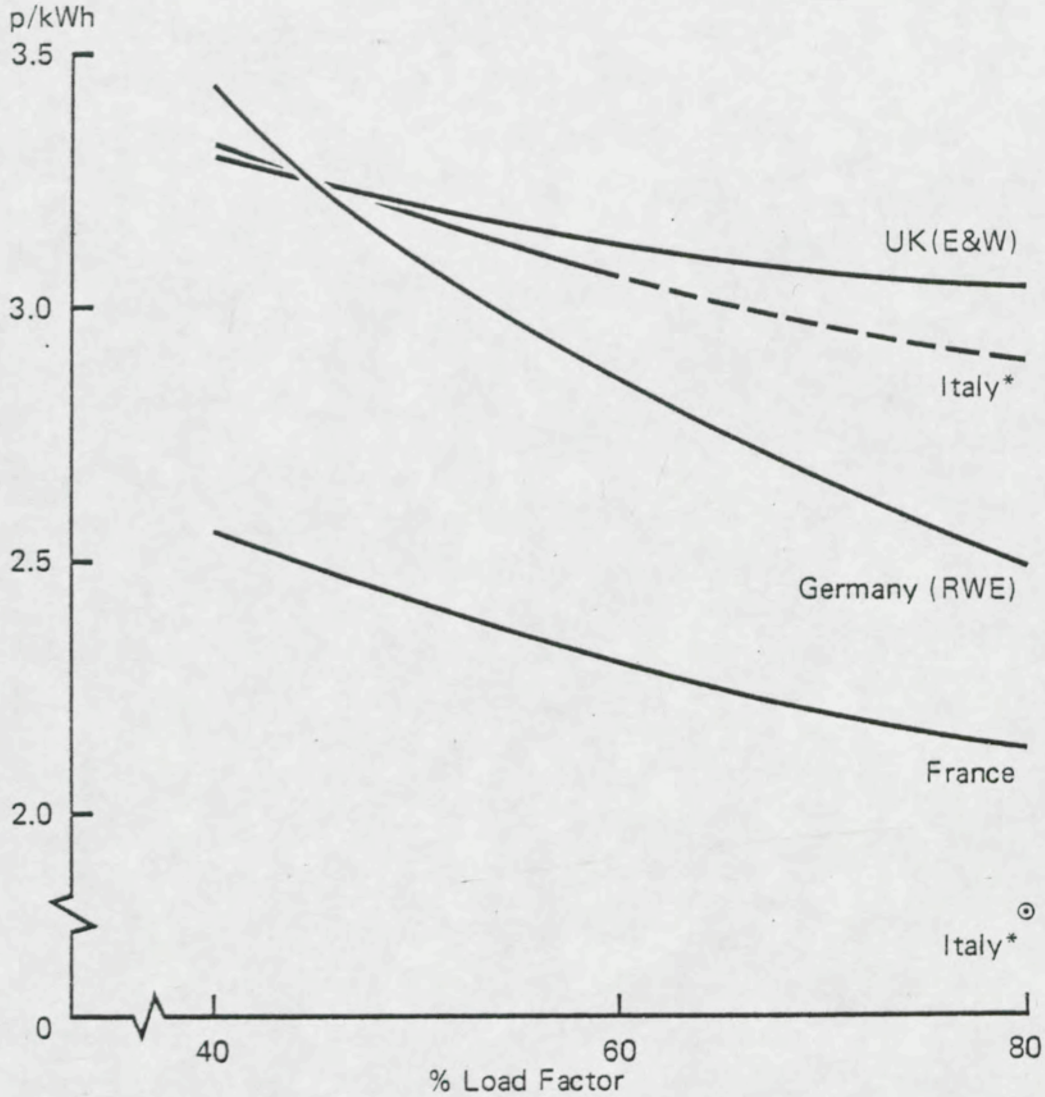
3.23. But, it can be argued, even if we accept the conclusion that the BST does not systematically discriminate against the heavy industrial user of electricity, it remains true that firms in France, and some of them in Germany and Italy, pay less than their counterparts here. What part does pricing policy play in those differences?

3.24. In general low load factor users in all countries pay more for each unit of electricity than high load factor users. Such tariffs are described as "degressive". The wider the difference between what high and low load factor users pay, the more degressive the tariff is. Clearly if the costs of producing electricity in two countries are the same, high load factor users will be better off in the country with the more degressive tariff, and low load factor users in the other. It is generally the case that tariffs in Germany are more degressive than elsewhere.

3.25. The graph in Figure 2 below compares, for large industrial consumers, tariff shapes in the United Kingdom with those elsewhere. The graph is based on Table 1A in Chapter 1 and the same qualifications apply.

3.26. The graph shows that, broadly speaking, in France and the United Kingdom costs are shared out in similar ways between low load factor and high load factor users. But the different levels indicate that costs overall are lowest in France. On the other hand, Germany's prices, as indicated by RWE, are more degressive, and high load factor users in RWE do very well compared with their competitors in other countries. The Italian curve is quite comparable to the United Kingdom's, until 80 per cent load factor is reached.

FIGURE 1 Industrial Tariff Prices per Unit (10 MW load, July 1982)



* Users at load factors of 80 per cent or more in Italy enjoy a substantial price concession. The tariff curve between 60 per cent and 80 per cent load factor has been estimated.

France

3.27. In France, most electricity is produced by the nationalised utility Electricite de France (EdF) which has a monopoly of the transmission and distribution of electricity. The French Government's intention is that industry should receive electricity at a competitive, but not subsidised, price, and the cost of supply to each category of smaller consumer, and if necessary each individual large consumer, should be recovered through the tariff. The marginal cost, together with an adequate contribution to overheads, would form the basis of individual prices.

3.28. The French generating system is not optimal at present - there is too much oil-fired capacity - and prices are set at a compromise between the marginal cost of the existing system and the more balanced one towards which EdF is rapidly moving. By 1985 EdF intend that the tariff structure should reflect the marginal costs of supply in the period 1985 to 1990. This complements the French Government's objective of increasing reliance on electricity, and on nuclear power as a way of generating it, in order to switch away from oil. The new counter-inflation strategy in force, however, means that prices have not been allowed to rise fast enough to prevent EdF incurring substantial deficits.

3.29. EdF has access to a wider range of loan facilities than the electricity supply industry in the United Kingdom; on some of them, interest is payable only at low rates (3-5 per cent) or not at all for some time, but on others EdF must bear exchange rate risks. EdF works closely with several different parts of the Government but has to accept constraints (sometimes severe) on the quantity of capital of various kinds to which it has access, constraints that the French Government might choose to impose for wider economic reasons.

3.30. Recently EdF's deficit has been causing concern; the foreseeable 1982 deficit of FF8bn (about £700m) could almost double the 1981 figure of FF4.4bn. A substantial part of the problem is exchange losses on borrowings abroad, caused by depreciation of the franc; about a third of EdF's debt is in foreign currency.

Germany

3.31. The German electricity system is the product of economic evolution, and changes in structure and trading relationships have taken place largely in response to market forces rather than government pressures. The system today consists of nearly 1000 separate undertakings ranging in size from small local distribution companies to large integrated regional authorities, of which RWE in Essen is by far the largest, accounting for 36 per cent of generating capacity. The various utilities form part of the private sector although the majority of the undertakings have an element, often a controlling element, of public capital in their equity. The public element is provided by the local Lander governments which have a direct relationship with the electricity undertakings operating within their territory. The federal government provides a framework for the electricity industry. The utilities are partially regulated by government, both national and local.

3.32. The German pricing structure contains three elements -

- tariff customers (mainly domestic and commercial);

- special tariff customers (mainly industry); and

- special agreements (only for large industrial customers).

Prices for the first category are the subject of published tariffs which are controlled by a price commission in each state authority under criteria set by the federal government. Prices to special tariff customers are separately negotiated and are subject only to oversight by the Cartel Office. These two categories of prices are publicly available and are inevitably closely related. The third category, special agreements, are for a small number of large industrial users and are privately negotiated and confidential.

3.33. In principle, cross subsidisation, undue preference and subsidy should play no part in any of these categories. There is, however, a significant amount of flexibility in price negotiations for special tariffs and special agreements. The Cartel Office can check any contract in these categories provided there is a basis for believing that misuse of monopoly power is involved.

3.34. The tariffs and the special contracts appear to be very degressive and the sensitivity of the system to particular groups is often reflected in special terms. For example, German iron and steel producers have their "peak demand" measured during a much smaller number of hours than ordinary consumers on tariffs; in the summer it can be as little as one hour a day. To the extent that they can avoid using electricity in these hours, they can reduce their bills. It has been argued that this approach is in effect a load management scheme and that there is an economic rationale behind it.

3.35. The independence of the different utilities results in significantly different cost structures and hence prices among different authorities. RWE with access to cheap brown coal is probably the lowest cost utility and one which supplies power to a large amount of heavy industry in the Ruhr area, particularly steel and chemical plants. However brown coal is running out and the extent to which RWE maintains its position as a low cost authority depends on the speed with which it can build nuclear capacity. Some utilities have achieved a substantial proportion of nuclear plant in their generating mix eg 39 per cent at NWK (supplying ICI at Wilhelmshaven).

3.36. As far as the special agreements are concerned, we have not been able to establish to our satisfaction that the lowest prices do cover current marginal costs of supply. We have the impression that many of these arrangements are below costs, assessed on today's terms, and that in some cases prices do not fully cover full nuclear costs, though they may cover variable nuclear costs.

3.37. These special agreements seem to have two separate rationales. In the case of the large utilities such as RWE they have been based initially on falling marginal costs, which resulted in cost-related contracts which were below average costs. However these conditions have passed; marginal costs are no longer falling and the economic justification for these special agreements has disappeared. The special agreements with RWE, enjoyed by a number of chemical and steel companies, expire in 1983, and RWE's intention is that they should not be renewed. With German heavy industry under pressure, and with high levels of unemployment, RWE will come under political pressure to renew such special contracts. The outcome is difficult to predict, but it seems certain that, if renewed, these special contracts would be on substantially less favourable terms.

3.38. A quite separate rationale is that of local industrial policy. Smaller utilities are more vulnerable to local political pressure designed to attract and retain heavy industry. Some subventions are in the form of rate relief etc; others are in the form of special agreements where there is likely to be a major element of cross-subsidisation. Such agreements generally have many years to run, and the political pressure for them is unlikely to diminish. It would appear that the Reynolds Aluminium contract in Hamburg (HEW) and the ICI contract at Wilhelmshaven (NWK) fall into this category. However increasing costs are likely to result in significantly higher prices when the contracts come up for renewal, even if some form of subsidy is retained.

3.39. Although the federal Government generally distances itself from the operations of German utilities, it does operate the Coal Utilisation Fund, through which domestic coal production is subsidised. German hard coal is expensive to produce and the utilities would prefer to use imported coal which is cheaper. The Government imposes a levy, called the Kohlepfennig, of about 5 per cent on electricity prices. The fund is needed to reduce the price of German coal bought by utilities to levels closer to (but not as low as) imported coal. Utilities are then allowed to import coal according to a formula based on the amount of German coal they buy.

Italy

3.40. Tariffs are controlled by CIP (Inter-Ministerial Pricing Committee) and have resulted in large operating deficits for ENEL, the state electricity utility; over the past year these amounted to 1,000 billion lire (about £400 million). The three areas of difficulty are -

i. the social tariff to domestic consumers. This was originally designed to protect the poorest citizens but now 90 per cent of household consumers benefit. Despite counter-inflationary pressures, some moves have been made to restrict the concessions but ENEL still fails to recover costs from most users;

ii. concessionary tariff levels to certain sectors of industry eg electric arc steel producers, who pay reduced rates during certain low load hours;

iii. the "thermal surcharge" (reflecting the increased costs of fuel) that ENEL has not been allowed to collect for the past 18 months, resulting in a deficit of 1,800 billion lire (and, in turn, interest charges of almost 400 billion lire a year). Industrial users on 80 per cent load factor or above enjoy a special reduction in the thermal surcharge.

3.41. The Government have recently announced a 2 per cent increase in electricity prices every 2 months in 1982, which should bring in 800 billion lire in 1982. In ENEL's view this and other measures fall far short of providing the 3,200 billion lire it needs. ENEL's financial health will, however, be a key factor in Italy's ability to carry forward its new National Energy plan.

Other countries

3.42. In the second group of countries, electricity prices are generally regulated in some way. In some cases prices for certain groups of users can be kept at an artificially low level. For example, recent price trends for high load factor users in Belgium indicate that they are being relieved of the burden of the nuclear building programme. This appears to be a commercial decision, there is no evidence of Government pressure, and apart from subsidising high cost domestic coal down to import price levels, energy is not generally subsidised in Belgium. Another example is provided by some American electricity utilities which are financially weak because, in general, regulatory Commissions are not prepared to allow them to pass on to consumers the financing cost of the construction of new capacity or conversions to coal until the plants are actually in operation. This clearly acts as a disincentive to utilities considering new investment which from the national point of view is needed, and is causing concern. The Public Utility Regulatory Policies Act of 1978 contained measures designed to ensure that regulatory bodies re-examine rate structures; the main responsibilities in this area now lie with the State, rather than Federal, governments.

3.43. In July 1982 the Dutch government announced a scheme to reduce prices paid by large consumers with high load factors, by allocating cheap gas to utilities. All units consumed over 30 GWh a year attract a discount of almost 1p/kWh.

Conclusions

3.44. The main conclusions of this chapter are -

i. There is no systematic bias in the present BST against large high load factor industrialists. Indeed, some load management terms, by going beyond what can be strictly justified on cost grounds, may be unduly generous.

ii. The various proposals for changes in the BST made by Coopers would benefit most industrial consumers, but would give less help - in some cases no help - to the high load factor industrialists who are already on load management terms.

iii. There is no economic case for allocating CEGB plant to industrialists so as to result in lower prices.

iv. Although some changes are proposed in pricing policies, and more should be done to explain and justify to industry the methodology of pricing, the CPRS considers the marginal cost pricing approach to be sound.

v. Lower prices for all industrial consumers in France are related to EdF's costs later in the 1980s when it will have completed its successful nuclear programme. In the meantime its prices involve EdF in substantial deficits. German tariffs are more degressive than elsewhere. Some large industrialists on special contracts in Germany, and high load factor users in Italy, pay lower prices than can be economically justified. The German special contracts are largely historically based and are being renegotiated to reflect current costs. An element of local Government subsidy is included in a few cases and is likely to be retained. Subsidy also plays a large role in the prices paid by large Italian industrialists.

CHAPTER 4 - PROSPECTS FOR PRICES

4.1. Given present prices for fossil fuels, nuclear power is much cheaper than oil generation and quite a lot cheaper than coal generation. These differences are likely to increase by the end of the century as real prices for fossil fuels rise. This Chapter therefore discusses the prospects for nuclear power in the United Kingdom and in other countries. It also briefly discusses utilities' fossil fuel costs and the possible impact of private generation in the United Kingdom.

Nuclear Prospects

4.2. The most important factor in containing future United Kingdom electricity costs will be our success in increasing the proportion of nuclear generation through the efficient construction of nuclear power stations. This is true even though on strict demand and capacity considerations, new generating plant will not be needed until some time in the the 1990s. The CEGB case for Sizewell shows that - provided it is able to meet its cost and performance targets - its net effective cost is negative ie building Sizewell B will reduce the overall costs of meeting current demand projections.

4.3. Nuclear plant at present meets only a part of the system's base load. The Department of Energy's Energy Projections prepared for the Sizewell Inquiry estimate that on existing programmes nuclear plant is not likely to meet full base load until about 2025. Existing plans were assumed in the central cases to involve the building of 5½ GW of nuclear capacity in the 1980s and a further 15 GW in the 1990s. Clearly an acceleration would be worthwhile. But a definite credibility problem exists. Sizewell (1.1 GW) alone will cost £1.1 billion to construct. Any substantial acceleration of the nuclear programme would entail a vast additional commitment of resources - both real and financial. The United Kingdom's past performance in building nuclear power stations not unnaturally causes hesitation and caution. Before resources on the required scale can be committed, we must be absolutely certain that the United Kingdom is building a sound system, and that construction performance will be adequate. Clearly the outcome of the Sizewell Inquiry will be crucial. And we cannot mount a nuclear programme on the scale required if there is widespread public opposition. The task of winning over public opinion is not made any easier by the current degree of excess capacity.

4.4. On current policies, assuming countries are able to meet the targets they have set themselves, the following pattern of electricity generation in 1990 emerges.

Table 9 - Electricity Generation in 1990

Per Cent

	Nuclear	Hydro and Other	Coal	Oil	Gas	Total
UK	24	1	63	12	0	100
France	72	19	9	0	0	100
Germany	32	4	52	3	10	100
Italy	11	19	32	34	4	100
USA	24	12	50	5	9	100
Japan	33	16	12	21	18	100
Canada	17	64	16	2	1	100
Sweden	44	51	3	3	0	100
Norway	0	100	0	0	0	100
Austria	0	72	14	6	8	100
Belgium	46	3	37	10	5	100
Netherlands	8	4	52	4	33	100

Source: Energy Policies and Programmes of IEA countries, IEA, 1982.

Countries have in the past proved to be over optimistic about their planned nuclear construction. Downward revisions have been common and substantial. Table 10 compares the amount of nuclear plant already operating or under construction with what is required to meet each country's 1990 target. Only France and possibly the USA have the kind of track record that inspires any confidence they will meet their target. Some, eg Germany, Japan and Italy, have put forward projections for 1990 (which means that the last

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Table 10 - Status of Nuclear Programmes at end of 1981

GW

	Operating	1990 Country Projections	Difference	Under Construction	Sites Approved & Authorised	Planned but no site Approval	Experience since end of 1978	
							New orders	Cancellations
United Kingdom	6.5	14.8	8.3	5.6	-	1.2	4.2	-
France	21.6	56.5	34.9	28.9	7.4	-	26.5	-
Germany	9.8	25.5	15.7	9.3	1.3	11.3	1.3	-
Italy	1.4	5.4	4.0	2.0	-	4.0	-	-
United Kingdom	6.5	14.8	8.3	5.6	-	1.2	4.2	-
United States	57.4*	121.0	63.6	80.7**	2.6	12.7+	-	30.9
Japan	15.5	51.0	35.5	10.1	6.1	17.0	3.8	-
Canada	5.2	15.0	9.8	4.9	-	5.2	-	-
Sweden	6.4	9.4	3.0	3.0	-	-	-	-
Belgium	1.7	5.5	3.8	3.8	-	-	-	-
Netherlands	0.5	0.5	-	-	-	-	-	-

* Not included 1.1 GW installed but not operating

** Of which 15.7 GW are less than 20 per cent completed and subject to delays or cancellations

\+ Not included 3.5 GW ordered but no permit application

Source: World Energy Outlook, IEA, 1982.

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station required to meet these projections must be started around 1984) that invite scepticism. The United Kingdom figures are somewhat above those implied by the Department of Energy's Energy Projections.

4.5. Nevertheless, Table 9 vividly shows the basis of France's cost advantage. If we make realistic assumptions about slippage of the programmes, in 1990 the United Kingdom will be roughly level pegging with Germany, USA and Japan. Prospects beyond 1990 are much more difficult to assess. The existing programme will - assuming its achievement - ensure that the proportion of CEGB's generation from nuclear plant will rise from about 20 per cent in 1990 to 35-40 per cent in 2000. The rise is in part held back by the retirement of 3½ GW of the Magnox generation of reactors. The problem of public acceptability is not confined to, or indeed most acute in, the United Kingdom. If however this problem is overcome, Germany, United States and Japan could establish sizeable nuclear programmes in the late 1980s, which would have a significant impact on their electricity costs by the turn of the century. The French have shown what is possible. The United Kingdom must at least match this possibility, otherwise electricity price disparities will widen to our disadvantage.

Fossil Fuel Prices

4.6. The price of fossil fuels to utilities will continue to be the dominant factor in the price of electricity for most of our major competitors up to 1990, perhaps beyond. There is considerable uncertainty both about the trend in world traded coal and oil prices, and how individual countries (particularly in regard to coal) will react to these. We believe that the basic presumption must be that they will broadly keep the price trend of fossil fuels to their utilities in line with those of world prices. It will be necessary to ensure that the NCB's coal prices match this (see paragraphs 2.8-2.18).

France

4.7. The French generating system is not optimal at present, as there is too much oil-fired capacity, but by 1990, almost three-quarters of France's electricity is expected to be generated by nuclear power. There has been a substantial (and successful) nuclear power station building programme for many years, and the expectation must be that the 1990 target will be met.

French prices at present anticipate some of the future benefits of its nuclear programme. When, about 1990, the French generating mix almost reaches the optimum, French prices can be expected not to decline any further; as the United Kingdom's nuclear capacity share increases, the disparity should then begin to narrow.

Germany

4.8. The German government is committed to the expansion of nuclear power but progress has in the past been constrained because of the complexity of the licensing system for PWRs; problems with reprocessing and waste disposal; and a combination of a lack of public acceptance of the need for nuclear capacity with laws and procedures that permit objectors to get court rulings to halt power station construction. The government has taken steps to streamline the licensing procedure and to try to resolve or defer the waste problems, but the climate of public opinion is still uncertain.

4.9. The United Kingdom Government is not alone in coming under political pressure on electricity prices; there is a similar debate going on in Germany. German industrialists are complaining bitterly about rising electricity prices and the impact on international competitiveness, particularly compared with France. The German electricity supply industry is mounting a major campaign to justify price rises on cost grounds and is strongly pressing the point that the only way to keep electricity-intensive processes competitive in Germany is to accelerate and extend the nuclear power programme. The nuclear power record has been markedly better in CDU than in SPD governed states, to the benefit of consumers in the former areas. It remains to be seen whether any new CDU national government would provide additional impetus to the nuclear programme in the face of continuing electoral progress by the Greens. If it does, and the Germans can maintain their good power station construction record, Germany could get well ahead of the United Kingdom in building up the proportion of nuclear plant in her electricity generating system.

4.10. As far as special contracts offering favourable terms to large industrial users are concerned, we have pointed out in Chapter 3 that the majority of those contracts are likely to be renegotiated on to current cost related terms as they come up for renewal. There may be a few cases where an element of subsidy is continued because of local government pressure, but even in these cases, the current differentials with United Kingdom industry can be expected to narrow.

Italy

4.11. In the 1970s Italy adopted an energy plan that involved a rapid increase in nuclear generating capacity, but this turned out to be impracticable mainly because of difficulties in getting agreement at regional and local level to the use of sites.

4.12. The new National Energy Plan adopted in 1981, and designed to reduce Italy's dependence on imported oil, involves a more modest expansion of nuclear capacity, energy conservation and the development of coal and gas imports. The plan involves a 50 per cent increase in the use of electricity, with oil burn held roughly constant, the nuclear contribution increasing from 0.5 to 8 mtoe and most of the increment being met by increased coal burn. Nevertheless, Italy will continue to be heavily dependent on oil, and hence on price movements in the world oil market, over the whole period to 1990. The other main generating fuel will be imported coal, again at world market prices.

4.13. The success of the plan depends on Italy's ability to carry forward a many-faceted development plan, not all of it involving direct action by the State. It requires the development of three major coal ports and inland distribution facilities, at an estimated total cost of 1,200 billion lire (£500m). The power plant construction element (17 GW new coal plant and 6 GW nuclear) requires ENEL to spend 34,000 billion lire (£14 bn) over the next ten years. ENEL's ability to fund this development will depend heavily on government decisions on pricing and indirect funding. There must remain doubts, both as to whether the plan goes far enough to meet Italy's problems, and whether it is achievable.

Other countries

4.14. The successful Belgian nuclear programme is near completion but there has been no debate or decision yet on further expansion. In several of the other countries, however, prospects for the development of nuclear power are uncertain because of the strength of public opposition. Austria's one nuclear plant has been mothballed after a referendum and Sweden is committed to no more nuclear capacity after the twelve reactors approved by referendum. In the Netherlands, the Dutch Parliament is due to decide in 1984 whether to proceed with nuclear. But the new government is unsympathetic to the nuclear option and is exploring the consequences of closing down or mothballing two stations.

4.15. As in other countries, delays are caused in Japan by the difficulty of finding suitable sites and the negotiation of compensation with local residents. A leakage of radioactive water at a plant in 1981 drew public attention to safety matters but does not seem to have affected the nuclear programme so far. In order to make siting easier, grants are now provided to local governments to reduce electricity rates for residents and firms close to nuclear plants.

4.16. The expansion of nuclear power is seen by the American government as an important objective; and the President's statement in October 1981 announced moves to speed up licensing procedures, lift the ban on reprocessing and resolve waste storage problems, develop fast breeder reactor technology and remove obstacles to the increased use of nuclear power. Among these obstacles is the weak financial state of utilities, which with the sharp decline in the growth of energy consumption has resulted in no new orders for nuclear power stations since 1978, and 22 cancellations. Another is growing public doubt about safety in the wake of the incident at Three Mile Island. A third is the lengthening of construction times as a result of safety regulations being changed during construction; the acceleration of the licensing procedures should help to reduce this though the President's target of 6-8 year lead times still looks ambitious.

Private Generation

4.17. We have also examined the potential impact of private generation and combined heat and power schemes on United Kingdom industry's costs. The Government's proposed new legislation for allowing private generation as a main business is designed to change the present culture and to provide a suitable environment for competitive and innovative enterprise. The proposals include the use of the national grid as a common carrier for private suppliers which will give the opportunity for private industry consortia to generate power in one place and sell it in another. This will enable industry to challenge the monopoly position of the esi and to test their feeling that prices would be lower in a competitive environment.

4.18. We consider that such schemes could be economically attractive, principally for nuclear stations but also perhaps for modern efficient coal stations, particularly at coastal locations using imported coal. However, there must be some doubts about the willingness of the private sector to invest in such projects. The public opposition to private sector nuclear power stations is likely to be a major constraint and any private investment would involve massive financial and managerial resources to build the size of power station that economies of scale require for viability. The electricity intensive industries tend to be under considerable competitive pressure for a wide range of reasons and it seems unlikely that such industries would want to commit resources to private sector power stations in the near future. Nevertheless there could be firms in other sectors which would be interested in supplying power both to their own industries and to the troubled electricity intensive sectors. There could also be some merit in private industry developing private generation projects in parallel with the CEGB in order to share expertise and assist construction.

4.19. The economics of private sector generation could be greatly improved by linking this approach with combined heat and power schemes. The electricity intensive industries tend also to be energy intensive and if the process heat demand can be matched to the heat produced from power generation, overall thermal efficiency can be increased from about 30 per cent to over 80 per cent. As well as schemes wholly within the private sector, we also consider that there is further potential for the esi to develop combined heat and power schemes in conjunction with industry.

4.20. We have also examined whether the sale of CEGB plant to the private sector would be both economic and desirable. We concluded in Chapter 3 that allocation of efficient coal fired plant would not provide industry with lower prices than the BST, and that allocation of nuclear plant would result in an unjustifiable cross-subsidy from other consumers. A similar argument applies to the sale of CEGB plant to industry. On the positive side, the long lead times and construction risks would already have been borne by the CEGB and it is possible that the private sector could operate such stations more economically, both through higher efficiency and, for coal stations, through imported coal. However, these factors are likely to be out-weighed by the fact that the sale of any stations which are attractive to the private sector is likely to increase the average costs of the esi and hence result in cross-subsidisation of the sale by other electricity consumers.

Conclusions

4.21. The main conclusions of this chapter are -

i. Looking ahead to 1990, and assuming that NCB coal prices remain related to the price of imported coal, the CPRS cannot see any cause for assuming that the costs which underlie United Kingdom electricity prices are likely to fall relative to those in competitor countries. The gap between the French and ourselves is likely to widen.

ii. Most of the advantageous contracts for German industrialists are to be renegotiated soon. They are then expected to be more related to current costs. Differentials with United Kingdom industrial prices can therefore be expected to narrow somewhat.

iii. Looking further ahead to say the year 2000, other countries could by then have achieved a substantial impact on costs through accelerated nuclear programmes. It is essential for us to be able to match this.

4.22. This chapter has implicitly assumed a constant exchange rate. Chapter 1 indicated that the deterioration in recent years in relative industrial electricity prices against the United Kingdom in the main reflects our substantial loss in competitiveness. Compared with 1979, competitiveness had by early 1981 deteriorated by over a third. Since then it has improved by some 10 to 15 per cent. Further improvements in competitiveness, as domestic costs continue to adjust, can be expected to contribute towards improving the United Kingdom's relative industrial electricity prices. The timing and extent of this is however uncertain.

CHAPTER 5 - THE IMPACT OF ELECTRICITY PRICES ON UK INDUSTRY

The General Picture

5.1. Figures derived from the 1974 census of production show that, on average, direct purchases of electricity accounted for 1.36 per cent of the costs of manufacturing industry. In only 18 of the 82 sectors was the average higher than 1.5 per cent and in only one (cement manufacture) did it exceed 5 per cent. A few figures for 1979 have recently become available. They confirm this general picture, although the overall average has risen to 1.54 per cent of total costs.

5.2. In addition to direct purchases of electricity by industry, electricity prices enter industry's costs indirectly through their impact on the cost of purchases of, for example, raw materials and components. Taking direct and indirect purchases together raises the average proportion of manufacturing industry's costs attributable to electricity to about 2½ per cent.

5.3. Thus a major reduction in the cost of electricity to industry - say of the order of 20 per cent - would have a very modest impact on total costs - it would not lower them more than ½ per cent in most cases. Such a reduction would of course be welcome and helpful to all parts of manufacturing industry, but it could not be regarded as a critical element in industrial competitiveness.

5.4. Within this broad picture, however, there are of course some businesses for which the cost of electricity is or could be a significant factor for international competitiveness and for future strategic and investment decisions. With the help of Departments and from other enquiries we have identified those industrial sectors which could be most seriously affected by the cost of electricity and we have examined its actual impact on them. By no means all heavy users of electricity will be at a disadvantage facing overseas competitors in the market place. Some electricity intensive products are not internationally traded to any great extent, usually because, like cement, their bulk to value ratio is very high and the cost of transport would be too high. Nevertheless if the price difference between these products in the United Kingdom and on the Continent goes on increasing, trade will eventually become attractive. There are signs for example that cement is beginning to be traded. These "non traded" products cannot therefore be ignored completely, though they are at present less important.

5.5. The sectors we have identified that could be at a serious disadvantage in competitive terms as a result of electricity prices are chemicals, iron and steel, textiles, paper and board and aluminium. As a result of our work we consider the first two to be the most important. In the following paragraphs we summarise our findings on all five industries, describe briefly the position of some other industries, and draw some general conclusions. Annexes A-D discuss the position of chemicals, iron and steel, textiles and paper and board more fully.

Chemicals (Annex A)

5.6. The chemicals sector uses more electricity than any other; it accounts for about 17 per cent of all industrial demand and 6 per cent of all electricity supplied by the esi. As a generalisation, the importance of electricity to costs is greatest at the beginning of the production chain and declines along the chain through intermediates to final products. For intermediates, electricity will typically account for 5 - 7 per cent of costs; in final products it will be as little as 2 per cent. Where figures of this order apply, electricity costs though important are only one of many factors affecting international competitiveness.

5.7. There are however a number of processes where electricity costs are of a much higher order of significance for competitiveness. The most important of these is the production of chlorine by the electrolysis of brine; a process in which electricity accounts for 50 per cent of total costs and 80 per cent of variable costs. ICI, the major United Kingdom firm involved, have waged a long campaign for electricity prices nearer to the very favourable electricity prices which ICI themselves currently pay in their German plant at Wilhelmshaven. (This is the result of a special contract, of the kind described in Chapter 3 above, which in our understanding results in prices which are below cost, at least in today's terms.)

5.8. Even in the case of chlorine, however, the importance of electricity prices can be exaggerated. Chlorine itself is not readily traded. Its most important uses are as an input, via intermediate products, to the production of PVC and of various chlorinated solvents. As we show in Annex A electricity accounts for some 10 per cent of the total cost of PVC. ICI have shown that at similar high load factors (90 per cent) electricity at Runcorn costs 1.7 times what it costs them in Germany; based on this figure the final cost disadvantage to the United Kingdom in the production of PVC is 4 per cent. Figures of the same order apply to other chlorine based products and put the disadvantage into proper context.

5.9. Moreover, under current conditions of depressed demand Runcorn is only 67 per cent loaded and application of the German tariff which strongly favours high load factor operation would in fact increase Runcorn's electricity bill. But, of course, if the German tariff applied in the UK ICI would have the incentive to load up Runcorn at the expense of smaller plants.

5.10. Unfortunately the PVC chain brings together the problems associated with chlorine production and those of ethylene based products. All European petrochemical producers are under severe pressure but ICI, dependent on naphtha rather than ethane as a feedstock for ethylene, have particular problems. ICI are currently making massive losses in PVC which is selling at 40 per cent of fully built up costs. It is doubtful whether ICI are even covering variable costs along the production chain from chlorine to PVC.

5.11. This helps to explain why ICI attach so much importance to electricity prices. And they are quite entitled to point out that if they operated in the UK at high load factor and they enjoyed the sort of electricity price they have obtained in Germany, their losses on chlorine based products would be substantially reduced. It is also possible that unless the differential between the prices currently paid by ICI in the UK and in Germany is significantly reduced ICI might withdraw from at least part of the chlorine based sector in the UK. However, the advantage enjoyed by ICI in Germany results from a special agreement which on today's terms would not appear to be covering costs. Although the renewal date of this contract is confidential, it seems likely that any renegotiation will result in higher German prices which will reduce the differential with UK prices significantly. The same result is likely for ICI's competition in Germany. In addition current ICI UK chlorine capacity is ten times that in Germany so any major shift of chlorine production by ICI to Germany would necessitate new electricity supply arrangements. We therefore consider that the threat to ICI's UK operations is less a function of competitive electricity prices, although we do not deny that this is one relevant factor, than a result of the general problems besetting the chemical industry - world overcapacity and, for the United Kingdom, a high sterling exchange rate. This conclusion is to some extent reinforced by ICI's recent announcement of its intention to increase its exposure in PVC through a portfolio swap with BP which presumably indicates a degree of confidence in the future.

5.12. Assuming however that a significant electricity price differential still remained, the logical course for ICI, when existing capacity needs replacing, would be to build this in Germany, closing down or substantially reducing chlorine production in the United Kingdom. It is unclear whether withdrawal would take the form of (i) the loss of all chlorine based production chains at Runcorn (of which PVC is only one); or (ii) the loss of only the upstream electricity-intensive processes in these production chains ; or (iii) the loss of only the total PVC production chain; or (iv) the loss of only the upstream electricity-intensive products from the PVC production chain. The first and third cases would lead to the import of finished products while in the other two cases imported intermediate products either from ICI or from competitors could be used to supply the UK downstream plants. Total job losses could range from 1,700 to 12,000 with possible detrimental effects on the balance of trade of between £50 million and £760 million a year.

5.13. The CPRS does not consider that such drastic measures are imminent and indeed they may never occur. However some form of withdrawal is a distinct possibility in the longer term. Although the extent and consequences of future ICI decisions cannot be predicted the CPRS considers that the cases (iii) and (iv) above are more likely than (i) or (ii). If so total job losses could be between 1,700 and 4,000 and the detrimental impact on the balance of trade could be between £50 million and £250 million a year.

5.14. As far as other chemical sectors are concerned, we list in Annex A three other processes known to be under competitive pressure and in which electricity prices are an important factor. In the case of magnesia (700 jobs involved) and titanium dioxide (1800 jobs), higher electricity prices here than in competitive countries probably contribute two or three per cent to total costs. In the case of aluminium oxide (50 jobs) the cost penalty is much higher, and closure of the plant must be a real possibility. It has been argued that aluminium oxide and magnesia are products of strategic importance; but they are internationally traded and supplies are unlikely to be restricted if domestic production ceases.

Iron and Steel (Annex B)

5.15. In Annex B we consider first the position of steel made by the electric arc process. BSC are the major force but the private sector also operates the process. About 25,000 jobs are directly involved and another 25,000 men work in the private sector's rerolling and finishing plants, whose existence would be in jeopardy if United Kingdom steel production ceased. The electric arc sector has suffered, and continues to suffer, severe competitive pressure, despite considerable demanning and closure of capacity.

5.16. Electricity accounts for between 8 and 15 per cent of total costs in the electric arc process. Our principal competitor is Germany and their steel producers may enjoy electricity prices 15-20 per cent lower; our disadvantage would thus amount to around 2-3 per cent on total costs. In today's hard times a penalty of this size is clearly material. But to put it in context, labour accounts for some 20 per cent of the cost of steel made by this process and the German labour rates are 80 per cent higher than United Kingdom rates.

5.17. In our view the cost of electricity in the United Kingdom imposes a material handicap on United Kingdom arc-based steelmakers in the public and the private sector. It has a more serious effect on those steel activities at the lower end of the range of value added, but it is material to all. Electricity prices could be an important factor in the future of certain very vulnerable activities like non-alloy rod and bar. But we conclude that for most arc-based activities electricity is unlikely to determine their long-term future.

5.18. Electricity is less important to the costs of BSC's integrated works which make steel by the hot metal route, but it is still very significant at between 5 and 8 per cent of total costs of saleable products. The problems of the BSC's integrated works do not need repetition here. In our opinion there is still very significant scope for reducing costs by improving capacity utilisation, productivity and other aspects of performance, and the cost penalty of higher electricity prices (perhaps 1-2 per cent of total costs) must be seen as a minor factor in this context. It is unlikely to affect the major decisions that BSC and the Government will need to take about the industry's future and financial support.

5.19. Electricity is also significant for the dispersed steel foundry sector at between 2 and 8 per cent of total cost of saleable products. The major problem for this industry is volume and major efforts are being made to improve capacity utilisation.

Textiles (Annex C)

5.20. In Annex C we consider textiles under three separate headings, - manmade fibres, yarn processing and downstream activities (eg bleaching and dyeing, cloth manufacture, making up final products).

5.21. In manmade fibre production electricity accounts for 5-7 per cent of manufacturing costs. The United Kingdom sector has contracted drastically in recent years and now employs some 12,000 people. There is still overcapacity and competitive pressure remains severe. Electricity costs must obviously have some impact on competitiveness (perhaps giving a disadvantage of 1 per cent or so on total costs compared with European competitors); but other factors are likely to be much more important for the future size of the UK industry.

5.22. Yarn processing is an interesting sector. It employs some 4,000 people often on short term contracts. Electricity accounts for as much as 25 per cent or more of total costs and many if not most of its competitors in Germany, France and USA enjoy a substantial electricity cost advantage. Although this sector has withstood the pressures of recent years, apparently able to remain competitive through technological excellence and quality of service, closures seem likely unless market conditions improve.

5.23. In the downstream sectors of textiles, where 600,000, the vast majority of the industry's workforce, are employed, electricity tends to represent such a small proportion of total costs (less than 2 per cent) that any differences with competitor countries are unlikely to be a significant factor in the industry's future.

Paper and Board (Annex D)

5.24. As with chemicals and textiles, the major significance of electricity for the paper industry lies in the upstream sector, ie pulp and bulk paper production. However, as with the other sectors, upstream operations are under competitive pressure and threat for reasons which are mainly structural. For conventional United Kingdom paper mills relying on imported pulp, electricity accounts for about 5 per cent of costs on average. Although it is therefore one of many factors influencing the competitive future of bulk paper production, the sector is likely to decline for more fundamental reasons related to the natural competitive advantages of overseas competitors.

5.25. For modern integrated pulp and paper mills, which will become an increasingly important part of the industry in other countries, the conclusion is even clearer. These plants are very electricity intensive (up to 40 per cent of total costs) and the price of electricity is a very severe handicap to their viability in the United Kingdom. The natural advantages (including cheap hydro power) enjoyed by competitors in for example Scandinavia are very large. Such integrated plants are both unlikely to have a competitive future in the United Kingdom and also likely to lead to even further contraction of the current United Kingdom industry.

5.26. In the downstream sectors, where the paper industry is likely to have a competitive future, electricity is not an important factor in competitiveness.

Aluminium

5.27. Following the closure of Invergordon, aluminium smelting in the United Kingdom consists of two substantial smelters, Anglesey and Lynemouth, enjoying special contracts negotiated in the late 1960s which result in cheap electricity, and two small smelters in the North of Scotland, owned by Baco and benefiting from hydro-electric facilities also owned by Baco.

5.28. Aluminium is often described as 'solid electricity'. Even with heavily subsidised power contracts the cost of electricity is usually at least 30 per cent of total costs of aluminium smelting. The basis for investment in the three substantial United Kingdom smelters built in the early 1970s was cheap nuclear power (except in the case of Lynemouth, where there is a special coal contract which is currently subject to renegotiation). Quite apart from the special problems of the particular new nuclear power stations, part of whose power was dedicated to smelting, the economics of nuclear power has not developed as favourably as was then hoped.

5.29. Aluminium smelting in the world today is based on electricity at about 1.0p/kWh or less. Where countries have sufficient hydro-electricity this can be provided commercially. The effect of this is that new aluminium smelting capacity is being and will be constructed on the basis of hydro-electricity in countries such as Venezuela and Canada. Elsewhere (eg Germany) aluminium smelters continue to benefit from specially favourable contracts, for which there can be no economic justification. No method of electricity generation, other than hydro or that based on other fuel whose opportunity cost is around zero, can provide competitive power: thus in France aluminium producers are under intense pressure. Special subsidies or cross-subsidies will be required, usually on a substantial scale, if production is to continue. In Japan the policy for the industry is leading to major contraction, and increasing reliance on imports.

5.30. The price of electricity to heavy industrial users will continue to be irrelevant to the future of the two remaining substantial United Kingdom aluminium smelters. Aluminium smelting is a case apart, requiring in the United Kingdom massive special power subsidies to be profitable; its future in the United Kingdom is likely to depend on the willingness of Government to make these available. Any decision to subsidise would therefore be based principally on the employment situation at the smelters (each of which employ about 1,000) and at any downstream activities which are considered to be dependent on them.

Industrial gases

5.31. Electricity, together with air, is the principal raw material of industrial gases and makes up 70 per cent of production costs, or 50-60 per cent of sales value. Because of the high bulk to value ratio there are no imports of oxygen or nitrogen (although small quantities of argon are now imported from Dunkirk), and the £300 million United Kingdom market is dominated by BOC, with Air Products providing some competition. Like the industrial gases business elsewhere it enjoys rapid growth and is profitable.

5.32. We understand that industrial gases are 10-15 per cent more expensive here than in Europe, and that this is due to higher electricity prices. This may at the margin reduce their growth in developing new markets for nitrogen in competition with natural gas, and this means that argon, as a by-product of nitrogen, has become liable to import competition and even shortage. Current imports of argon are about £10 million per annum.

5.33. The higher cost of industrial gases in the United Kingdom has an effect on their major users in the steel and chemical industries. Integrated steelworks use about £3.50 worth of gases per saleable tonne, so that gases account for about 1½ per cent of costs. The effect on total steel costs of higher prices for industrial gases may be about 0.15 - 0.2 per cent. This is a substantial aggregate bill for BSC, but not material for competitiveness. The impact of industrial gases on the cost structures of chemical processes is similar.

5.34. BOC have campaigned for many years for lower electricity prices. We conclude, however, that BOC's position in the United Kingdom in its main business (industrial gases) cannot be affected more than marginally by electricity prices, because that business is not under serious competitive pressure from overseas suppliers. Electricity prices were however clearly material in BOC's recent decision not to site in this country a new plant for making carbon graphite electrodes (see Annex A).

Cement

5.35. Cement production is an electricity-intensive process; about 10 per cent of costs are attributable to electricity. Coal is even more important, however, accounting for some 16 per cent of costs.

5.36. Over 90 per cent of the United Kingdom cement industry is accounted for by three large groups - Blue Circle Industries, RTZ (which now includes Ketton, Ribblesdale, and Tunnel) and Rugby Portland. These activities have been consistently profitable and enjoy a legal restrictive price agreement. Because of the high distribution costs international trade in cement is very limited.

5.37. Cement has been available in continental Europe at substantially lower prices than in the United Kingdom. This has prompted major cement consumers, such as the British Precast Concrete Federation, to investigate the possibility of constructing major import facilities at East Coast ports. However it would be difficult to make this viable because of the need for long term supply agreements, technical and quality problems, and high distribution costs.

5.38. United Kingdom cement manufacturers have reacted to this threat by price restraint, and if they continue with this policy, it seems probable that they will not be seriously threatened in the United Kingdom market. This market, although somewhat contracted because of the decline in construction activity, is broadly stable. It is important that the manufacturers have access to coal at international prices, which they now effectively have.

5.39. We conclude that electricity prices are one factor making for relatively high prices for cement in the United Kingdom. The cement industry is however well insulated from international competition because of the high transport and distribution costs of the product and the industry is not in a really vulnerable position. Electricity costs in the United Kingdom do of course increase the costs of products with a high cement content, but the impact of electricity prices to cement manufacturers on the final costs of construction projects is very small indeed.

Conclusions of Chapter 5

5.40. There are a few industrial processes where electricity is the principal element in costs. In some cases - cement and industrial gases are good examples - there is little international competition and so no great problem arises. Of course the cost of electricity is reflected in the prices of these goods, which in turn impact on other industries eg construction, steel and chemicals. But their significance in final costs is small.

5.41. In the case of other electricity intensive products, however, there is effective international competition and the United Kingdom's position is very vulnerable. Some industrialised countries (eg in Scandinavia and North America) enjoy significant natural advantages which lead to much cheaper electricity than we could ever expect. Other countries may enjoy a real but manmade advantage (eg more nuclear generation), or they may decide to subsidise the processes involved.

5.42. Two signal examples are aluminium smelting and integrated pulp and paper manufacture. The United Kingdom cannot ever hope to be competitive in these processes without very large subsidies to the producers. The impact of economically justified United Kingdom electricity prices on these processes would be very damaging but this cannot be regarded as giving us any useful messages about electricity pricing policy. It does of course raise questions about industrial support.

5.43. There are indeed some processes and investment projects which have already gone abroad because of the lower electricity prices to be enjoyed there. This was a significant factor in BOC's decision to site its carbon graphite electrode plant in the USA, not in Consett. Parts of our native chemical industry, such as the electrothermal processes for carbide, phosphorus and nitride production, have emigrated to areas of lower electricity prices.

5.44. The production of chlorine and part at least of the production chains derived from chlorine could join the list of emigrant industries. We have discussed the position of ICI's chlorine processes at some length above, and in Annex A. This is because it has been argued that the future in the United Kingdom of a large part of ICI's Mond Division is largely dependent on electricity prices. ICI faces many problems and in our opinion the importance of electricity prices, even in chlorine based products, can be exaggerated; we have attempted to set them in context. And the differential between UK and German electricity prices for chlorine makers may well close somewhat as the German utilities seek to phase out below-cost contracts. We do not think ICI is imminently intending to close or run down its UK chlorine operations. In the longer term, however, if wide price differentials persist, ICI could well close or transfer some at least of its chlorine-based business overseas. Our best guess is that up to 4,000 jobs could be lost, with a loss to the trade balance of up to £250 million a year.

5.45. Next, there are quite large tracts of basic United Kingdom industries - steel, upstream chemicals, manmade fibres, yarn processing, conventional bulk paper production - for which electricity costs are an important but not the major factor. All these industries are passing through very difficult times for more fundamental reasons. In principle, therefore, they must be even more than usually affected by electricity costs which are higher than their competitors'. But in each case the future of the United Kingdom industry is likely to be decided by more fundamental and important factors such as labour rates, productivity, technical innovation and adaptability in the face of changing world trade patterns, and especially of emerging competition from newly industrialised countries.

5.46. Finally, for the rest of United Kingdom industry - and it is much the greater part of it - electricity costs are not really significant for competitiveness. As pointed out above, in most industries a major reduction of say 20 per cent in electricity prices would lower total costs by ½ per cent or less.

CHAPTER 6 - DISCUSSION AND CONCLUSIONS

6.1. In the previous five chapters we have examined prices, and prospects for prices, in the United Kingdom and our main competitor countries; the main factors influencing them; and the effect they have on the competitiveness of industry. In this chapter we -

a. draw the threads together in a summary (paras 6.2-13);

b. discuss the arguments for giving industrial consumers some relief from the impact of electricity prices (paras 6.14-26); and

c. set out some points on which we recommend action (paras 6.27-33).

Summary

6.2. Some countries such as Canada and Sweden have access to cheap and plentiful hydro-electric power. They enjoy a natural and significant advantage over the United Kingdom and their electricity prices are always likely to be well below ours. But our main competitors in the EC, the USA and Japan are not in that position.

6.3. Prices in France are significantly lower than ours for industrial consumers. Prices in Germany tend to be broadly comparable with ours for most industrial consumers, but significantly lower for high load factor users and particularly for some large users on special contracts. The same sort of picture applies in Italy. Japanese prices are higher than ours. It is impossible to generalise about the USA, where some utilities with access to cheap power offer lower prices than ours, but other are dearer.

6.4. In making these comparisons we must remember that the picture looks a good deal more unfavourable to the United Kingdom now than it did up to about 5 years ago, and this is not in the main due to changes in the comparative efficiencies or tariff policies of the electricity industries here and overseas, but rather to changes in the exchange rate. While it is true, generally speaking, that United Kingdom industry has a somewhat greater competitive problem than 5 years ago because of a relative rise in the sterling cost of electricity, the same is true of a whole range of other inputs. The deterioration in our relative position in relation to electricity costs is in the main simply a reflection of the general problem of loss of competitiveness; and for most of industry it is a minor aspect of that problem.

6.5. The CPRS considers that the costs of the United Kingdom electricity supply industry can be minimised in the long run by a vigorous programme of building nuclear power stations, and this should be done. However there are problems over gaining public acceptance; and the required improvements in the planning and construction of the nuclear programme may not be achieved. The existing programme will not make a major impact on costs until well into the next century. In the short and medium term, the scope for improvements in operating efficiency would not make much difference to costs.

6.6. One very important factor which we discuss in Chapter 2 is coal prices. It will in the CPRS view be necessary to keep under careful review the price at which the NCB sells coal to the CEGB, in particular when the current understanding between the NCB and CEGB expires. We believe that the price to the CEGB should be related to the price of imported coal and that the financial framework for the two industries should be set with this in mind. We have considered and rejected the argument that the NCB's coal prices should be based on their net realised export prices. In our view therefore the NCB price is about right at present, but it is likely soon to rise above the price of imported coal. It would be possible in principle to avoid this by closing high cost pits, and by opening up the coal market to imports and competition. But if in practice the industrial relations situation rules out such measures and NCB production needs to be further subsidised, this should in our view be at the expense of taxpayers generally and not of electricity consumers.

6.7. In Chapter 3 we discuss pricing policies. We conclude that certain changes are required in the United Kingdom electricity tariffs. Coopers and Lybrand have argued persuasively that the capacity charges in the Bulk Supply Tariff are too high. If these recommendations are accepted, the result would be to lower CEGB prices by 5 to 10 per cent. Ironically, however, lower capacity charges would do little to help the large users who are amongst the most vociferous complainants about electricity prices. This is because the current CCL scheme allows such users to avoid or reduce capacity charges. This CCL scheme, and the flexibility allowance which Area Boards use in dealing with large consumers, are not wholly justified on cost grounds, and incorporate some bias in favour of large users. We recommend in paragraph 29 below that in due course these schemes should be phased out. This might leave some consumers who are currently taking full advantage of the concessions somewhat worse off than they are now. We set out in paragraph 30 a recommendation about tariff changes which are economically justified; but the important point is that taken together they are not likely to result in any major change in the prices paid by most large industrial users, including the principal complainants.

6.8. In Chapter 3 we also examine and reject two of the main arguments which industrialists put forward to justify changes in the tariffs, namely that pricing should be related to an optimal generating system, and that efficient low cost plant should be dedicated or allocated to industrial users. In paragraph 31 below we recommend measures to improve communication between the CEGB and industry.

6.9. The fact remains that some industrial users in our main competitor countries enjoy very significantly lower electricity prices than their United Kingdom counterparts. The French have a better generating mix than we do, with more nuclear capacity, and are improving it further very rapidly. They are now moving towards prices that reflect the (lower) cost of supply in 1990, and in addition EdF is currently incurring heavy operating losses. In Germany tariffs tend to be more degressive than ours and thus to favour high load factor users; and some larger German users in the steel, chemicals and aluminium industries are on special contracts with even more attractive terms. Some at least of these result in prices which do not cover costs, and reflect local Government subsidies and pressures. Italian high load factor users and arc steel producers enjoy substantial concessions which reflect Government subsidy.

6.10. In Chapter 4 we examine the prospects for prices. In brief, the considerable difference between French prices and ours will persist until we match their nuclear capability and costs; the gap will widen before it begins to narrow. German utilities will seek to renegotiate their special contracts to cover costs more fully. Although a subsidy element may be retained in some cases, we would expect this to be reduced. We cannot predict a significant lowering of United Kingdom electricity prices in relation to other countries unless and until the United Kingdom has a much higher proportion of nuclear plant; and unless we achieve that rapidly, there is a danger that other countries will keep up with or outstrip our performance.

6.11. In Chapter 5 we assess the impact on United Kingdom industry of present electricity prices. For most of British industry the cost of electricity is such a small component of total costs that even a major cut in the price of electricity would have only a very modest impact on competitiveness. There are some industrial sectors which are more seriously affected by electricity prices; these include chemicals, iron and steel, aluminium, textiles and paper and board. For the most part these are sectors which are in any case having to face severe competition and world overcapacity. A few processes eg aluminium smelting and integrated manufacture of pulp and paper are so electricity-intensive that they cannot be expected to survive in the United Kingdom without very large and permanent subsidies. There have already been casualties in these and other sectors, notably chemicals, from which some electricity-intensive processes have emigrated.

6.12. The most important process now at risk is the production of chlorine and part at least of its production chains of which PVC is probably the most significant. As we make clear in Chapter 5 and Annex A, ICI is suffering from the numerous problems which beset the chemical industry, of which the price of electricity is only one. And while electricity for chlorine manufacture is very much cheaper in Germany than here, the low price enjoyed by ICI in Germany results from a special agreement which on today's terms does not appear to be covering costs. Although the renewal date of this contract is confidential, we would expect that any renegotiation will result in higher German prices which would probably reduce the current differential significantly. The same result is likely for ICI's competition in Germany, not all of whom enjoy prices as low as ICI's German plant. In addition current ICI United Kingdom chlorine capacity is ten times that in Germany so any major shift of chlorine production by ICI to Germany would necessitate additional electricity supply arrangements almost certainly on less favourable terms. All this should not however obscure the point that if the prices currently paid by ICI in the United Kingdom and in Germany are not brought closer together, ICI might well withdraw from at least part of the chlorine based sector in the United Kingdom. We do not think this is imminent. Our best guess is that ultimately up to 4,000 jobs could be lost at ICI, with a loss to the trade balance of up to £250 million a year.

6.13. There are a number of other industrial processes whose future in the United Kingdom is uncertain and which are affected significantly but not crucially by electricity prices. The most important example is steel production via the electric arc process. This sector is vulnerable for many reasons, and it is not possible to assess how many jobs might be lost or saved by changes in electricity prices.

Industry's case

6.14. Our analysis is that a relatively small part of British industry is seriously affected by electricity prices; that some changes in United Kingdom tariffs are justified but that in general these changes are likely to give least help to those who are most affected; and that relativities between United Kingdom and overseas prices are unlikely to improve very much. The fact remains that some United Kingdom firms' costs are higher than those of their overseas competitors because of differences in electricity prices; and that lower prices in the United Kingdom would help them (at least in the short term) to protect economic activity and jobs.

6.15. Some industrialists have sought to rationalise their case by arguing that the esi's tariff policies are seriously wrong. As we show in paragraphs 3.13 to 3.19 above, we do not find these arguments convincing: broadly speaking there is no systematic bias against industry in the tariff structure. Industrialists can however mount a case on more general grounds: they argue that they should not pay for the past mistakes and present inefficiencies of the monopoly esi; that electricity prices have risen sharply over the last two years while industry has been in recession and unable to pass on increased costs fully; that other countries favour their industrial electricity consumers and so we should too; and that while electricity may not be the critical factor for many jobs, it is for many firms one of the straws that threaten to break the camel's back. We discuss these arguments below.

6.16. It is true that today's electricity costs would be lower if mistakes and errors (identified with the benefit of hindsight) had been avoided in the past. It is sometimes suggested that industrialists are paying the cost of today's excess capacity. In fact the esi, having built more capacity than is at present needed, has ensured that the plant now used for generation is more efficient than it otherwise would have been. Moreover, in moving over to CCA accounting the esi wrote off some of the costs of excess capacity as assets were revalued. And, as we have shown, the CCL scheme and flexibility allowance already favour many large users by insulating them from capacity charges which are too high.

6.17. A second argument is that consumers today are paying too much because we now have the wrong type of capacity; and indeed it would be very advantageous today to have a lot more nuclear plant. We must here distinguish between illusion and reality. Unless we very rapidly reverse the errors of the past, and embark on a large and successful nuclear programme (which is not the present prospect) then past mistakes will effectively dictate the future's costs. The French have a vigorous programme and have justifiably decided that they do not wish the accounting cost burden of their past electricity system to prevent them from fully realising the benefits of their new system. Therefore they have a financial regime for their esi which anticipates the imminent benefits of a high proportion of nuclear plant. We are not in that position. On the other hand we are not alone in having a shortage of nuclear capacity. It is a problem that afflicts most other European countries, who have to live with and pay for, now and in the future, the errors of the past. Italy, for example, no doubt now regrets the extent to which it became locked into heavy dependency on oil generation.

6.18. Since 1979 industry has been faced with increasing pressures on its competitiveness which have forced it to make continuous and major adjustments in order to survive, and over the same period it has suffered significant real price increases from nationalised industries. Nevertheless, we consider that, after a decade of varying degrees of pricing restraint, the Government has been right to insist on pricing at economic levels in order to avoid distortions in the economy. The esi's required rate of return of 1.7 per cent on CCA assets is by no means excessive either in isolation or in comparison with that of manufacturing industry (2.1 per cent on replacement cost assets in 1981).

6.19. But it can be argued that while there is an unassailable case for economic pricing in theory, in practice prices should be restrained in the short term to help industry survive the recession. However it should be noted that German electricity utilities reject the argument that they should phase price movements in sympathy with the economic cycle. More fundamentally, as many sectors (eg chemicals, steel) have painfully come to realise, the current period is for them not primarily one of cyclical recession, but one of structural adjustment. Price trimming does not provide an appropriate solution to this sort of problem.

6.20. It would clearly be unfortunate if the process of structural adjustment was unnecessarily distorted by unfair competition based on subsidised electricity prices. For this reason we welcome the fact that a number of the German special contracts are shortly coming up for review, and we consider that the Government should not rush to phase out concessions such as CCL which partially compensate for current German practices. However it would be wrong to increase such concessions at the present time, since this might make it less likely that the favourable terms enjoyed by some German industries will be phased out. But where relatively favourable terms are likely to continue overseas, whether because of genuine cost disparity or, in a few cases, because of sustained willingness to subsidise, we would regard it as a misallocation of resources for the United Kingdom to follow suit. Given that the United Kingdom will not become a low cost electricity country in the foreseeable future, it would not be sensible to encourage the continuation of processes which will go on requiring subvention to survive. We should do better to compete in areas in which we can develop a sustainable comparative advantage.

6.21. While electricity prices are not crucial to more than a few sectors of British industry, it is true that for a much larger part they are another 'straw on the camel's back'. Among the wide range of cost increases which industry has faced, electricity prices are seen as among those more directly under the Government's control, along with other nationalised industry prices, non-domestic rates and the national insurance surcharge. But if it is accepted that Government should, as far as possible, act to lighten the burdens on industry, the only reason why electricity prices should be chosen as the means of or criterion for giving relief is that the threat to jobs in electricity intensive industries is visible and concentrated. But since these areas are in any case under intense pressures there is no guarantee that relief on electricity prices would do more than delay job losses. Taking industry as a whole, there are certainly more cost-effective methods of reducing the burden on industry with better prospects for successfully supporting employment overall.

6.22. Because the problems of electricity-intensive industries are visible and concentrated we do not rule out the possibility that there may be particular cases where temporary and specifically targetted subsidies might be justifiable but each case would have to be considered very carefully on its merits.

6.23. We recognise that the arguments deployed in paragraphs 16-21 above may not convince the industrialists who have been most vocal in the past; and certainly political difficulties lie ahead if, as seems likely, high load factor users stand to gain little or nothing, compared with other users, from economically based revisions of the electricity tariffs. We do not think that the Government should alter its basic policies but it may be helpful to comment briefly on some points that would arise if special relief for heavy industrial users were to be considered.

6.24. Relief could be given to industry in a number of different ways. First, some or all industrial users could be cross subsidised by other electricity users. This would obviously be open to serious political as well as economic objections. It would also fall foul of the statutory provisions on undue preference. Repeal of the provisions is possible at least in theory but would expose electricity pricing to a flood of special pleading - and it would run the very real risk that in due course industry would find itself subsidising domestic consumers.

6.25. A second possibility is that assistance could be channelled to industry from the taxpayer via electricity prices. This is in effect what happened when the esi's EFL was relaxed to allow Area Boards flexibility in dealing with large users and when the CCL scheme was introduced. This method of giving help is difficult to target accurately, but at some considerable cost (£100 million in 1982/83) it has relieved many of the worst affected firms. It also avoids discrimination in favour of particular firms or industries and therefore seems to have escaped challenge on grounds of undue preference or as a breach of international obligations. But it cuts across the Government's policy of economic pricing for energy and risks reducing the incentive for efficiency in the esi.

6.26. The whole thrust of our conclusions has however been that electricity should be priced on economic principles and that economic pricing would not result in very marked changes from the present position. We would therefore argue that if Government wished as a long term policy to assist firms which are adversely affected by electricity price differentials, this would represent an aspect of industrial policy, and that the aid should be given directly, not through distortion of the electricity pricing system. International obligations do of course limit what could be done by way of overt state aids; but given that the sectors worst affected by electricity prices (chemicals and steel) are distressed for a wide range of reasons, general measures to help with their problems are possible. But we repeat our view that there are more cost effective ways for the Government to reduce burdens on industry and support employment than through subsidies to heavy users of electricity.

Recommendations

6.27. We have in the course of this study identified a number of points on which action is desirable. None of them is likely to make a big impact on electricity costs or prices in the short or medium term. We list these points in the following paragraphs.

6.28. Our first two recommendations are aimed at the general containment of generation costs. They are not new, but they alone of our recommendations can, in the longer term, make more than a modest impact on electricity prices.

We recommend that every effort is made to ensure a vigorous and well executed nuclear programme aimed at substantially increasing the contribution of nuclear plant to electricity generation by the end of the century.

We recommend that NCB coal prices to the CEGB should be set on economic energy pricing criteria related to import prices and that the financial framework for the two industries should be set with this in mind. If NCB production is to be further subsidised, this should in our view be at the expense of taxpayers generally and not of electricity consumers.

Electricity prices to Industry

6.29. The electricity tariff structure is basically sound and involves no bias against those industrial consumers whose electricity prices are higher than in other countries. If anything, with the present temporary CCL terms and flexibility (which are specifically allowed for in setting the EFL), it is too generous. We believe that electricity prices in the United Kingdom should be properly based on economic prices, without any subsidy from the taxpayer or cross subsidy from other consumers. We consider that certain refinements to the tariff structure are justified, and that there is a permanent place for a load management scheme. Relations between the esi and its major customers could also be improved. There can be no doubt however that the recommendations in this section will not on balance be seen as of significant help to the industries at risk.

We recommend that in the course of the review of the BST that takes place as a result of the Coopers' report a permanent, cost reflective load management scheme be devised.

We recommend that the present 3 per cent flexibility allowance for Area Boards to use in negotiating with large industrial electricity consumers should be phased out.

We recognise, of course, that the existing CCL scheme still has two years to run, and in any case we would not recommend an abrupt withdrawal of the concessions which heavy industrial users now enjoy. The timing of the withdrawal of any of these concessions will have to be decided in the light of other changes in the tariff structure and level, and perhaps in the level of overseas subsidies (see para 6.20 above). We would hope that the esi would consult some of its largest customers about its proposals for new load management terms. The esi does not have a monopoly of wisdom - and needs to dispel the impression that its attitude is essentially one of 'like it or lump it'.

6.30. The BST averages the CEGB's cost structure into four time of day energy rates and the capacity charges element. Area Boards average further in their tariffs and contracts. This has in our view obscured the cost signals that should encourage the most efficient pattern of use.

We recommend that the esi should make more sophisticated terms available in their tariffs and contracts, and make more effort to explain and justify them publicly.

6.31. There could be cases where negotiation between large industrial users and the CEGB - something which currently requires the Secretary of State's approval - could lead to special terms which were more advantageous to both sides. Such direct negotiation would also increase the generating side of the industry's market awareness of the concerns of its consumers.

We recommend that large industrial users should be given a real opportunity to deal directly with the CEGB.

Private Sector Electricity Generation

6.32. There is scope for private generation, particularly when linked with combined heat and power schemes, although we have some doubts about the extent to which the private sector will respond. It is important that the esi is not allowed to stand in the way by unfairly influencing the prices paid for electricity transferred between the esi and the private sector. The principle which should be adopted is no subsidy by either side, but within that the prices should be such as to encourage competition to the maximum extent.

We recommend that the definition of fair terms and conditions in the proposed new legislation on private generation should be interpreted so as to stimulate competition with the esi, consistent with economic pricing.

6.33. There is no economic justification for dedicating CEGB plant to particular industries or firms if this results in higher prices to other consumers. For this same reason it is doubtful whether the sale of CEGB plant on economic terms would be attractive to industry. Some industrialists may however feel that they could run a power station more cost effectively than the CEGB.

We recommend that the case for the sale or lease of CEGB plant should be explored, and applications from industry considered on a case by case basis.

ANNEX A

THE CHEMICAL INDUSTRY

General Discussion

A.1. The chemical industry is the largest industrial consumer of electricity in the United Kingdom accounting for 17 per cent of the demand by manufacturing industry. Current purchases total about 13,000 GWh a year. The industry is also the largest self-generator of electricity, the output being about 6,000 GWh a year, mainly in combined heat and power schemes of high thermal efficiency. Unless there is considerable growth in combined heat and power schemes, it is expected that purchased electricity consumption will grow fairly closely in line with chemical output.

A.2. The importance of electricity tends to decline along the chemical production chain from upstream intermediate products to downstream end-use products. For the chemical industry as a whole, the average contribution of electricity to total manufacturing costs of intermediate chemical products is about 5-7 per cent compared with about 2 per cent for end-use products.

A.3. Nevertheless, in terms of electricity consumption, the chemical industry has some large plants - one of 200 MW (ICI Runcorn), 15 of 20 MW, 33 of 5 MW and 88 of one MW. About 130 consumers operating with load factors of 60 per cent or more account for over 60 per cent of the total value and cost of electricity purchased. For these users, electricity costs range from 10-50 per cent of total costs for intermediate products and 2-10 per cent of total costs for end-use products. Chlorine manufacture is the most electricity intensive process where electricity accounts for 50 per cent of total costs or 80 per cent of variable costs. However, the dominance of electricity in the cost structures of downstream chlorinated products is less marked and in the case of polyvinyl chloride (PVC), for example, electricity represents about 10 per cent of total manufacturing costs.

A.4. Of the 3 broad categories of electricity use in the chemical industry - mechanical power, direct process use and thermal use, only the first 2 are of major significance in the United Kingdom. Over two-thirds of total United

Kingdom consumption is for the provision of mechanical power. Direct process use is mainly limited to electrolysis, and indirect use of electricity as a source of heat is mainly confined to specialist operations such as the production of metals and metal oxides. Most electro-thermal processes have been lost from the United Kingdom.

A.5. The chemical industry's ability to take advantage of load management varies considerably although nearly all users taking more than 20 MW are on load management terms. Most chemical processes operate most efficiently at steady, continuous load, so there are usually cost penalties arising from load management.

A.6. The chemical industry faces intense international competition and the petrochemical sector is particularly exposed. The problems of this sector are acute and widely documented and can be briefly summarised as massive over-capacity, access to and costs of feed-stocks, severe international competition and the effects of the current recession. The problems are similar to a greater or lesser extent for all European countries and are resulting in a major rationalisation and reconstruction of the European industry. The result is, and will continue to be, a severe decline in the production of bulk petrochemical intermediates and a move downstream to speciality and higher value added products.

A.7. Against this background it would appear that electricity is the least of the industry's worries. Electricity, for example, contributes less than 2 per cent to the cost structure of ethylene and although it is certainly one of many factors affecting international competitiveness, it does not appear that electricity is the major consideration influencing the survival of the industry. Chlorine and chlorine based petrochemicals are perhaps the one exception to this rule and are discussed at length in the following sections.

A.8. The general problems of the inorganic sector are less acute although the sector is dependent upon the general health of the United Kingdom industry. Electrical energy is of critical importance for the production of chlorine, caustic soda, carbides, phosphorus, nitrides and industrial gases.

Of these, the electro-thermal processes for carbide, phosphorus and nitride production have emigrated from the United Kingdom to areas of cheap electrical energy. The industry has expressed some concern about the viability of downstream sectors which depend upon the import of electrochemical intermediates although there are no difficulties in importing these products. Of the others, caustic soda is produced with chlorine by the electrolysis of brine and is discussed below. Industrial gases are discussed separately in Chapter 5. For the longer term, substantial improvement in the international performance of the United Kingdom inorganic sector should not be expected and it is probable that a small number of energy intensive products may be gradually lost from the United Kingdom.

A.9. In summary, the CPRS view is that for most processes in the chemical industry, electricity costs, although important, are only one of many factors affecting international competitiveness and the survival of the United Kingdom industry. There are, however, a limited but significant number of processes where electricity costs will have an important impact on the long term future. Of these, the most important is the production of chlorine and chlorine based products, although the list also includes certain metal oxides such as magnesia, titanium dioxide and aluminium oxide. The Chemical Industries Association agrees with this assessment and we discuss the processes concerned below.

CHLORINE AND CHLORINE-BASED CHEMICALS

Introduction

A.10. The production of chlorine by the electrolysis of brine is the most electricity intensive process in the chemical sector. 1.1 tonnes of caustic soda are produced in conjunction with 1 tonne of chlorine with electricity accounting for 80 per cent of variable costs and 50 per cent of total manufacturing costs. This explains why the chlorine-based sector has received most attention in the electricity price debate.

A.11. Total chlorine capacity in Western Europe is 11.6 mta with the major producers being West Germany (3.9 mta), France (1.7 mta) and the United Kingdom (1.4 mta). 1.1 mta or 80 per cent of United Kingdom production is by ICI, whose total European production is 1.2 mta. ICI's Runcorn complex, part of the Mond Division, produces about 0.75 mta chlorine and 0.8 mta of caustic soda. A further 0.36 mta is shared between four sites in the north of England. Runcorn, with a demand of about 200 megawatts, is the largest single electricity charge point in the United Kingdom and probably also in Europe.

A.12. ICI have provided information indicating that at average load factors of 90 per cent, electricity prices paid at Runcorn (with load management) and at Teesside (for technical reasons without load management) are higher by a factor of 1.7 and 2 respectively than ICI's 0.12 mta chlorine plant at Wilhelmshaven in Germany which pays about 1.5p/kWh. The difference is mainly a result of the degressive nature of the German special contract which gives greater benefit to high load factor users than the United Kingdom tariff. In addition the prices paid by ICI in Germany appear to be below cost, at least in today's terms.

A.13. ICI have also confirmed that the throughput of the Wilhelmshaven plant over the last year was 99 per cent of the nominal chlorine capacity of the plant (120,000 tpa). Because of the differences in electricity prices, the Wilhelmshaven plant is run flat out and chlorine production is balanced in the United Kingdom. The throughput of the Runcorn plant over the last year was 67 per cent of the nominal chlorine capacity of 750,000 tpa and for Teesside 40 per cent (nominal capacity 170,000 tpa).

A.14. If average load factors are equated to capacity loadings the corresponding electricity prices for Wilhelmshaven, Runcorn and Teesside would be 1.4p/kWh, 2.3p/kWh and 3.0p/kWh respectively. The ratio of Runcorn and Teesside prices compared with Wilhelmshaven would then be 1.6 and 2.1 respectively.

A.15. It is, however, relevant to note that the less degressive nature of the English tariff enables ICI to optimise operations at periods of depressed market demand. If Runcorn was operating under the German tariff at an average load factor of 67 per cent, the price paid would be 2.6p/kWh, ie more than the current Runcorn price. This point also applies to Teesside at 40 per cent average load factor which on a German tariff would pay 3.2p/kWh. These results mean that at current loadings ICI would be worse off if the German tariff applied to United Kingdom operations.

A.16. However, if the German tariff did apply in the United Kingdom, ICI would have an electricity price incentive to shut Teesside and Wilhelmshaven and load up Runcorn to 92 per cent throughput. Nevetheless, such rationalisation decisions are usually not as straightforward as economic logic would imply and it is relevant to ask why ICI do not shut the Teesside chlorine plant and load up Runcorn under today's conditions. The answer has partly to do with expectations of an upturn in the market and is partly because the Teesside plant is one of ICI's newest and one which received a regional development grant.

A.17. ICI do not have definitive information on the electricity prices paid by their European competitors. Nevertheless, their strong impression is that these are in line with the ICI German contract at Wilhelmshaven. Our understanding is that this special contract results in prices which are below cost and reflects both the economic conditions prevailing at the time of negotiation and an element of subsidy. Dow Chemicals have chlorine capacity in the same region of Germany and probably have a similar contract. The other German plants probably also enjoy special contracts, but not on such favourable terms as ICI at Wilhelmshaven. Most French chlorine capacity is found in the South East of France where hydro power would be expected to lead to cheaper than average electricity prices. Despite some uncertainty about these figures, it is clear that United Kingdom operations are at a significant disadvantage although it should also be pointed out that, under current depressed market conditions and reduced plant loadings, ICI would not necessarily be better off if the German tariff applied to United Kingdom operations.

<u>The Sector</u>

A.18. About 13 per cent of ICI's chlorine is sold for chemical manufacture and water purification. The remainder is used to produce large tonnages of chlorine derivatives. The most important production chain (accounting for 21 per cent of chlorine) is:

Chlorine ↘
Ethylene ↗ Ethylene Dichloride → Vinyl Chloride Monomer (VCM) → Polyvinyl Chloride (PVC)

It is on this production chain, which brings together the problems of chlorine based chemicals and ethylene based petrochemicals, that ICI has particularly sought to focus attention in complaining about electricity prices. A further 16 per cent of ICI chlorine is used to produce such chlorinated solvents as Triklone and Genklene (mainly used for metal cleaning and a variety of formulation applications) and Perklone which is used in dry cleaning. Chlorine is also used in the manufacture of a variety of chloromethanes (9 per cent) which are in turn used in making additives for motor fuels, cellulose ethers and specialised solvents for the manufacture of acetate rayon, paint removers and so on. Among the other uses of chlorine are hydrochloric acid (9 per cent) and sodium hypochlorite (3 per cent).

A.19. The caustic soda which derives from the same process is sold, in the case of ICI, as follows:

direct exports	28 per cent
soap and detergents	17 per cent
synthetic fibres	15 per cent
chemicals	12 per cent
water treatment	5 per cent
others	23 per cent

A.20. The businesses grouped under the Mond banner represent 15-20 per cent of ICI's interest in the United Kingdom in terms of assets, sales and number of employees. 10,000 people work for Mond, of whom 7,000 are at Runcorn. To maintain competitiveness Mond has in recent years invested heavily (£400 million in 1977-81) in the United Kingdom in the latest technology, bringing the total replacement value of its plants and equipment to over £2,500 m. About 70 per cent of Mond's external sales are to United Kingdom customers - to other chemical companies, to the glass and engineering industries, to textiles, iron and steel. It has been calculated that over 20 per cent of these sales find their way into customers' exports. The remaining 30 per cent of Mond's external sales are direct exports.

A.21. The production of chlorine and chlorine based products accounts for about 70 per cent of Mond's total business. Although VCM, the building block of PVC, is one of Mond's largest products and its financial impact is substantial, it is clear from the preceding paragraphs that VCM represents a relatively small part of the total Mond business.

Cost Structures

A.22. ICI have provided information on the contribution of electricity to the cost structures of intermediate products in the PVC production chain together with the figures for Triklone and Perklone. More detailed cost structures are shown in the Appendix to this Annex. Table 1 below distinguishes between electricity attributable to chlorine production only and the total contribution of electricity to manufacturing cost. The former figure is relevant because the electricity price debate tends to concentrate on high load factor operations, ie chlorine and less on lower load factor operations, ie downstream processing. Nevertheless, in terms of international competitiveness the full contribution to the cost structure is significant.

Table 1

Electricity as a % of total costs

	From Chlorine	From other	Total
Chlorine	51	-	51
EDC	16	3	19
VCM	7	4	11
PVC	5	5	10
TRI/PER	11	2	13

A.23. If average load factors of 90 per cent were achieved in both United Kingdom and German plants, so that the electricity prices paid by ICI at Runcorn were 1.7 times prices paid at Wilhelmshaven in Germany, Runcorn's competitive disadvantage would be:

Table 2

	Based on electricity in chlorine only	Based on total electricity
Chlorine	21%	21%
EDC	7%	8%
VCM	3%	5%
PVC	2%	4%
TRI/PER	4%	5%

These figures put the competitive disadvantage into context and raise questions about the true significance of electricity for the total chlorine industrial sector, particularly given the earlier comments that ICI would not be better off at current production rates with a German type tariff for United Kingdom operations. ICI have been asked whether there are any offsetting

United Kingdom competitive advantages compared with Germany but the company considers that in terms of technical knowledge, age of plant, level of skill, productivity and infrastructure, the United Kingdom chlorine based operations are competitive with their own German plant and with other overseas suppliers.

A.24. As a further indication of the competitive pressures on ICI, it should be appreciated that VCM and PVC are currently selling at 57 per cent and 40 per cent respectively of fully built up costs. It is doubtful, therefore, whether ICI are even covering the total variable costs of PVC production, both direct and indirect, which are about 40 per cent of total manufacturing costs. As electricity represents about 80 per cent of the variable costs of chlorine and about 25 per cent of the variable costs, both direct and indirect, of PVC, any change in electricity prices would have a major impact on revenues.

A.25. It appears that ICI's losses on the chlorine/caustic business totalled £35-40 million in 1981 although isolating the profitability of these products is difficult. ICI's total electricity bill in 1982/3 is expected to be £110 million of which about £48 million will be incurred by Mond Division and about £38 million by Runcorn. (Without load management and load manipulation, Runcorn's bill would be about £44 million.) ICI consider that their corporate disadvantage resulting from electricity differentials will be about £30-35 million (£13.5 million at Runcorn).

Polyvinyl Chloride (PVC)

A.26. One reason for the great prominence given to the competitive position of PVC is that this product brings together both the problems of chlorine based chemicals and ethylene based petrochemicals. As explained above, chlorine and ethylene are made into ethylene dichloride (EDC) which is the link in the PVC production chain.

A.27. It should also be appreciated that chlorine accounts for only 10 per cent of PVC costs whereas ethylene accounts for 31 per cent. The contribution of electricity to the costs of ethylene is less than 2 per cent.

A.28. ICI are suffering major difficulties in ethylene based petrochemicals, not only because the European industry in general is under pressure (heavy losses, overcapacity etc) but also through ICI's dependence on naphtha rather than ethane as a feedstock. ICI recently sought, and the Government refused, tax relief on naphtha feedstocks.

A.29. The result is that PVC is under threat for two main sets of reasons - one set chlorine based and the other ethylene based. The former affect principally Runcorn, employing 7,000 people while the latter affect principally Teesside, employing 9,000 people.

A.30. The following figures for the United Kingdom industry as a whole illustrate the degree of both import penetration and overcapacity in the producton of EDC, VCM and PVC during 1981.

	EDC	VCM	PVC
Capacity mt	1195	620	670
Production mt	505	315	325
Imports mt	15	22	110
Exports mt	-	2	90
Home consumption mt	520	335	345
Overcapacity %	68	49	51
Import Penetration %	3	7	30

The relevant figures for overcapacity and import penetration for PVC in 1977 were 35 per cent and 23 per cent respectively.

Rationalisation

A.31. In response to the problems of overcapacity in the petrochemicals sector, ICI and BP have recently announced a joint major reconstruction programme. In very general terms the effect will be to increase the importance of PVC in ICI's operations. As United Kingdom PVC capacity is currently split ICI 48 per cent, BP 27 per cent and other producers 25 per cent, this is likely to give even higher profile to ICI's concerns over electricity prices.

A.32. If approved, the BP/ICI rationalisation will increase loadings on ICI's chlorine and downstream plants in the PVC chain from about 50 to 75 per cent. Although this will reduce fixed costs per ton, variable costs per ton will increase as a greater proportion of day time electricity will need to be used. As ICI are not even covering variable costs on VCM production at the moment, the reconstruction will not improve short term profits.

A.33. One effect of the BP/ICI rationalisation will be much higher loadings on ICI's new Teesside chlorine plant. This plant and its associated EDC plant have always been aimed at the export market, particularly as the PVC capacity at Wilhelmshaven is currently much greater than the chlorine capacity. It is therefore ironic that in practice Wilhelmshaven is being partly sourced by EDC produced in the United Kingdom. This situation is based upon the earlier strategic decisions which were made at a time when electricity was not considered such a significant factor. However, unless the price differentials change, ICI's inclination in future will be to source PVC production in the United Kingdom from imported EDC.

A.34. In the circumstances it is relevant to ask why ICI should wish to increase their dependence on PVC which is a loss making business subject to considerable price cutting. Presumably the company hopes that capacity rationalistion will lead to some strengthening of prices; but have they also assumed that help will be forthcoming on electricity prices and/or naphtha feedstock taxation policies?

A.35. ICI have not revealed whether their assessment is based on anticipated changes in electricity prices and feedstock taxation, but it seems unlikely that they have gambled to that extent. Our opinion is that they consider that the PVC business will be viable in the future. However, we cannot rule out the possibility that, if the United Kingdom continues to be more costly than Germany, ICI's next step would be to supply the United Kingdom from an extended ICI complex at Wilhelmshaven.

A.36. It is relevant here to discuss the likely future of ICI's German contract. We do not know when this special agreement, which on today's terms would not appear to be covering costs, comes up for renewal. But it seems likely that any renegotiations will result in higher German prices which will reduce the differential with United Kingdom prices significantly. The same result is likely for ICI's competitors in Germany not all of whom enjoy such low prices as ICI's German plant. Moreover, ICI's chlorine capacity in the United Kingdom is ten times that in Germany so any major shift of chlorine production by ICI to Germany would necessitate new electricity supply arrangements. We therefore consider that the threat to ICI's United Kingdom operations is less a function of competitive electricity prices, although we do not deny that this is one relevant factor, than a result of the general problems besetting the chemical industry.

A.37. Assuming however that a significant electricity price differential still remained when existing capacity needs replacing, it would be logical for ICI to build this in Germany, closing down or at least cutting back production of chlorine in the United Kingdom. If this happened, it is unclear whether United Kingdom withdrawal would apply to all stages of the PVC production chain. Chlorine is hazardous to transport and is not a traded commodity. EDC, VCM and PVC are all internationally traded, and in a fiercely internationally competitive market the scale of operations for any petrochemical sector must be aimed at European markets to be competitive. Given the efficiency of the United Kingdom PVC plants, it is plausible to imagine EDC or VCM sourced from Germany for conversion to PVC in the United Kingdom for the United Kingdom market. This would remove the production of PVC intermediates from Runcorn with major consequences for that site but preserve a United Kingdom based PVC sector. It should also be noted that the newest, largest and most efficient PVC plant in the United Kingdom, built only 3 years ago at a cost of £35 million, will be transferred to ICI from BP as part of their restructuring. Given the other activities of ICI Mond, the withdrawal of ICI from EDC and VCM manufacture would not necessarily close down the other chlorine sectors and the caustic soda activities. Their future would depend upon the viability of continuing chlorine production at Runcorn without a requirement for EDC and VCM.

A.38. The potential effects on ICI's operations world wide are difficult to predict. Although ICI have in recent years expanded overseas facilities, this has been with the aim of strengthening their competitive ability in overseas markets. Some 60 per cent of the Group's assets are in the United Kingdom and in the case of Mond Division their re-equipment programme in the late 70s reflected an expectation that the United Kingdom would continue to be a major manufacturing centre. This is why they are now pressing so strongly for a long term solution to the problem of electricity costs.

A.39. ICI have themselves expressed some doubts whether it will be possible to preserve a PVC business in the United Kingdom of current size given continuing electricity price differentials. Certainly any expansion, unlikely though that appears at the moment, would be sited in Europe and not in the United Kingdom. It is also possible that United Kingdom plants would tend to be phased out as and when major spending is required.

A.40. Although ICI are obviously concerned about chlorine competitors, it does appear that the location of ICI's own chlorine production is also a major factor. ICI will need to take strategic decisions about expanding German production capacity at the expense of United Kingdom capacity if the current price differentials continue. Although this is an issue relating to ICI's own rationalisation, the consequences for the United Kingdom industry are similar whether German production is by ICI or competitors. The downstream impact may be slightly mitigated as the prospects of preserving ICI's downstream United Kingdom PVC operations are greater if imported EDC and VCM is sourced by ICI rather than competitive plants.

Consequences of Withdrawal

A.41. The following factors are relevant in assessing the competitive position of the ICI Runcorn site and the implications of withdrawal by ICI from chlorine based operations. Such assessments are difficult, particularly as in an integrated operation overheads are spread over a wide range of different products. It is, therefore, difficult to make specific cutbacks without weakening the operations which are left. There is thus a tendency to put off the evil day in the hope of recovery, which results in giving short term cash requirements priority over long term profitability.

A.42. If all ICI chlorine and downstream operations including PVC and other products were shut down, the loss of employment would be about 9,000 including 7,000 in Mond Division, 1,400 in Petrochemicals and Plastics and 200 HQ support staff. There would also be a loss of about 3,000 jobs in the chlorine based plants of Albright and Wilson, Tioxide and other downstream manufacturers. Assuming the same level of home consumption, the detriment to the balance of trade would be about £660 million a year.

A.43. As a second case, consider all chlorine production plus upstream intermediates being shut down and the downstream production chains being sourced by imported intermediates, eg EDC and carbon tetrachloride. The total loss of employment would be 9,000 jobs, compared with 12,000 in the above case, and the detriment to the balance of trade would be about £540 million a year.

A.44. If the PVC production chain alone, including the part of the chlorine operation relevant for PVC, was shut down, about 3,500 ICI employees and 500 workers in other companies would become surplus. The detriment to the balance of trade would be about £150 million a year.

A.45. If the chlorine and EDC in the PVC production chain were shut down, but the United Kingdom PVC plants were sourced by imported EDC and the production of other chlorine based products continued at Runcorn, 1,700 jobs would be lost within ICI. The balance of trade loss would be £50-70 million a year. There would be a further penalty to the balance of trade of perhaps £100 million a year in each of the four cases quoted above if PVC prices eventually rise to cover total costs.

A.46. It is unclear whether the operations at Runcorn would be viable if the chlorine and downstream plants associated with PVC were shut down. It would be possible to shut down particular chlorine cell rooms, leaving the complex to produce the other chlorine based products although this would involve a greater allocation of overheads to these products. It is probable that the site could continue on this basis although such proposals would need greater study.

A.47. Although PVC is currently a much more fiercely competitive market than the other chlorine based products and the caustic soda products, it is not possible for ICI to allocate a greater share of costs to these other sectors in order to improve the competitive position of chlorine based petrochemicals. As both the major caustic soda and most of the other chlorine based products are traded in bulk and customers have access to alternative sources of supply, ICI must price competitively.

A.48. The CPRS does not consider that withdrawal by ICI is imminent; and it may never occur. However some form of withdrawal is a distinct possibility in the longer term. On balance, loss of part or all the PVC production chain would seem more likely than withdrawal from all chlorine based products. If this is right, total job losses would be in the range of 1,700-4,000.

Conclusions on chlorine

A.49. The cost of electricity is very important indeed in the production of chlorine, although chlorine is not a traded commodity. Its derivatives are traded but electricity contributes progressively less to costs as the production chain lengthens. Electricity prices in the immediate future are likely to influence the balance of new investment by ICI in the United Kingdom and Europe, rather than to lead to actual cutbacks in the United Kingdom. If the current electricity price differentials continue on a long term basis, withdrawal by ICI from at least part of the chlorine based United Kingdom sector is possible, even likely. The consequences for United Kingdom employment and the balance of trade would be serious but not catastrophic.

OTHER CHEMICAL PROCESSES AT RISK

A.50. Three other smaller companies in different sectors which have made representations to government about electricity prices are Steetley Chemicals, Tioxide and Electro-Furnace Products.

Steetley Chemicals Ltd

A.51. Steetley is the only magnesia plant in the United Kingdom. The company was originally set up with government encouragement during the war to provide a strategic source of magnesia products.

A.52. Magnesia is used in high temperature technologies and is produced in two grades. The refractory grade is used in the steel industry and for refractory bricks; the chemical grade is used in oil and rubber additives and in sugar processing.

A.53. Steetley's plant at Hartlepool provides 60 per cent of the total United Kingdom chemical and refractory magnesia products. The other 40 per cent is imported. In addition 60 per cent of the Hartlepool plant's production was exported in 1981.

A.54. The process is electricity intensive requiring electricity for the electrolysis of brine and for pumping vast quantities of sea water to the plant. Electricity contributes 11 per cent of total production costs. As magnesia is internationally traded the plant is under severe competitive pressure from overseas companies. Octel uses a similar process at Anglesey to make bromine from sea water but as bromine is not a traded product it is not under the same competitive pressure.

A.55. Closure of the Hartlepool plant could also have serious consequences for dolomite production. Steetley operate 2 quarries producing a range of grades of dolomite, one of which is used in magnesia production. The loss of the magnesia business would seriously jeopardise the total dolomite production and in particular the production of calcine dolomite used in the steel industry. Steetley is the only United Kingdom producer of this product.

A.56. The total complex employs 700 people, 400 of whom work in the magnesia plant. The impact on the balance of trade if the magnesia plant was forced to close, taking into account both lost export earnings and the consequential need for imports, would be £25-30 million a year. If the two quarries also closed the additional effect on the balance of trade would be £10 million a year.

A.57. It would be possible to make the production of these products competitive if the plant was radically redesigned to make it less energy intensive at a cost of £14 million. The company say they cannot afford this and the Department of Industry are currently looking at options under Section 7 of the Industry Act.

A.58. Although the loss of this process would not be very significant in terms of employment and industrial production, the company argue that magnesia is a strategically important material. However, availability of magnesia for United Kingdom industries is unlikely to be restricted if United Kingdom production is not available.

Tioxide Ltd

A.59. Tioxide are one of two manufacturers in the United Kingdom (Laporte is the other) of titanium dioxide pigments which are primarily used in paint and related products. Tioxide have plants at Greatham and at Grimsby employing 1800 people.

A.60. Electricity accounts for 8-9 per cent of total manufacturing costs. Tioxide also operate plants in Spain and France where, they say, electricity prices are 73 per cent and 63 per cent of the levels of Greatham respectively. Greatham is not able to take advantage of load management for technical reasons. The Grimsby plant is, and presumably therefore pays rather less than Greatham.

A.61. It appears that if Tioxide were paying in the United Kingdom the same sort of prices for electricity that apply in France or Spain, their manufacturing costs would be 2-3 per cent lower. At this level, therefore, electricity prices are an important, though not necessarily decisive, factor in the long term competitiveness of the United Kingdom plants. Titanium dioxide is a traded commodity and the United Kingdom industry would be able to import titanium dioxide if electricity prices and other factors forced Tioxide's withdrawal.

Electro-Furnace Products Ltd

A.62. Electro-Furnace Products Limited at Saltend manufactures fused aluminium oxide, an important artificial abrasive for the production of grinding wheels, sandpapers etc, and a material which is also used in some refractory products. The main markets are in the engineering and steel industries.

A.63. Electro-Furnace Products supply approximately two-thirds of the United Kingdom market and until late 1980 supplied significant export tonnage. It is the only United Kingdom source and until 1960 all United Kingdom requirements were imported. The balance of trade contribution attributable to United Kingdom production is about £3-4 million.

A.64. The plant's capacity is 30,000 mt but a market collapse has seen utilisation drop from 84 per cent in 1979 to 40 per cent in 1981. The more labour intensive half of the plant has closed with a reduction in jobs from 134 to 52.

A.65. Electricity charges comprise 30 per cent of the plant's production costs compared with employment costs of 17 per cent. Electricity is therefore a major competitive factor particularly as the main competitors for this company are sited in France, Germany and the USA.

A.66. There is little chance of the plant increasing its utilisation unless the electricity price differential is reduced. Even then customers lost in recent years would be difficult to win back. The consequences of closure would be that United Kingdom industry would depend on imports, as was the case before 1960.

Graphite Electrodes

A.67. Graphite electrodes is an example of an electricity-intensive process industry lost to the United Kingdom. Airco, a wholly owned subsidiary of BOC, recently investigated the possibility of siting a carbon graphite electrode plant at Consett. Although various schemes were considered, including autogeneration of electricity, the company eventually decided to site the plant in the USA. The high cost of electricity in the United Kingdom was a major factor in this decision.

A.68. Carbon graphite is used to produce the graphite electrodes which produce the arc which melts the steel in electric arc furnaces. World wide demand for electrodes is expected to rise to 1.2 million tons by 1985 against 920,000 tons in 1980. Alongside this growth in demand, customers are intent on reducing the high price of electrodes, currently about £6 per ton of steel produced. BOC's decision to invest in the USA is based on assurances of a plentiful supply of cheap electricity.

APPENDIX TO ANNEX A

COST STRUCTURES FOR THE ECU, EDC, VCM, PVC AND TRI/PER EXPRESSED AS PERCENTAGES

%	ECU
Electricity	51
Other Variables	13
Fixed Costs	13
Other Fixed*	23
TOTAL	100

1 ECU is equivalent to the co-production of:

1 t chlorine
1.13 t caustic soda
and 0.027 t hydrogen

%	EDC	VCM	PVC	TRI/PER
Chlorine	31	14	10	21
Ethylene	52	45	31	25
Other Variables	-	7	11	9
Fixed Costs	5	17	23	22
Other Fixed	12	17	25	23
TOTAL	100	100	100	100
Electricity as a % of total cost				
via Chlorine	16	7	5	11
Service Electricity	3	4	5	2
TOTAL	19	11	10	13

*Other fixed costs include Support Costs to Division Level, CCA depreciation and adjustments and a 2% CCA Rate of Return.

Source: ICI

ANNEX B

IRON AND STEEL

B.1. All steelmaking by current technologies involves heavy use of electricity. However semi-finished and finished steel products from the electric arc route have a higher proportion of electricity costs (8-15 per cent) than do products from integrated hot metal steelworks (5-8 per cent).

Arc Furnaces

B.2. The price of electricity is a major factor in the economics of arc furnace based steel. Information made available to CPRS demonstrates that electricity accounts for at least 8 per cent of total costs (including historic cost depreciation but excluding interest on capital); the figure ranges from about 8 per cent in special exotic and aerospace steels, to 10-11 per cent in engineering steels and between 10-15 per cent in common grade steels. The typical figure in BSC Special Steels, which accounts for the bulk of BSC's electric arc steelmaking, is 13-13½ per cent. In comparison labour costs range from 11 per cent to 30 per cent (most between 16 per cent and 21 per cent).

B.3. The principal United Kingdom operators of electric arc furnaces are -

	Location	Manning '000	Turnover £m (1981/82)
BSC Special Steels	Rotherham Tinsley Park (Sheffield) Stocksbridge	12.2	409
BSC Tubes	Clydesdale	2.5	(est) 50
BSC Stainless	Tinsley Park Panteg (South Wales)	3.5	150
Firth Brown (to become 50% of Sheffield Forgemasters - BSC/JFB)	Sheffield	2.9	50

	Location	Manning '000	Turnover £m
GKN Brymbo	North Wales	1.5	(est) 80
Allied Steel (BSC/GKN)	Cardiff	0.3	(est) 80
Round Oak (99% BSC)	Dudley	1.3	(est) 60
Hadfields	Sheffield	1.0	32
Manchester	Manchester Bidston	0.8	39
Sheerness	Sheerness	0.8	(est) 65
Alpha	Newport (South Wales)	0.3	(est) 40
Aurora	Sheffield Manchester	0.4	15
Lloyds	Wednesbury Dudley	0.4	60

The employment figures of 26,000 (plus) shown above exclude about 25,000 employed in separate private sector steel rerolling and finishing plants, whose existence is partly dependent on the continuation of United Kingdom steel production.

B.4. These activities have been under severe pressure in the last three years. Manning and capacity have been substantially reduced both in the private sector and within BSC. These pressures continue in the form of a depresed United Kingdom market, and continuing overcapacity in Europe causing intense competition and reduced real prices. In addition certain of BSC's most modern activities are threatened by United States anti-dumping actions.

B.5. The competitive position of the industry may be summarised as follows -

a. Special tool steels (Aurora and certain smaller companies) suffer from intense competition from Austria, Italy, France and Sweden and imports enjoy a 70 per cent market share. Investment is planned (especially by Aurora), and combined with major rationalisation, should help the industry match the productivity of its competitors.

b. Exotic and aerospace steels (Firth Brown and part of BSC Special Steels) has suffered principally from loss of volume (eg from Rolls Royce).

c. BSC Stainless suffers severe overcapacity, and a historically dominant import market share.

d. Engineering steels (GKN Brymbo, Hadfields, part of BSC Special Steels) have suffered major loss of volume (eg from the automotive industry). The strongest international competition is from Germany.

e. BSC Tubes (Clydesdale) has benefited from oil activity in the United Kingdom and United States, although substantial new mill investment will be required to ensure the continuation of the business in the face of competition from Germany, France and Italy.

f. Non-alloy rod and bar (Sheerness, Manchester and parts of BSC Special Steels) suffer severe international competition based on price, led by the "Bresciani", the Italian electric arc steelmakers. Despite high productivity, these facilities are under extreme commercial pressure.

g. Strip (Alpha) is an opportunistic producer, whose investment was regarded as undesirable by the EEC Commission, and which only operates when market conditions are favourable.

B.6. United Kingdom arc furnaces generally have load factors between 35 per cent and 45 per cent. The major use of electricity is at the time the steel-making vessel is charged, with lesser amounts required thereafter. Hence this use is not continuous, and it is possible to adjust the load pattern by rescheduling production.

B.7. United Kingdom arc based steelmakers believe that they will pay about 2.7p/kWh in 1982/83 by taking advantage of the Contracted Consumer Load Scheme. This compares with the latest information on 'as found' prices, adjusted for recent tariff increases, as follows -

p/kWh	80MW	25MW
Germany	1.99 - 2.24	2.12 - 2.36
France	1.74 - 1.98	1.82 - 2.15
Italy	3.22 - 3.40	3.24 - 3.65

(Source IMR Report (Oct 1981), adjusted for changes in tariffs and exchange rates; load factors not available, and not always meaningful since definitions vary; see para B.11 below). The information on which the German figures are based is not wholly reliable, and it may be that these figures should be slightly higher. The Italian figures are based on load factors of less than 80 per cent. At that level, substantially reduced prices obtain and this benefits electric arc furnaces.

B.8. Taking a price of 2.3p/kWh for Germany would give a disparity of 15 per cent on electricity costs. This would be equivalent to about 2 per cent on total costs. However some steelworks in Germany are paying lower prices - say 2.1p/kWh, which gives a disparity of 22 per cent and which would be equivalent to up to 3 per cent on total costs. These figures are clearly material to competitiveness. On the other hand German steelmakers suffer a cost disadvantage of about 80 per cent on labour rates, which account for a higher proportion of costs (say 20 per cent) and hence potentially a very much higher overall burden than electricity prices. They compensate for this by achieving much higher labour productivity.

B.9. French steelmakers enjoy a much greater advantage in the price of electricity. In general the French steel industry has not been a major competitive threat to United Kingdom arc-based steelmakers, but it should be noted that, as part of French steel rationalisation, major capital investment in higher-grade steel is planned. This could in time become a more serious threat, especially in stainless and special tool steels.

B.10. United Kingdom arc steelmakers are convinced that further adaptation of their load pattern might be possible if incentives were made available. It is likely that their particular characteristics would only be matched to the of the electricity supply industry if this were done by direct negotiation, or a tariff related to these characteristics. However the normal pattern of United Kingdom working is 18 shifts, round-the-clock. Apart from a greater use of Sunday working there is a limit to the rearrangement of production which would be possible. In principle it would be possible to concentrate production at night by increasing capital investment. However the penalties of running plant at low overall utilisation and the higher labour costs involved would far outweigh the advantages of lower electricity prices. We therefore doubt whether rearrangement of steel production to take more precise account of the costs of the electricity industry will lead to a significant reduction in electricity charges.

B.11. German electricity prices are based on a degressive tariff which favours both high load factor and large users and steelmakers enjoy the added benefits of special arrangements. The effect of the special arrangements is to allow steelmakers to calculate an artificially high load factor, and achieve major consequent benefits under the German tariff. The German electricity utilities have indicated that they intend to phase out these special arrangements in 1983/85. It will be hard to implement this and even if this is achieved German steelmakers will still enjoy the benefit of a degressive tariff.

B.12. The importance of these United Kingdom steelmaking activities to manufacturing industry varies. Some steel products (eg non-alloy rod and bar) are common grades, ie commodities which are easily available internationally. Some engineering steels as well as the exotic and aerospace steels are more specialised, and it is convenient to source these steels nearby, particularly at times of intensive product development. However, it is unlikely that the future development of any United Kingdom manufacturing activity would be materially hindered if the source of these steels was outside the United Kingdom.

B.13. The size of the electricity price difference with Germany, the principal competitor, is significant for total costs in this sector. However it is dwarfed by the reverse difference in labour rates, even though higher German productivity compensates for this. The electricity price difference in itself will not determine the fortunes of these activities. They will be dominated by the speed of recovery of the United Kingdom market, by what happens to the European steel industry overall, and in the case of BSC by HMG's overall policy of financial support and by the outcome of the United States anti-dumping action.

Integrated Plants

B.14. The price of electricity is less important in United Kingdom integrated steel-making from the hot metal route, but it still amounts to about 5-8 per cent of the total costs of saleable products. Furthermore these activities, all of which are within BSC, are considerably larger than the arc-based sector. Within the five integrated sites BSC employment is about 35,000 and BSC's separate mills, with an employment of a further 22,000, currently depend on BSC steel. The value of the semi-finished steel from these activities is about £1.7 bn, and the total turnover attributable to finished steel products from the hot metal route is about £2.5 bn.

B.15. The major raw materials used are iron ore and coking coal, and coke acts both as material and source of energy in iron-making. For most products electricity accounts for about 5-6 per cent of costs, rising to 7-8 per cent in certain cases. Taking account of the electricity required to make the oxygen used in the BOS process can raise these figures by ½-1 per cent. The proportion of electricity used in semi-finished steel is maintained in finished steel: thus the proportion of electricity used in hot rolled strip (including that attributable to oxygen) of 6.5 per cent is maintained, after two other major processes, at 6.5 per cent in tinplate. These costs are based on a price of about 2.7p/kWh which these plants will pay in 1982/83 by taking advantage of the Contracted Consumer Load Scheme.

B.16. Of the electricity used in United Kingdom integrated plants 27 per cent is self-generated by taking advantage of waste gas. It would not be economic for BSC to increase this proportion, unless electricity prices were significantly higher than at present.

B.17. The principal sources of imports into the United Kingdom of steel made in integrated plants are Germany, Belgium, the Netherlands and France in that order. Competition is especially acute in strip products, where BSC lost substantial market share in the early 1970s due to production and quality problems. Producers in Germany and France enjoy the advantages shown in paragraph B.7 above; Belgian steel producers pay similar electricity prices to those in the United Kingdom; and Dutch steel production is based on electricity prices believed to be about 10 per cent higher than those in the United Kingdom.

B.18. BSC's objective is to achieve cost competitiveness with Europe by further increasing labour productivity, and by improving manufacturing performance and utilisation of energy (including coke). The scope for improvement remains substantial, and will depend partly on matching facilities to effective demand so as to achieve the fullest possible utilisation of the assets in use.

B.19. The enormous pressures on these plants are well known. Despite drastic reductions in manning and major improvements in productivity these works have only survived because of substantial subventions from HMG. The fundamental problems of a depressed United Kingdom market and continuing overcapacity in Europe continue, and are particularly acute in strip products which account for three of the five integrated works. The survival of these plants will depend on the evolution of the steel market and HMG's willingness to continue financial support: this in turn will be based principally on the progress of the plants in achieving their objectives of costs competitive with Europe. The price of electricity is a significant factor in this, but it is unlikely to be critical to the major strategic decisions on financial support.

Steel Foundries

B.20. Electricity costs in steel foundries account for between 2 and 8 per cent of the costs of production. The industry has a turnover of about £150 m and 12,000 employees. Comparative figures exchanged within the industry indicate electricity costs in French steel foundries of about 52 per cent of United Kingdom costs, and German electricity costs 68 per cent.

B.21. The industry is dispersed among seventy small and medium-sized operations. The three largest private companies in the industry are F H Lloyd, North British and Lake and Elliott, and BSC have steel foundries in Sheffield and Motherwell. Of these, F H Lloyd, with three foundries in Burton, Wednesbury and Cardiff, and North British, with two foundries in central Scotland, are likely to be seriously affected because their products have a lower value added than those of Lake and Elliott.

B.22. The major problem for the industry is volume, and major efforts at rationalisation are being made to improve capacity utilisation. Import/export trade is limited, but imports could be increased if price disparities of steel castings become too great for United Kingdom customers to tolerate.

TEXTILE INDUSTRY

INTRODUCTION

C.1. The textile industry can be sub-divided into upstream operations - fibre production, and yarn processing; and downstream activities - finishing and final products. As with chemicals and paper, the importance of energy and electricity decreases along the production chain to finished products.

C.2. The contribution of electricity to man-made fibres sectors is about 5-7 per cent of total manufacturing costs. The contribution of electricity to natural yarn production is minimal. 20-28 per cent of yarn processing costs are electricity but, as these costs are only about 2 per cent of man-made fibre production costs, the combined upstream electricity cost contribution remains at about 5-7 per cent. For downstream operations, electricity represents only about 1-2 per cent of total production costs and the average contribution of electricity across the total production chain is less than 3 per cent.

Man-Made Fibre Production

C.3. The United Kingdom man-made fibre producing industry is technologically based and capital intensive. Its operations are highly concentrated in the hands of a small number of major companies. The United Kingdom has shed 40 per cent of capacity in this sector in recent years and there are currently only two major producers - Courtaulds and ICI Fibres. Hoechst and Monsanto have factories in Northern Ireland supported by Government assistance. Total United Kingdom production has fallen to about 400,000 tons compared with a peak level in 1973 of 730,000 tons. Total employment in this sector has fallen from 28,000 in 1979 to about 12,000 by mid-1982. With the contraction of the United Kingdom industry there is now virtually no bulk man-made fibre production in the United Kingdom and the activities of Courtaulds and ICI in man-made fibre manufacture are directed towards speciality fibres.

C.4. Despite the restructuring, the sector is still suffering from over-capacity of about 30-40 per cent. The competitive pressures for rationalisation and restructuring are not unlike those acting on chemicals and steel. The future of the sector will depend heavily on the growth of customer demand and on the trading performance of the textile and clothing industries.

C.5. Electricity accounts for 5-7 per cent of the total costs of man-made fibre production. It is a continuous process with the result that little advantage has been taken of load management schemes.

Yarn Processing (throwsters)

C.6. The next stage in the production chain belongs to the throwsters who pass the yarn through a texturising process. Yarn processing is electricity intensive, with electricity representing 20-28 per cent of costs. However, firms in this sector are normally too small to qualify for load management schemes; and they depend upon high through-put and continuous operations to preserve profit margins.

C.7. The British Throwsters Association, which represents yarn processing companies, has expressed grave concerns to the Government about the effects of electricity costs upon its members.

C.8. The sector is operated as a service to the textile industry and consists of 30 small firms ranging in size from a dozen to 600 employees with an average of 130. About 4,000 people are employed often on short term contracts of about 3 months. These companies are concerned entirely with the processing of man-made fibres into higher value added yarns, frequently of specialist specifications. Their market is international but competition is almost entirely from other developed countries particularly the USA, Germany and France. The process is capital intensive and the rate of technological change rapid. Competitive pressure, particularly from overseas, means that investment in new plant must be maintained and the combination of a strong pound and high interest rates has created great problems in cash flow.

C.9. Texturising is an international business and some of the United Kingdom firms, for example, take flat yarn from Mexico, texturise it in the United Kingdom and sell it to Nigeria. The United Kingdom has established a competitive advantage in this sector through technology and quality of service which currently appears to outweigh the disadvantage created by electricity prices. As a result in recent years only a few firms have closed although the pressures on the remaining firms are considerable. Unless there is an upturn in the market more closures are likely.

Downstream Sectors

C.10. The final stages in the production process from finishing to final products are highly diversified and are normally the domain of small firms employing perhaps 100 people. The finishing processes - bleaching, dyeing etc are sometimes but not always integrated with the weaving and knitting industries. The latter's financial difficulties have slowed down restructuring programmes despite labour costs savings offered by modern machinery. A number of insufficiently specialised spinning firms have closed.

C.11. These downstream operators employ about 600,000 people (60 per cent in cloth manufacture and 40 per cent in making up final products) compared with over 1 million 10 years ago. About 160,000 jobs have been lost in the last two years. However, these parts of the textile industry are not particularly intensive users of electricity which accounts on average for about 1-2 per cent of total costs. The major competitive threat is from cheap labour countries and any changes in electricity prices would be unlikely to alter the United Kingdom competitive position significantly.

Summary and conclusions

C.12. The textile industry as a whole continues to be under the very severe competitive pressures which have already resulted in the loss of some 175,000 jobs in the last two years. The industry faces competition both in the upstream and downstream sectors. Upstream operations are dependent upon capital intensive continuous processes and competition is from developed countries with access to cheaper energy sources. Downstream operations face competition from low wage suppliers, principally in the developing countries. As a result the United Kingdom industry is having to concentrate on specialised products upstream and high quality products downstream.

C.13. In the production of man-made fibres electricity accounts for some 5 per cent of costs. There is little scope for reducing the cost through load management. The lower prices enjoyed by overseas competitors should not be a crucial factor in the industry's future but could have an impact at the margin.

C.14. Electricity costs are very important in yarn processing (up to 28 per cent of total costs) and there is little scope for cutting costs by load management. So far this small sector (4,000 employees) has survived despite the recession and the electricity cost disadvantage. However, if these disadvantages continue, they could well contribute to a major contraction in this sector.

C.15. Much the greatest part of the textile industry in terms of employment is involved in manufacturing cloth and making up final products. Here electricity is not a major factor in costs.

ANNEX D

PAPER AND BOARD INDUSTRY

Introduction

D.1. This industry can be sub-divided into three sectors - pulp, bulk paper and downstream products. The industry in Britain is not vertically integrated and there are some 125 manufacturing sites, mostly engaged on the production of bulk paper or in downstream processing operations. These sites consume anything from 1 to 50 megawatts of electricity.

D.2. The United Kingdom is involved only to a very limited extent in the first stage, the production of pulp, and the majority of pulp is imported. However, waste paper is becoming an increasingly important alternative feedstock for the second stage of the production process and now accounts for over 50 per cent of the fibre input.

D.3. Bulk paper itself is also traded internationally, and the overall import penetration into the paper sector is over 50 per cent.

D.4. The downstream sectors - printing and publishing and paper conversion - are not of particular interest to this study. The end products are not internationally traded on a large scale, import penetration is only 5 per cent, and the contribution of electricity costs is no higher than the average industrial level. If the upstream United Kingdom industry declined through lack of international competitiveness, it is probable that the downstream paper processing industry could continue, sourced by imported materials.

D.5. The important parts of the United Kingdom industry for this study are therefore those concerned with pulp and bulk paper production which have to be internationally competitive to survive. For the traditional United Kingdom mills which mainly rely on imported pulp, electricity costs average about 5 per cent of total manufacturing costs. (The NEDC reports included an averaged figure for the whole industry's electricity costs which did not bring out the greater importance of electricity for upstream operations.)

D.6. Between 1970 and 1979 the labour force in the United Kingdom industry fell by 25 per cent. The problems have continued over the last three years. Since January 1980 24 mills have closed, 62 machines have been shut and nearly 11,000 people have been made redundant. The industry's total capacity has been reduced by about 20 per cent in this period.

D.7. The demand for paper and board closely reflects the state of domestic economic activity and thus tends to be cyclical. The strength of sterling against the US dollar was also an important factor in the closure of about two-thirds of United Kingdom news print capacity in 1980/81 - news print is effectively sold in dollars. As pulp is also sold in dollars, a strengthening dollar has not helped those parts of the United Kingdom industry which use imported pulp, although higher pulp costs do improve conditions for mills making competing products from waste paper. In general prices continue to be depressed and profitability is low or non-existent.

D.8. This position, coupled with shortage of cash flow, high interest rates and a general lack of confidence about the future has depressed investment. There are a few projects in progress which were started before the current recession when market forecasts were more optimistic, the largest of which is the Thames Board mill at Workington which is due to start production this year. The proposed United Paper Mill at Shotton in North Wales would be an exception.

Electricity

D.9. The paper and board industry is the sixth largest energy using industry in the United Kingdom and the second largest private generator of electricity. Combined heat and power has been an important factor in making the most efficient use of primary energy fuels and decreasing the dependence on purchased electricity. However, although the older manufacturing mills require both heat and power in sufficient quantities to justify CHP schemes, the more modern integrated mills require much less steam ie heat. The result is that the scope for CHP schemes is decreasing and the share of purchased electricity increasing. The percentage of self-generated electricity has fallen from 66 per cent to 38 per cent in 1980 as a result.

D.10. The current cost of energy is estimated to be about 17 per cent of total manufacturing costs for an average paper mill, ranging to over 30 per cent at the top end of the scale. The average contribution of purchased electricity to this total is 11 per cent on a calorific basis but 30 per cent on a cost basis. The average electricity contribution to total United Kingdom manufacturing costs of bulk paper is therefore about 5 per cent although there is a wide divergence around this figure. In conventional mills reliant on electricity and with no auto-generation facilities, electricity costs can rise to 14 per cent of total manufacturing costs.

D.11. Most United Kingdom mills are in the range of 1 - 10 MW. 85 mills take more than 1 MW, 25 more than 5 MW and 3 more than 20 MW. Load factors are generally 50-60 per cent although there is a significant distribution between 30 per cent and 80 per cent. Without auto-generation, typical load factors would be of the order of 80 per cent. Paper mills are continuous processes and for technical reasons it is not possible to stop the process at short notice. The paper industry has therefore only been able to take advantage of load management to a limited extent, usually where alternative auto-generation facilities are available.

Competition

D.12. The main sources of international competition in the pulp and paper sector are Scandinavia and North America, which account for nearly half the United Kingdom market. The EEC is less important although competition from waste based production and non-volume production could develop. The German paper industry, in contrast to the United Kingdom industry, has been investing heavily in modern equipment and the current capital stock is significantly more competitive than that in the United Kingdom.

D.13. All EEC countries will be under increasing competitive threat from Scandinavia as existing trade barriers will be abolished by 1984. In Scandinavia, paper mills are usually integrated with power stations, often with common ownership. Although competition is mainly based upon natural competitive advantage, the wood industry is extremely important to Scandinavia and there have been some suspicions of state aids to this sector. There is currently an EEC case being brought against pulp suppliers.

D.14. Import penetration in the bulk paper grades reached 51 per cent in 1980. These grades can be produced more economically in integrated mills in which pulp mill production is fed directly on to a paper machine. Since the 1960s the Scandinavians in particular have sought to exploit their natural advantages by adding value to their wood products and moving increasingly from pulp production to paper and board production. By comparison with North America and Scandinavia, the United Kingdom has limited and fairly scattered timber resources and depends for over 40 per cent of raw material on imported pulp supplied mainly by countries who are also our main competitors. In finished paper and board this places the United Kingdom industry in a vulnerable position.

D.15. In the future the main sectors of the European industry are likely to be -

i. integrated pulp and paper manufacture;

ii. downstream conversion;

iii. some production of speciality grades;

iv. bulk and speciality grades based on waste paper.

D.16. It is unlikely that the United Kingdom has a long term competitive future in the first category in view of the natural advantages enjoyed byScandinavian and North American producers (local timber and cheap hydro power). This conclusion is supported by the fact that, for a modern integrated pulp and paper plant, electricity costs can be of the order of 40 per cent of total manufacturing costs. There is currently only one modern integrated plant of this type in the United Kingdom and the proposed UPM plant at Shotton would be a second.

D.17. The absence of a pulp and paper sector will have a major impact on wood suppliers of which the Forestry Commission is the largest. However, United Kingdom wood would at the most provide feedstock for two modern integrated pulp and paper mills and a wood resource does not in itself guarantee a viable paper industry.

D.18. The alternative of importing pulp would be difficult to sustain in the longer term, both because of cost disadvantages and because overseas pulp suppliers are likely to develop downstream into bulk paper production. Part of the United Kingdom cost disadvantage is that by contrast with integrated mills, pulp has to be dried before export to the United Kingdom, remixed with water to make paper and dried again, thus increasing energy costs.

D.19. The competitive sectors for the United Kingdom industry are therefore likely to be downstream conversions and speciality grades, in some grades of which United Kingdom companies are world leaders. It is generally true that downstream industries have been, and will tend to be, unaffected by upstream closures. There is also some scope for products which use pulp but which are unsuited to large scale integrated processes and for products which are better produced at the source of consumption eg tissues. In none of these sectors is electricity critical to survival.

D.20. That part of the United Kingdom industry based on waste paper fibre rather than imported pulp is also likely to have a future. In some sectors, notably corrugated case materials, the United Kingdom industry has been successful in developing waste based alternatives and import penetration has been held back. But the industry still has to sell such products at a discount to those made from virgin fibre and is vulnerable to a weak market and a strong pound.

Conclusion

D.21. As with chemicals and textiles, the major significance of electricity for the paper industry lies in the upstream sector, ie pulp and bulk paper production. However, as with the other sectors, upstream operations are under competitive pressure and threat for reasons which are mainly structural. For conventional United Kingdom paper mills relying on imported pulp, electricity accounts for about 5 per cent of costs on average. Although it is therefore one of many factors influencing the competitive future of bulk paper production, the sector is likely to decline for more fundamental reasons based on natural competitive advantages.

D.22. For modern integrated pulp and paper mills which will become an increasingly important part of the industry in other countries, the conclusion is even clearer. These plants are very electricity intensive (up to 40 per cent of total costs) and the price of electricity is a very severe handicap to their viability in the United Kingdom. The natural advantages (including cheap hydro power) enjoyed by our competitors are very large and such plants are both unlikely to have a competitive future in the United Kingdom and are also likely to lead to even further contraction of the current United Kingdom industry.

D.23. In the downstream sectors, where the paper industry is likely to have a competitive future, electricity is not an important factor in competitiveness.

Nat-Ind
f/c JV

Prime Minister (2)

MCS 7/10

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Nigel Lawson MP
Secretary of State
Department of Energy
Thames House South
Millbank
London SW1P 4QJ

6 October 1982

Dear Secretary of State

STANDING CHARGES FOR DOMESTIC CONSUMERS: GAS AND ELECTRICITY

Thank you for sending me a copy of your minute of 1 October to the Prime Minister on this subject.

I recognise the force of the considerable campaign which has been mounted against standing charges and the pressure in the press and elsewhere on this subject. I therefore welcome your initiative in asking the gas and electricity industries to commission consultants to examine the level of standing charges, the scope for cost saving on the relevant operations and whether all the costs are properly recoverable through standing charges.

I can see the attraction also in a rule that no standing charge should exceed 50 per cent of any bill. However I should make clear now that I do see some drawbacks which would need to be considered before we took a final decision on this. First it is not clear that it would be of greatest benefit to those in need; second homes, for example, would benefit greatly. Second, the rule might create difficulty for other industries like British Telecom and the water authorities. Thirdly, of course, there would be a significant cost. I assume that you intend, if your suggestion is implemented, that each industry's loss of revenue would be made good by off-setting tariff increases so that there would be no effect on their external financing requirements.

I am sending a copy of this letter to the Prime Minister, the Secretaries of State for Energy, Northern Ireland, Environment, Scotland, Wales, Industry and Social Services and to Robert Armstrong.

Yours sincerely

JSG. Gieve

LEON BRITTAN
[Approved by the Chief Secretary
and signed in his absence]

Nat Ind

Gas & Elec

Pt 6

- 6 OCT 1992

File

DSS.

Nawlud

bcc: John Vereker.

10 DOWNING STREET

From the Private Secretary

4 October 1982

Dear Julian,

STANDING CHARGES FOR DOMESTIC CONSUMERS: GAS AND ELECTRICITY

The Prime Minister was grateful for your Secretary of State's minute of 1 October about his review of the impact of gas and electricity standing charges.

The Prime Minister is pleased to know that Mr. Lawson has arranged for Price Waterhouse/Deloittes to examine the level of standing charges, and that there will be no further increases at least until these reports have been acted upon; she is also glad to know that he is asking the industries to consider instituting a rule by which no standing charge will exceed 50% of any bill; and that he will be making announcements to this effect this week.

I am sending copies of this letter to Margaret O'Mara (HM Treasury), John Gieve (Chief Secretary's Office), John Lyon (Northern Ireland Office), David Edmonds (Department of the Environment), Muir Russell (Scottish Office), Adam Peat (Welsh Office), Jonathan Spencer (Department of Industry), David Clark (Department of Health and Social Security) and Richard Hatfield (Cabinet Office).

Yours sincerely,

Michael Scholar

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

010

Prime Minister ①

cc ~~JV~~

Agree, ~~subject to colleagues' views~~?

Yes not MCS 1/10

PRIME MINISTER

STANDING CHARGES FOR DOMESTIC CONSUMERS: GAS AND ELECTRICITY

As you know, I have been reviewing the impact of gas and electricity standing charges.

Despite their undoubted unpopularity, I am satisfied that the principle of standing charges should remain. A two part tariff in which those costs which do not vary with the amount of fuel consumed are covered to a large extent by a fixed charge, reflects the principles of economic pricing and has the full support of the Gas and Electricity Consumer Councils. Moreover, if the standing charge were to be abolished, gas and electricity prices would have to rise by about 15 per cent. This would be particularly hard on low income families - which is why the child poverty lobby, for example, also supports the present two-tier system and would strongly oppose its disappearance.

However, while the principle of standing charges is justified, I remain to be satisfied that they have not now reached too high a level. In other words, it is possible either that the industries have gone beyond the inclusion of genuinely fixed costs, or that they have not made sufficient effort to cut those costs, or both. At my request therefore, the industries have agreed to commission Price Waterhouse and Deloittes to examine the level of standing charges, the scope for cost-saving on the relevant operations, and whether all these costs are properly recoverable through standing charges. They are due to report on this by the end of the year. There will be no further increase in standing charges at least until these reports have been fully evaluated and acted upon.

At the same time, I would like to find a way of helping the very small consumer who pays more each quarter for his or her standing charge than for the gas or electricity actually consumed. There are $\frac{3}{4}$m electricity and over one million gas consumers in this position, of whom about half a million are pensioners, and their grievance is constantly highlighted in the press and elsewhere. I have therefore asked the industries to consider instituting a rule by which no standing charge would exceed 50% of any bill. This would have only a very small effect on the overall revenues of the gas and electricity industries, which could be made good without a significant increase in tariffs. But it would remove this particularly well-publicised grievance. So far, the industries have been reluctant to accept this suggestion. I therefore intend to announce, at the same time as the Price Waterhouse/Deloittes investigations, that I have asked them to consider this proposal, thereby increasing the pressure on them and making clear where the Government stands on the issue. (I am advised that I cannot direct them to adopt it).

I propose to make both announcements at the Party Conference next week, when I reply to the debate on energy prices. Good. MT

I am copying this minute to the Chancellor of the Exchequer, the Secretaries of State for Northern Ireland, Environment, Scotland, Wales, Industry and Social Services, and to Sir Robert Armstrong.

J.S. Clark

Secretary of State for Energy
1 October 1982

(Approved by the Secretary of State and signed in his absence)

CONFIDENTIAL

Nalld cc JV

Prime Minister (2)

MLS 14/9

01-211 6402

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
London SW1

14 September 1982

Dear Chancellor,

I wrote to you on 24 June setting out details of the British Gas Corporation's offer to the Gas Staffs and Senior Officers (GSSO) when they met on 17 June.

At their further meeting with the GSSO on 9 September the Corporation tabled a revised offer. The basic rate increase offered to junior staff remains at 5.5% but the offer at the top end of the range (for senior grades) has been increased from 7.0% to 7.4%. This would increase average earnings by just over 7% for a full year and increase the Corporation's wage bill by 7.2% overall.

The Trade Union side claimed that their members would probably reject the offer. However they did not specifically say that they would recommend rejection. They are now consulting at regional level and a formal response is not expected for at least a week.

I am copying this to the Prime Minister, other members of E Committee, George Younger, John Sparrow and Sir Robert Armstrong.

Yours sincerely

J.S. Clough

pp NIGEL LAWSON

(Approved by the Secretary of State and signed in his absence)

Nat Ind, Gas & Elect, Pt 6

14 SEP 1982

RESTRICTED
MANAGEMENT IN CONFIDENCE

PS/ Prime Minister

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 5902
SWITCHBOARD 01-212 7676

From the
Minister of State
Norman Lamont MP

NBPM
MLS 9/9

The Rt Hon Nigel Lawson MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
London SW1

8 September 1982

Dear Nigel

GAS SAFETY ETC

I have seen copies of your letter of 4 August to Janet Young and of Janet's reply.

While I remain sceptical of the need for a rigorous licensing system for gas installers I recognise the implications of our stance on the disposal of gas showrooms and I am content to leave the matter to your judgement. To minimise the inevitable criticism, particularly from small firms, any system of licensing should be as simple as possible and not restrict unduly the entry of new firms into the gas installation market. It would also be helpful if we could present the introduction of licensing as being the other side of the coin to the new opportunities for private enterprise following the disposal of BGC's gas retailing activities.

I welcome the proposal to merge the relevant metrology functions of your Department and of the National Weights and Measures Laboratory. As the recent ACARD report "Facing International Competition" observed, the fragmentation of metrology responsibilities in this country is not to our advantage. I trust, however, that this merger would not prejudice the question of the proposed merger between the NWML and the National Physical Laboratory which the Prime Minister will be reconsidering in the Autumn.

Whatever organisational solution is adopted I assume that the possibilities for private sector participation mentioned in paragraph 20 of the report will be pursued. In particular it would be consistent with practice of quality assurance elsewhere for the meter manufacturers to check their own meters.

I am sending copies of this letter to the recipients of yours.

Yours ever

Norman

Nat Ind ! Gas Pt 6.

9 SEP 1982

FC 52

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Nigel Lawson MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
LONDON
SW1A

6 September 1982

Dear Nigel

GAS SAFETY ETC

Thank you for sending me a copy of your letter of 4 August to the Lord Privy Seal. I have seen the letter of 9 August from the Lord Privy Seal's Assistant Private Secretary to your Private Secretary, Norman Tebbit's letter to the Lord Privy Seal of 17 August and Arthur Cockfield's letter of 24 August.

Your proposal to make the Health and Safety Executive responsible for the licensing of gas installers has the advantage that it can be introduced relatively quickly under existing legislation, and should in principle be the most economic solution if we are going for a system of licensing. While I am sympathetic to Norman Tebbit's argument for a system of control without licensing, I think that only a system involving licensing will carry conviction and enable us to go forward with the disposal of the showrooms.

However, I hope that despite what has been said in Parliament it will prove possible to confine the licensing system to companies since this will reduce the staff requirement. The option of licensing companies alone should therefore be thoroughly explored, including its manpower implications. Could your officials please keep mine in close touch on this aspect in their consultations with the Health and Safety Executive, so that we can decide how to deal with the increased staff for licensing in the manpower count exercise.

Finally, on the licensing work, I assume that it will be entirely self-financing with fees from licensees covering HSE's expenses. This seems appropriate since the costs should be borne by those who will primarily benefit, ie the installers who will no doubt pass the charges on to their customers. This is not a cost to be borne by the taxpayer through public expenditure.

I have no objection in principle to the transfer of gas safety functions from the Gas Standards Branch to the HSE, nor to the establishment of unified legal metrology service subject to the following two points:

i) whatever arrangements are agreed, do not obstruct the development of checks on the meters used for measuring flows of oil and gas for tax and royalty purposes;

ii) there should be no increase in the running costs of Government or in civil service manpower as a result of such reorganisation. Indeed, our aim should be thereby to secure savings. Your officials should be in touch with mine about the PES transfers necessary.

We need to be satisfied on these two matters before we come to final decisions.

Finally, could I ask about your proposals for the disposals of BGC's gas showrooms? I recall from last year that there was also discussion about the future of BGC's wholesaling and contracting business and I should be interested to know your plans for this as well.

I am sending copies of this letter to the Prime Minister, Norman Tebbit, Arthur Cockfield, Patrick Jenkin and to Janet Young.

Yours ever
Nick

NICHOLAS RIDLEY

06 SEP 1982

DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SW1H 0ET Telephone [illegible]

c/c JV

From the Secretary of State

The Rt Hon Baroness Young
Lord Privy Seal
Management and Personnel Office
Whitehall
London SWIA 2A Z

24 August 1982

Dear Janet,

GAS SAFETY ETC

Nigel Lawson proposes in his letter of 4 August taking decisions of principle immediately on both the transfer of gas safety and licensing to the HSE; and of his metrology functions to me.

I agree with the first and the suggestion that the actual method of licensing should be looked at further. I hope his and HSE officials will keep in touch with mine on that work, mainly because of our competition policy interest.

Of course extension of my Department's existing metrology functions has obvious attractions. It would be a substantial step towards a comprehensive legal metrology service. But I myself am not satisfied yet that there would be clear net benefit from the change. There are a number of issues, particularly regarding resources, lines of responsibility and the like, which are not touched on, or only partially so, in the report by the Working Group, which itself recognised that further work was required. I think that should be done before any decision is taken. I am therefore arranging for these matters to be looked at quickly by my officials, in consultation with the Department of Energy and your own Office as necessary. That can take place while Nigel Lawson's people are looking at the licensing detail.

We must of course get on with this since it has been around so long. But both aspects, the licensing and the metrological, raise more problems than perhaps were expected and we must avoid running into difficulties later.

I am copying this letter to the Prime Minister, Nigel Lawson, Norman Tebbit, Patrick Jenkin and Nicholas Ridley.

Yours,

Arthur

LORD COCKFIELD

EJV

SECRETARY OF STATE FOR EMPLOYMENT

Caxton House Tothill Street London SW1H 9NA

Telephone Direct Line 01-213 6400

Switchboard 01-213 3000

The Rt Hon The Baroness Young
Lord Privy Seal
Management and Personnel Office
Whitehall
LONDON SW1A 2AZ

17 August 1982

Dear Janet,

GAS SAFETY ETC

Nigel Lawson sent me a copy of his letter to you of 4 August.

I agree with his conclusion in favour of option II in the Working Group's report, in so far as affects safety. The issue of the administration of metrology is not one upon which I feel able to comment. Bill Simpson the Chairman of the Health and Safety Commission has also written to me giving the Commission's support for option II.

I also agree that further work needs to be done on the arrangements for controlling gas installation work. A majority, but not all, of the Working Group accepted the case for some form of licensing but there was no agreement on what the form should be. I quite accept the reasons why Nigel Lawson sees a need for licensing but I feel that I should repeat my earlier view that licensing is a costly approach requiring additional resources and one that we have not adopted in other hazardous areas, and that we should think carefully before setting a precedent which could lead to pressure for similar schemes in other areas.

The Health and Safety Commission has suggested that it should carry out formal consultation with the interested bodies as it does on other proposals for which it is responsible. It estimates that it could bring forward its advice within four months. This strikes me as the best way forward and, if Nigel Lawson agrees, his officials and the HSE should quickly start discussions on arrangements for transferring the existing gas safety work from his Department and for consultations on controlling gas installers.

Yours,
Norman

18 AUG 1982

10 DOWNING STREET

CP

Gas Safety Etc

Are Industry and Trade intending to comment on the proposals in Mr Lawson's letter of 4 August?

MA
18/8

Thanks

MA 18/8

MB
Trade will reply next week. Industry have no comments. Trev.

Management and Personnel Office
Whitehall London SW1A 2AZ
Telephone 01-273 } 4400
GTN 273 }

LORD PRIVY SEAL

9 August 1982

BF with other Ministers' comments. 10/8

Jeremy Clayton Esq
Private Secretary to the Secretary of State
Department of Energy
Thames House South
Millbank
London SW1P 4QJ

Dear Jeremy

Before she went on holiday, the Lord Privy Seal saw your Secretary of State's letter of 4 August, and was glad that the official working group's advice had been found helpful.

For her part, she is happy with the proposals in your Secretary of State's letter, and considered that they represented the most effective ways of discharging these tasks. The proposals do, of course, involve changes in the machinery of Government which are a matter for the Prime Minister, who will no doubt consider them in the light of the views of the other Secretaries of State concerned.

Copies go to the Private Secretaries to the other recipients of Mr Lawson's letter.

Yours sincerely

Douglas Board

D R H BOARD
Assistant Private Secretary

Nat Ind: Coal Elec Pt 6

fc JV

Prime Minister 2

4/8

01 211 6402

The Rt Hon Leon Brittan QC MP
Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
London
SW1P 3AG

4 August 1982

Dear Chief Secretary,

CEGB COAL IMPORTS

In your letter of 6 May you agreed that the CEGB could be compensated by up to £30m, by means of a discount on its payments to the NCB, for limiting its imports to the agreed figure of 0.75 mt in 1982/83. My officials have since discussed with the Generating Board the latest estimated cost of doing this, which turns out to be £35m, and have let your officials have the details. It does not seem possible to fault this figure.

My officials have examined carefully means of minimising this compensation. In principle, one way might be to sell off the CEGB's Australian coal before it is put into stock on the Continent. But in the present depressed market, the losses would amount to the cost of storage for 1½-2 years. Therefore no savings in 1982/83 could be made in this way. Nevertheless, I will keep the question of selling under review with the CEGB in the light of market developments.

Of course, should circumstances later in the year point to increasing imports above the agreed level, there would be a corresponding reduction in the amount of compensation payable. But we cannot count our chickens before they are hatched.

I hope therefore you can agree to the revised figure of £35m for compensation to the CEGB, subject to any savings that may be possible.

I am copying this letter to the Prime Minister, Willie Whitelaw, Patrick Jenkin , John Nott, David Howell, Norman Tebbitt, George Younger, Sir Robert Armstrong and John Sparrow.

Yours sincerely

J. S. Clayton

NIGEL LAWSON

(Approved by the Secretary of State and signed in his absence)

AUG 1982

s/c SV
Nat Ind 2

Prime Minister

Mr Lawson recommends that we move quickly to implement option II below.

01-211 6402

The Rt Hon Baroness Young
Lord Privy Seal
Management and Personnel Office
CSD
Whitehall
London SW1A 2AZ

4th August 1982

Dear Lord Privy Seal

GAS SAFETY ETC

In your letter of 26 March you offered the services of your officials to convene a Working Group charged with recommending organisational arrangements to cover the licensing of gas installers and the work of the Gas Standards Branch (GSB) and the Electricity Meter Examining Service (EMES). I have now considered the Working Group's Report.

On gas licensing, the Working Group concluded that powers under existing Health and Safety legislation could be used to set up a system of gas licensing. They also agreed that licensing was a necessary corollary of the action to be taken on gas appliance retailing following the Monopolies and Mergers Commission Report. But they were not able to recommend a particular licensing system.

On organisation, the Group identified the following options covering gas licensing and the present functions of GSB (gas safety and legal metrology) and EMES (legal metrology);

I - maintain the broad status quo: gas licensing to go to GSB (responsible through HSC to myself).

II - divide the functions: gas licensing and gas safety to go to the HSE (responsible through HSC to myself) metrology work of GSB, EMES and National Weights and Measures Laboratory (NWML) to be combined into a new central service.

III - treat metrology as in (II) but gas safety and licensing as in (I).

IV - set up a new non-departmental public body to cover gas licensing and the work of GSB, and possibly also the functions of EMES.

The Group also identified a sub-option which is to leave metrology as at present (option I) but to place gas safety and licensing within HSE (option II).

The Group's Report sets out the arguments for and against each option, and I will not repeat them. I should however stress the importance of introducing a rigorous system of gas licensing quickly so that progress can be made on the follow-up to the MMC Report.

My objectives are to provide effectively and quickly for gas safety before taking action on appliance retailing, and to ensure that the statutory functions now carried out by GSB and EMES continue to be carried out satisfactorily. Any proposals for organisational change need to take into account both cost and career structures for the staff concerned.

The Working Group favoured options II and III with some preference for option II (gas safety based in HSE and a unified metrology service). My own preference is also for option II, and I think that we should now endorse that in principle.

On gas safety, I am sure that the Working Group were right to recommend that GSB's existing gas safety responsibilities and the new gas licensing function should be carried out together. I am also persuaded by the argument that the Health and Safety Executive have the experience of licensing systems and the administrative superstructure to take on this task relatively quickly and at a relatively low cost. The line of responsibility would run from the HSE through the Commission to myself. Experience with similar arrangements for the Nuclear Installations Inspectorate and the Mining Inspectorate suggests that this would work satisfactorily. The transfer of GSB's gas engineers to the HSE would provide a helpful degree of continuity.

On metrology, the establishment of a unified legal metrology service seems a sensible approach which would result in greater efficiency from which Government, consumers and industry should benefit. It would also establish a broader career structure for the officials concerned.

I do not agree with the suggestion in Paragraph II of the Report's Summary and Conclusions that further work will be necessary before agreement can be reached on metrology. Paragraph 26 of the Report fully makes the case for a unified service. We need to minimise any delay, both because urgent action is required on gas safety and to avoid prolonging uncertainty for the staff concerned. I propose therefore that we should agree now to the establishment of a unified legal metrology service. Officials will of course need to consider further the details.

On gas licensing, it is clear that more work is required before a final decision on the type of licensing system can be taken. I therefore propose that my officials should discuss urgently with the HSE the transfer of gas safety and gas licensing. I can then further consider possible licensing arrangements, and also what administrative arrangements need to be made to transfer to HSE the functions covered by existing gas safety legislation.

To sum up, it is clear that a more effective disposition of functions within Government would be achieved by transferring the tasks of GSB and EMES from my Department to a unified legal metrology service and to the HSE. In addition, I am satisfied that the HSE could take on the urgent task of licensing gas installers rapidly and cost-effectively. I should be grateful for your agreement and that of colleagues to these proposals.

Copies of this letter go to the Prime Minister, Norman Tebbit, Arthur Cockfield, Patrick Jenkin and to Nicholas Ridley.

Yours sincerely

pp NIGEL LAWSON
(approved by the Secretary of State and signed in his absence).

cc JV

Dat ind

Prime Minister (2)

To see x

MES 30/7

01 211 6402

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
London
SW1

30th July 1982

Dear Geoffrey

ELECTRICITY PRICING

Thank you for your letter of 19 July. Our officials are already in touch about the appreciation you mentioned. I hope we can consider this very soon.

I am grateful for your agreement to my seeking further information from the industry. Time is short if, as we must, we are to take detailed decisions within the timescale for the public expenditure cycle and for setting the industry's next EFL and financial target. I have therefore asked my officials to proceed on the basis you have suggested.

Finally, it may be of help to you to have some idea at this stage of the possible public expenditure consequences in 1983/84 of action on electricity prices arising from Coopers' recommendations - and appropriate action is, I believe, essential. As you recognise, further work remains to be done before precise figures can be arrived at, but the order of magnitude looks like being some £500m, recognising that the final figure could be different.

I am sending copies of this letter to the Prime Minister and Sir Robert Armstrong.

Yours ever
Nigel

NIGEL LAWSON

30 JUL 1982

Nat Ind
cc JV

Prime Minister (2)

Nigel Lawson referred to this at E last week: if accepted this approach would mean a large increase in electricity EFL's?

MCS 20/7

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

19 July 1982

The Rt. Hon. Nigel Lawson, MP
Secretary of State for Energy

Dear Nigel

ELECTRICITY PRICING

(Cooper and Lybrand)

Thank you for your letter of 8 July. As you say, the Report raises some major issues concerning economic pricing and resource allocation, e.g. in relation to coal prices, the correct interpretation of long run marginal costs, and the possibility of adopting different pricing principles for large industrial consumers and other consumers. The report contains some interesting suggestions on these points, but it clearly is not the last word: much more work needs to be done. As you know, even marginal changes in tariff policy would have large public expenditure consequences.

I quite see that you will have to consult the industry before making firm proposals for change after the Recess. However, in my view it could be very damaging to send them the consultants' Report as it stands as the basis for discussion. Even if you were to do so in confidence, there would be a serious risk that some of the consultants' comments, for example on coal prices, as well as their main conclusion that electricity prices are significantly too high, would leak, and that pressure for the Report to be published would grow. This would make it difficult for us to examine the issues dispassionately. Considerations of this kind led us in February not to announce the appointment of the consultants: they point now to your not releasing the report to the industry.

We need in any case to clear our own minds on what options are worth pursuing before going to the industry. I understand that officials in our two Departments have already met for an initial discussion of the issues raised by the Report; I suggest that - perhaps in consultation with the CPRS - they should as a matter of urgency prepare an appreciation of the main issues that need to be resolved on electricity pricing and the proposals put forward by the consultants. This should not greatly delay consultations with the industry on options worth pursuing further. Nor of course would it stop your officials seeking further information from the industry in the meanwhile on detailed methodology and figuring.

/I am

CONFIDENTIAL

I am sending copies of this letter to the Prime Minister and Sir Robert Armstrong.

GEOFFREY HOWE

Nat Ind Mr Scholar

PERSONAL AND CONFIDENTIAL

PA

10 DOWNING STREET

The Right Honourable
Nigel Lawson, MP,
Department of Energy,
Thames House South,
Millbank,
London, SW1.

19 July 1982

Dear Nigel,

THE COOPER LYBRAND REPORT ON THE PRICING OF ELECTRICITY

I gather from our conversation that you would like me to review generally the report and give a first opinion. I am afraid that I cannot find the time to review it in the detail and depth the report so richly deserves.

My overall view is that it is a good report. Occasionally it does not have the courage of its analysis and conviction, but on many important issues it does. The analysis is usually correct and the conclusion well drawn. (I think the essence is, in short, in para 6.25. This virtually says it all.)

The basic argument is that the CEGB is wrong in using long-run marginal costs as the basis for pricing. This is entirely correct. Long-run marginal cost is relevant only when it happens to be equal to short-run marginal cost. I put this point as succinctly as I could almost 20 years ago in The Economics of Road User Charges. Mutatis mutandis it applies also to electricity supply. (Annex A).

In electricity pricing where the authorities accurately predict future output so the optimum amount of capacity is always present, then long-run and short-run marginal costs are the same.* The vast majority of economists, and the CEGB, have blithely assumed such infallibility as a basis for their pricing policies.

One of my main points of disagreement with the Cooper Report is where they accept a "sound economic argument for an LRMC approach in designing most retail tariffs" (para 6.4). Coopers accept the argument that the present price of electricity will influence future consumption when the costs of meeting increment and demand are different from now. But this proposition is quite a general one. Present investment in electrical appliances etc, will depend upon the expected future prices of electricity. The expected future prices, however, need have no relationship at all to present prices. And it is not at all clear why future prices should be determined by present prices, as the report alleges. (After all, such expectations have been dramatically discredited in the Seventies!) Thus, I cannot see the case summarised in para 6.11.

/The argument

*Assuming that there are constant returns to scale.

The argument that the tariff based on short-run marginal costs would give rise to insufficient revenue to cover costs is valid under either one of two propositions. Either the investment is optimal, that is to say there is no excess capacity (which for the moment I leave deliciously vague), but there are increasing returns to scale; then there will be a problem of covering the cost. The second possibility is that there are no significant economies of scale but because of the optimistic forecasts we have overbuilt the plant and have too much spare capacity. Then again you will not be able to cover costs. It seems to me quite clear that the latter proposition is the most relevant one.

If one is constrained to raise a certain surplus of revenue over and above costs, or indeed one is constrained to make a loss less than that which would be implied by short-run marginal cost pricing, then the inverse elasticity rule suggested by Coopers is clearly the valid one. It is the analogue of charging what the traffic will bear. I extract a simple proof of the proposition from my book. (Annex B)

As you can adduce, I am, and indeed always have been a proponent of short-run marginal cost pricing. For many years the long-run marginal cost concept, developed largely by infallible French economists, has ruled the roost in electricity pricing. It has always seemed to me to be a grave mistake, but the consequences of such mistakes did not appear while there was an expanding market roughly in accordance with the planned capacity. Now it is different. We are operating well below capacity and SRMC pricing is very different from LRMC pricing.

There remains, however, the revenue question. But this should be tackled on its merits using the inverse elasticity rule. It should certainly not be "solved" by the mystique of allocating by some arbitrary rule the costs over the various tariffs. And even if one attempted to recover to full costs, as with the existing system, the use of the modified short-run marginal costs rule would give a very different tariff from that which at present obtains.

We considered short-run marginal cost pricing in electricity some time ago when David Howell was Secretary of State. I recall that the calculations we then saw were very odd - but it was difficult to challenge them at that time. Now the Coopers report will give a valuable basis for restructuring tariffs.

Yours ever
Alan

ALAN WALTERS

the consequences in detail in the next chapter. What must be emphasized here is that there is no economic rationalization for "balancing the road budget"—although, as we shall see, a case may be argued in terms of the consequences of alternative policies. Each policy must stand or fall by the *consequences* and not by any abstract *obiter dicta*. If it be thought that the roads should bear higher taxes than those which emerge from our economic analysis—then let the case be argued in terms of the alternatives, such as running a budget deficit, or reducing government expenditure or increasing running a budget deficit, reducing government expenditure or increasing other taxes. The balanced road budget is, to the economist, merely a graven image.[48]

6. *Concepts of Cost and Their Difficulties*

The Unit of Cost Analysis

114. Some exponents of the theory of road pricing have argued that the *long-run* marginal cost is the appropriate value for fixing prices. In this study, however, we have stressed that the short-run marginal cost and not the long-run marginal cost is always the appropriate concept for pricing purposes. It is easy to show that the long-run marginal cost is efficient only when three conditions are met. The first requirement is that traffic be growing and expected to grow, so that there is no question of simply making the best use of a road that is too big; all roads must be enlarged. The second condition is that there be no indivisibilities and joint-product relationships in the supply of roads. In other words, the highways should be described appropriately by a putty model. The third condition is that the government always carries out the efficient investment program; it never lags behind in building new roads when they are desirable and it never makes mistakes by overbuilding.

115. If these three conditions are present, the long-run marginal cost will provide an appropriate measure of the efficient user charge. It is important to see why under these conditions the long-run marginal cost pricing policy

[48] Since there is a complete theoretical symmetry between the deficits arising from the use of the consumer surplus criterion and the profits that may arise from congestion levies, they should be treated symmetrically. Both are rents—the former are negative rents and the latter positive rents. Administrators are much more concerned about negative rents than about positive rents. Yet if one is concerned about too little money being extracted from private persons for government schemes in the first case, should one not, in the positive rent case, be equally concerned about *too much* resources being siphoned off to the public sector? Administrators rarely evince any concern of the second kind—largely because they are under pressure to provide a tax base for government schemes. Whether governmental expenditure is "better" than the private expenditure it displaces is another, rather large matter.

is correct. For it is *only* when these three requirements are met that the long-run and short-run marginal costs are equal. In other circumstances they will generally be different. Thus the long-run marginal cost is useful as a criterion for user charges *only* when it is equal to short-run marginal cost. When the long-run differs from the short-run cost, the long-run concept is the wrong basis for pricing policy. The short-run marginal cost is *always* the appropriate value at which to fix the user charge.

116. Any concept of cost must be associated with the decision to which it is related. The concept of cost used throughout the whole of this study comprehends solely the escapable cost as one course of action is selected rather than another.[49] In any well specified situation there are a number of feasible alternative courses of action; and also a set of circumstances which one cannot change. Taking the latter as given, we calculate the value of the resources used up if we adopt different courses of action. There is therefore an infinity of concepts of cost—but each one is uniquely related to the decision specified in each situation.

117. Which concept of cost is relevant for the user charge policy of the road authority? For this purpose we must inquire into the role of price in the budgets of consumers and firms that use the highways. Clearly each user takes the price (user charge) as given and "buys" highway services so that the additional satisfaction derived from the last unit of highway service just equals the price he has to pay. Since the consumer of highway services can buy units of highway services as small as he likes, the relevant unit for pricing purposes is the "small" increment in road service which the consumer may buy. The appropriate cost concept is therefore uniquely defined as the marginal cost of supplying an additional (small) unit of the road service—and the marginal cost is "the value of the resources which would be saved by not supplying a (small) unit of road service."

118. It is quite wrong to imagine that this concept is arbitrary. It is not. It is determined by the nature of the "commodity"—it is possible to use a road in very small units at a time[50]—and by the fact that the decisions of

[49] It will also be recalled that, in the extreme simplified model of Figure 3 marginal cost was defined to *include rent*. We return to this problem below.

[50] It is easy to sketch (but perhaps hard to imagine) the conditions under which the relevant pricing unit would be much larger. Suppose, for example, that the road authority decided to sell road journeys in "blocks" of 1,000 vehicle-miles, and that subcontracting (or retailing road services to third parties or trading in any units smaller than 1,000 vehicle-miles) was declared to be illegal with very high (prohibitive) penalties. Then the only possible unit of contract is the 1,000 vehicle-miles of road service, and this is the relevant unit for the analysis of cost. But it is misleading to talk about the marginal cost of these large units. We shall analyze all cases with "sticky" prices in the next subsection.

tal stock of roads will be growing quadratically. All the oscillations in net investment are fully reflected in this measure of costs, whereas a figure reflecting the true value of resources used would be much smoother.[38] If there were no oscillations in investment, and if investment increased at the same steady rate for a very long time, then the incremental cost would grow at the same rate as the development and long-run marginal cost. For any given year, however, the incremental cost would be higher than either the development cost or the long-run marginal cost. With steady growth the incremental method has the effect of shifting the responsibility for cost to an earlier period in time.

90. This is analogous to calculating the cost *as if* the roads were all used up in the year in which they were built. Thus in years where investment is a large fraction of the capital stock of roads, the convention of the incremental method will overestimate the cost of the roads used up, whereas in periods when the investment in roads is a relatively small fraction of the capital stock, the Incremental Method will underestimate the value of the roads used up. Thus the Incremental Method is a particularly misleading measure of costs when investment varies considerably over time and when the ratio of investment to the capital stock of highways changes greatly from one period to another. This is a serious disadvantage of the incremental concept.

91. If one accepts the political and administrative reasons for "covering the costs" however, the incremental cost does seem to be the least bad definition available. It has the additional advantage that the increased taxes may stimulate saving to match the increase in road investment. There is, as it were, a built-in stabilizer. This has a great appeal to development economists faced with the problem of mobilizing resources for development.

92. The main purpose of this chapter was to examine the case for departing from the *EUC* principle and to decide whether road charges should cover the costs of the highway system. The main conclusion is that, although one may justify some departure from *EUC*'s in certain practical cases, there is no *economic* argument for balancing the road budget.

ANNEX: MATHEMATICAL NOTE*

93. We can show that if a budget constraint is imposed on the roads the formal solution is for the road authority to recoup its costs where the

[38] Note that if the investment follows a *sine* curve the capital stock will follow a *cosine* curve—i.e. the oscillations will have the *opposite* movements over time.

* I am very grateful to Professor William Vickrey who found an error in a draft of this note.

elasticities are lowest, i.e. to charge in proportion to what the traffic will bear.

Let benefits be B and the costs C for n road services, the quantities of which are denoted by $x_1, x_2, \ldots x_i \ldots x_n$. Each of the services is sold at a price $p_1, p_2, \ldots p_i, \ldots p_n$. The condition that the budget be balanced is then

$$C = \sum_i p_i x_i$$

To find the best price system we maximize the *net* benefits $\underline{B} = B - C$, subject to the condition that total costs are recovered. With Ψ as a Lagrangean multiplier, we have:

$$\underline{B} = B - C - \Psi(\Sigma p_i x_i - C)$$

Stationarity conditions are given by finding:

$$\frac{\partial \underline{B}}{\partial x_i} = \frac{\partial B}{\partial x_i} - \frac{\partial C}{\partial x_i} - \Psi\left(p_i + \sum_j \frac{\partial p_j}{\partial x_i} \cdot x_j - \frac{\partial C}{\partial x_i}\right)$$

and equating to zero, i.e.

$$0 = p_i - \frac{\partial C}{\partial x_i} - \Psi\left(p_i + \sum_j \frac{\partial p_j}{\partial x_i} \cdot x_j - \frac{\partial C}{\partial x_i}\right)$$

or we might write it as:

$$p_i - \frac{\partial C}{\partial x_i}(1 - \Psi) = \Psi\left(p_i + \sum_j \frac{\partial p_j}{\partial x_i} \cdot x_j\right)$$

Now the bracket on the right-hand side of this equation measures the marginal revenue which the authority obtains by expanding its service x_i by a small amount and maintaining constant all other services. (Prices must adjust so that the same x_k, $(k \neq i)$, are bought.) The natural interpretation is therefore to define the right hand bracket as follows:

$$p_i + \sum_j \frac{\partial p_j}{\partial x_i} \cdot x_j = p_i\left(1 + \frac{1}{\epsilon_i^*}\right),$$

where ϵ_i^* is defined as the *total* elasticity of demand for the i^{th} service. This *total* elasticity takes into account the indirect effects, on the prices of other services, of expanding the i^{th} service on the revenue of the authority. Thus we obtain the simple result:

$$\frac{p_i - \dfrac{\partial C}{\partial x_i}}{p_i} = \left(\frac{\Psi}{1 - \Psi}\right)\left(\frac{1}{\epsilon_i^*}\right)$$

Thus the "mark-up" of price above marginal cost should not be constant but should vary in inverse proportion to the *total* elasticity of demand for the service.

A particularly simple case of this rule is where:

$$\sum_{j \neq i} \frac{\partial p_j}{\partial x_i} \cdot x_j = 0$$

and so the cross-effects on demand cancel out. Roughly interpreted, substitute road services are as important as complementary road services. Then the rule becomes:

$$\frac{p_i - \dfrac{\partial C}{\partial x_i}}{p_i} = \left(\frac{\Psi}{1 - \Psi}\right)\left(\frac{1}{\epsilon_i}\right)$$

where ϵ_i is the *partial* elasticity of demand for the i^{th} service.[39] The proportional "mark-up" of price above marginal cost is inversely proportional to the partial elasticity of demand for each service.[40]

94. In examining the road/rail problem the same approach can be used. The first practical question is, supposing that the railway is constrained by the requirement of a balanced budget, would it be a good idea also to so constrain the road authority? Clearly no such general presumption can be deduced. Indeed it is always true that one can find an optimum policy for roads, given the rail budget constraint; and that policy will only accidentally give rise to a balanced road budget. Thus when the balanced road budget is imposed it is either unnecessary or harmful.

95. Given the fact that the railways are required to break even, a balanced road budget *may* be better than the simple EUC on the roads. But one can always achieve at least as good a solution, and in the vast majority of cases a better one, by adjusting the EUC's in some other way—for example one would adjust only those road prices that were competitive or complementary to rail, leaving the others at the EUC.

[39] A sub-case is the much more restrictive case where:

$$\frac{\partial p_j}{\partial x_i} = 0 \text{ for all } j \neq i \text{ cases}$$

This is where demands are independent.

[40] It would perhaps be more relevant if we took the prices of the services, other than the i^{th}, as *fixed* and considered the net benefits as the p_i is varied with consequential variations in the x_j to maintain the same prices $p_j (j = i)$. Such an approach however causes complications in the analysis of costs and has not been pursued here.

CONFIDENTIAL

01 211 6402

Prime Minister

This would means a reduction in electricity prices - but an increase in public borrowing.

MCS 8/7

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON SW1

8th July 1982

Dear Geoffrey

ELECTRICITY PRICING

I have just received a draft from Coopers and Lybrand of their confidential report on the Electricity Council's review of the CEGB's Bulk Supply Tariff (BST). The report is critical - it suggests that the CEGB's theoretical approach to setting marginal cost prices needs modifying, and argues that a number of the Board's cost estimates are too rough and ready. It concludes that an economically defensible BST would probably yield significantly less revenue than does the present one.

I shall need to discuss the report, urgently and in confidence, with the industry. But it clearly raises some major issues of economic policy concerning economic pricing in the public monopoly sector, resource allocation, counter-inflation and industrial costs. We shall need to discuss the report's implications collectively and I shall put a paper to E Committee with my specific proposals as soon as possible after the Recess. Meanwhile, my officials will of course keep in close touch with yours and with the CPRS, both of whom have the papers.

I am copying this letter to the Prime Minister and to Sir Robert Armstrong.

NIGEL LAWSON

8 JUL 1982

c/c JV Nat led

Prime Minister (2)

MCS 29/6

01 211 6402

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
London
SW1

28 June 1982

Dear Chancellor,

GAS INDUSTRY PAY

At a meeting with the unions representing the Higher Management on 24 June British Gas made an increased pay offer of 7% on salaries (equivalent to about the same increase on average earnings). This matches the 7% salary increase currently on offer to the most senior of the Gas Staffs and Senior Officers, reported in my letter of 24 June.

The unions said that the offer was unacceptable and are considering their formal response. No arrangements have been made for a further meeting.

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

Yours sincerely

J.P. Clayton

NIGEL LAWSON
(Approved by the Secretary of State
and signed in his absence)

net fuel

c ¢ J.V. Nat. Industry

DEPARTMENT OF ENERGY
THAMES HOUSE SOUTH
MILLBANK
LONDON SW1P 4QJ

Direct Line 01-211 3390
Switchboard 01-211 3000

PARLIAMENTARY UNDER
SECRETARY OF STATE

Prime Minister (2)

MCS 25/6

Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3HE

25 June 1982

Dear Chancellor

POWER ENGINEERS PAY NEGOTIATIONS

A settlement with the power engineers was reached at a meeting of the electricity supply industry's National Joint Board on 18 June, following an earlier discussion on 15 June when the unions had rejected an offer of 7% across all pay scales. The Electricity Council made a final offer of a pay increase ranging from 7.3% to 7.6% at the top of the scale. No increase was given to trainee engineers in their first two years. The Union side who had been pressing for a 9.2% increase across the scales were brought to accept this.

The effect of the settlement will be to increase the engineers' average earnings by 7.4% and the annual pay-bill by 7.2%.

The settlement operates from 1 February 1982.

I am copying this letter to members of E Committee, George Younger, Sir Robert Armstrong and John Sparrow.

Yours sincerely

Christine Sparway

DAVID MELLOR

(Approved by Mr Mellor and
signed in his absence)

25 JUN 1982

qf JV

Prime Minister (2)

MCS 25/6

01 211 6402

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
H M Treasury
Parliament Street
London
SW1

24 June 1982

Dear Chancellor,

Thank you for your letter of 14 June about the arbitration award to manual workers in the gas industry.

The consolidation of bonuses comes into operation only on 1 January 1983 (almost at the end of the settlement year) and takes the form of setting a 7 per cent minimum level for bonuses. Since the current average bonus is about 30 per cent, this is unlikely to be very expensive and the Corporation's latest estimate is lower than the tentative figure of 0.4 per cent in my letter of 2 February - perhaps close to zero.

There are two reasons for the similarity between the earnings effect of the award and the basic rate increases:

a. only a few technicians receive the highest increase of 8 per cent on basic rates, so that the weighted average increase in basic rates is closer to 7.5 per cent than 8 per cent;

b. other components of earnings are unchanged or increase by less than 7.5 per cent or benefit only a small proportion of the workforce.

When the Corporation met the Gas Staffs and Senior Officers (GSSO) on 17 June, they offered increases ranging from 5.5 per cent for the most junior staff, up to 7.7 per cent This would increase average earnings by just over 6 per cent. The unions rejected this offer (NALGO had been in conference that week and the Corporation believe that they sounded their members), but there were no threats of industrial action. The Corporation expect the unions to ask for a further meeting in the next week or so. They would consider the use of unilateral arbitration only as a tactical move, to achieve a lower settlement than they could negotiate and to avoid industrial action.

As you say in your letter, when we discussed the general question of unilateral arbitration at E Committee last November, it was decided that it would be untimely to raise the matter with the Corporation. Given the continuing sensitivity of their oil asset disposals and our commitment to deal with their monopoly of appliance retailing, I do not think the position has changed.

I am copying this letter to the recipients of yours.

Yours sincerely,

Janet Chadwick

NIGEL LAWSON
(Approved by the Secretary of State
and signed in his absence)

14 JUN 1982

MG

MCS seen

PC JV

SECRETARY OF STATE FOR THE ENVIRONMENT

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref: H/PSO/14384/82
Your ref:

18 June 1982

Dear Secretary of State

POLICY LETTER FOR THE NEW CHAIRMAN OF THE CENTRAL ELECTRICITY GENERATING BOARD

I have two comments to make on the draft policy letter and, subject to you accepting these minor amendments, I would not press for a discussion.

The first sentence of paragraph 4 of the draft seems to me to pre-judge the use of nuclear power at a time when we have said we have an open mind in listening to arguments to be produced at the Sizewell public inquiry. I would prefer the sentence to read "........... you should ensure that the Board is in a position to make successful use of nuclear power".

My second proposals is for the insertion of a new paragraph between paragraphs 4 and 5 (ie dealing with all CEGB activities, not just nuclear) as follows:

> "You should ensure that the Board achieve the best practicable environmental standards in its developments and operation."

I am copying this to the Prime Minister, Geoffrey Howe and other members of E(NI).

Yours sincerely,

Helen Ghosh

MICHAEL HESELTINE
(approved by the Secretary of State & signed in his absence)

The Rt Hon Nigel Lawson MP

MCS seen

g/c JV

JH 641

CONFIDENTIAL

Secretary of State for Industry

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

17 June 1982

Julian West Esq
Private Secretary to the
Secretary of State for Energy
Thames House South
Millbank
London SW1

Dear Julian

The Secretary of State has seen a copy of your Secretary of State's E(NI) Paper on the draft policy letter for the new Chairman of the Central Electricity Generating Board (E(NI)(82)17). Mr Jenkin has also seen Mr Lawson's letter of 14 June asking for comments on the draft.

2 As you are aware, my Secretary of State would like to suggest that paragraph 1(d) of the draft letter should be amended to read:

> "the Board should maintain and develop policies to secure supplies of both fuel and equipment at the lowest cost consistent with its view of its long term interest in the health of its UK suppliers, their export requirements and their international competitiveness."

3 I am copying this to the Private Secretaries to E(NI), Gerry Spence (CPRS) and David Wright (Cabinet Office).

Yours sincerely

Graham Austin

GRAHAM AUSTIN
Private Secretary

16 JUN 1982

CONFIDENTIAL

17 June 1982

Prime Minister ①

Agree the policy letter subject to X?

On Y would it be better for me simply to say that you warmly endorse Mr Lawson's intention to speak to Sir W Dr Marshall in this sense?

MCS 18/6

Yes MT

MR SCHOLAR

cc Mr Walters
Mr Mount

DRAFT POLICY LETTER TO THE CHAIRMAN OF THE CEGB

We have only one comment (suggested by Alan) on the draft letter itself, enclosed with Mr Lawson's paper for E(NI). That is that we delete the phrase "on a continuing basis" from paragraph 6, so as to leave room for appropriate pricing policy. Otherwise, we have discussed the draft with the CPRS, and their point about the corporate plan reflects our own views; we see no need for a meeting.

But one important point does arise from the second paragraph of Mr Lawson's covering paper. Mr Lawson indicates his intention to discuss with Dr Marshall the resumption of coal imports in due course at economic levels. We accept - just as we have accepted it in the NCB context - this cannot be spelt out in the policy letter. But it does raise the question of how this approach of doing good by stealth will be pursued. The Prime Minister may feel that you ought, in indicating to Mr Lawson's Private Secretary that she is content with the letter, to ask what time scale Mr Lawson has in mind for resuming coal imports; and whether, and if so when and how, he proposes to arrange for the expansion of our capacity to import coal.

On Y - I agree

JOHN VEREKER

CONFIDENTIAL

cc Mr. Mount

MR. VEREKER

DRAFT POLICY LETTER TO THE CHAIRMAN OF THE CEGB

1. I agree with your memo of 14 June. Most of it is unexceptionable. However, there is of course the inevitable exception. Para 6 talks about the Board setting its prices "so as to reflect the costs at the margin of meeting demands on a continuing basis". I think this would be interpreted as setting prices at long run marginal costs. Yet we know that long run marginal cost is only an appropriate basis for policy when it is equal to short run marginal costs, which is only under the following conditions:

(a) there are long run constant costs in producing electricity;

(b) the investment programme is exactly adjusted to demand;

(c) there is no deviation between projected and actual demand; and

(d) there is no "lumpiness" in the assets structure of the industry.

2. Of course all these conditions are violated in practice. And we have seen one particular example recently when, because of the reduction in demand and the fact that there was a great deal of surplus generating capacity, it was suggested that the price be cut roughly down to the fuel cost of electricity. We did not quite get that far but we went some part of the way. Very sensible too.

3. Obviously we can't go into all these details in this letter, but I suggest that we eliminate the phrase "on a continuing basis". This will then leave room for appropriate manoeuvres of pricing policy.

17 June 1982

ALAN WALTERS

CST V

Nat. Ind.

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Nigel Lawson MP
Secretary of State
Department of Energy
Thames House South
Millbank
London SW1P 4QJ

16 June 1982

Dear Secretary of State,

POLICY LETTER FOR THE NEW CHAIRMAN OF THE CENTRAL ELECTRICITY GENERATING BOARD (E(NI)(82)17)

+PM

In your letter of 14 June you asked for comments on the draft of this policy letter.

Drafting a policy letter for the CEGB is difficult because we have still to settle several important policies towards the electricity industry. Inevitably therefore the letter has to be somewhat vague on some important issues. But within that constraint, I think that your draft is helpful and should let Walter Marshall know what is expected of him.

My particular comments on the draft are as follows:

(i) Efficiency and cost control: I agree that it is right to make this the prime objective. On a detailed point, the Board are asked under this heading to

> "... maintain and develop policies to secure supplies of both fuel and equipment at the lowest cost consistent with its view of its long-term interest in the health of its UK suppliers and their international competitiveness."

I understand that this passage would contravene assurances given very recently to the European Commission on public procurement policy. The Commission were told that Ministers do not regard the relationship between Government and the nationalised industries as permitting them to give directions on the latter's purchasing policy. The Commission remain unsatisfied with this assurance and are still pursuing the point with us. In these circumstances inclusion of a UK procurement objective in a policy letter, which could leak, could prove embarrassing.

I therefore suggest that the passage should either be omitted or a passage should be agreed with the Treasury which would not conflict with Community obligations (though this may prove impossible to draft).

(ii) Competition and private risk capital: this objective asks the Chairman to make positive recommendations on the injection of private risk capital into areas of the Board's operations wherever possible. This objective would be given more weight if the Chairman was given a timetable for making his recommendations. This could be done by adding the words "and should let me have an interim report on possibilities by the end of the year" at the end of the second sentence of the second objective.

(iii) Nuclear power: Walter Marshall, with his unrivalled knowledge of the nuclear industry, may be tempted to build up the CEGB's capacity for building nuclear power stations at the expense of the already weak private sector nuclear power station construction industry. This would not be consistent with our general policy of relying on the private sector wherever possible. This point could be guarded against by adding at the end of the fourth objective ",..., and recognising the need to develop a stronger and more effective private sector nuclear industry".

I am sending a copy of this letter to the Prime Minister, Members of E(NI) and to John Sparrow and Sir Robert Armstrong.

yours sincerely

for LEON BRITTAN
[Approved by the Chief Secretary
and signed in his absence]

sk JV

CONFIDENTIAL

CABINET OFFICE

Central Policy Review Staff

70 Whitehall, London SW1A 2AS Telephone 01-233 - 7798

Qc.03065

15 June 1982

Dear Secretary of State,

Policy Letter for the new CEGB Chairman

John Sparrow has been kept in touch with the drafting of the policy letter for the new Chairman of the CEGB, and in his absence / with MCS? on leave I am responding to your request for comments on E(NI)(82)17. The CPRS has of course been closely involved in the preparation of the policy letter, and I confirm that we are content with the version now circulated. No doubt we can look again at the wording when a statement of objectives, based on this policy letter, is prepared and circulated in the autumn (perhaps along with the corporate plan) - there may be a need for sharper specification in that context.

2. The only point we would like to make now concerns the corporate plan. I understand that the Department of Energy, as well as the CPRS, is in principle in favour of a separate corporate plan for the CEGB. However, we recognise that the objective of developing a corporate plan for the ESI as a whole has not yet been fully secured and will itself be a major step forward. Paragraph 5 of the policy letter confirms this principle, and it will now be important to ensure that an industry corporate plan is developed as soon as practicable, and that it includes an acceptable section on the CEGB. The question of separate corporate plans for the major components of the industry, together with the question of separate EFLs, will need to be examined as a second stage.

3. I am sending copies of this letter to the other members of E(NI) and to Sir Robert Armstrong.

Yours sincerely,

Alan Bailey

A M BAILEY

The Rt Hon Nigel Lawson MP
Secretary of State for Energy

CONFIDENTIAL

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MR. WALTERS

the word 'imports' does not occur in the letter so far as I can see; the resumption of imports at economic levels' is only to be mentioned in Lawson/Marshall discussions about the letter. Can such a furtive approach result in action to improve import facilities & hence levels of imported coal?
FM 16/6

c.c. Mr. Mount

Draft Policy Letter to the Chairman of the CEGB

I think you ought to have a look at Mr. Lawson's paper, attached, for ENI containing his proposed draft policy letter to the Chairman of the CEGB.

I do not think it raises such difficult issues as we have been addressing in the case of the similar letter to the NCB; and, on the assumption that the CPRS and the Department of Energy between them have got the details right, I would be content with it. I was struck by the lower profile of the corporate plan in this draft, compared with the NCB one; the CPRS tell me that this is because the CEGB has not been in the habit of producing corporate plans, and the nearest we have to it at present is a medium-term development plan produced by the Electricity Council. So, the provision for a corporate plan at all is a considerable change.

J. M. M. VEREKER

Mr Mount

It's the same issue as arose in the context of the NCB policy letter: how far we dare go public on that intention. We have had to accept, I think, that of all the sensitive issues in the coal industry – pay, manpower, closures, safety, nuclear etc. – imports is one of the hardest to make progress on save by stealth.

J 17/6

14 June, 1982.

CONFIDENTIAL

CONFIDENTIAL

Nat Ind Gas 3 Elec ... Pt

cc JV

Mail Ind

Prime Minister (2)

MLS 14/6

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

14 June 1982

The Rt. Hon. Nigel Lawson MP
Secretary of State for Energy

MS

Dear Secretary of State,

GAS INDUSTRY PAY

Thank you for your letter of 8 June about the arbitration award to the gas industry manuals.

Although the Corporation's last offer before arbitration was on the high side, it is good that the arbitrator has not added materially to it. Given that the award, unlike the 10 March offer, includes consolidation of bonuses, it is however odd that the earnings effect of the award is still estimated at no more than 7.9 per cent. It is also a little surprising at first sight that the earnings effect of the award is not significantly higher than the effect on basic rates, in view of the number of other features besides the basic increase which the award contains. Perhaps officials could check these points.

More important is the question of the future arbitration arrangements in the gas industry. When we discussed this in E Committee last November, we felt that we should not ask British Gas to seek to change the arbitration arrangements, in view of the number of other issues which you were discussing with them. But the unions' reference to arbitration this year has shown that the arrangements can certainly not be regarded as having fallen into disuse, although they have only operated occasionally in the past, and I see that the Corporation are thinking in terms of arbitration for the Gas Staffs and Senior Officers (where you reported a 5 per cent offer in your letter of 25 May).

On this occasion the arbitration award was not unfavourable to British Gas; but they cannot count on being so fortunate in future. You may wish to raise with them the question of terminating the unilateral access to binding arbitration which is a feature of the present arrangements. This may actually be less difficult for them in the wake of an award that has favoured their case than it might otherwise be.

/Finally, I hope

Finally, I hope that we can reinforce the Corporation in their intention to take a firm line in negotiations with the Gas Staffs and Senior Officers (and I hope also with the Higher Management grades). In particular I hope that there will be no assumption that these staff must ultimately get as much as the manuals. The present offers of 5-6 per cent seem to me to be in about the right area.

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

Yours sincerely

John Kerr.

GEOFFREY HOWE

[Approved by the Chancellor and signed in his absence.]

14 JUN 1982

Nat Ind

cc JV

Prime Minister ②

MCS 8/6

01-211 6402

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1P 3HE

8 June 1982

Dear Chancellor

PAY OF GAS MANUALS

In my letter of 2 April I reported that BGC's gas manual unions had rejected BGC's offer and decided to put the issue to arbitration, which either side can do unilaterally.

The arbitration award was made on 4 June and is binding on both sides. The award is as follows:-

(a) an increase in basic rates ranging from 7.5% for labourers to 8% for technicians with full flow-through to bonus;

(b) an increase in the General Obligations Payment of 50 pence a week (this is a payment in respect of flexible working procedures which reckons for all pay purposes);

(c) an increase of £2.50 in stagger payments (for working on a scheduled basis outside normal hours);

(d) an increase in the holiday bonus supplement from 30% to 35%;

(e) a small relaxation in the rules governing local holiday entitlements;

(f) some reform of the earnings structure (along the lines outlined in my letter of 2 April). This involves a 7% consolidation of bonuses, a £2.50 incentive bonus for those with no bonus, and some bonus smoothing. But it is not to be implemented until 1 January next year, and will not be applicable to waiting time; and

(g) a recommendation that the earnings structure package should be reviewed 12 months after the structure described above has been implemented (ie 1 January 1984). BGC do not propose to accept this recommendation but merely to note it.

This award is essentially the same as BGC offered the unions on 10 March, with the addition of some consolidation of bonuses. The overall cost to BGC's pay bill will be 7.9% in a full year and about 7.6% this year.

On the Higher Management pay negotiations BGC met the unions on 4 June. They offered 6% on all grades and rejected both an additional grade in the pay structure and an earlier settlement date. The unions said that this was unacceptable and another meeting will be arranged towards the end of the month.

For this meeting and for the Gas Staffs and Senior Officers' meeting on 17 June, British Gas are concerned that the unions may decide to go to arbitration again. As a result BGC are inclined to take a robust line and refuse to negotiate to the limit for fear of then being taken to arbitration. They will also consider using arbitration themselves if the unions start moves towards industrial action. They will, however, have a clearer idea of their tactics after the NALGO annual conference, which starts next week. I will, of course, keep you and colleagues in close touch with developments.

I am copying this to the Prime Minister, the other members of 'E' Committee, George Younger, John Sparrow, and Sir Robert Armstrong.

Yours sincerely

Janet Chadwick

pp NIGEL LAWSON

(Approved by the Secretary of State
and signed in his absence)

JUN

Prime Minister (2)

MES 2/6

DEPARTMENT OF ENERGY
THAMES HOUSE SOUTH
MILLBANK
LONDON SW1P 4QJ

Direct Line 01-211 3390
Switchboard 01-211 3000

PARLIAMENTARY UNDER
SECRETARY OF STATE

Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
12 Downing Street
London
SW1A

1 June 1982

Dear Chancellor

ELECTRICITY INDUSTRIAL STAFF: WAGE NEGOTIATIONS

As forecast in Nigel Lawson's minute of 27 May to the Prime Minister, an increased offer has now been made by the Electricity Council to the industrial unions in the electricity supply industry. The claim then was settled at a meeting of the National Joint Industrial Council at 9.00 pm on Friday 28 May. The threat of industrial action was therefore withdrawn.

The additional increase offered was £1 pw for the lowest paid workers tapering to 50 pence pw for the highest paid. In addition an extra day's holiday was offered for some workers, but there will be no increase in the maximum allowance. There were further minor adjustments in respect of standby pay; and a change in allowances for some apprentices.

The overall effect of the offer accepted by the unions would be to increase average earnings by 7.4% and the wage bill by 6.4%, although it is intended that the additional amount offered on Friday will be paid for by increased productivity and manpower savings.

The Council do not intend to give any undue publicity to this award.

I am copying this letter to Members of E Committee, George Younger, Sir Robert Armstrong and John Sparrow.

Yours sincerely

Christine Sparrow

for DAVID MELLOR

(Approved by Mr Mellor and
signed in his absence)

- 2 JUN 198[illegible]

~~cc Press~~ / Nat. Ind.

CC J.V.

Mrs
PM has seen
MCS to see o/r

CONFIDENTIAL

MAP 28/v.

Prime Minister

There is an ACAS meeting this afternoon, & we will get a report in the course of the evening. But this report is worrying.

MAP 28/v

PRIME MINISTER

ESI INDUSTRIAL WAGE NEGOTIATIONS

1. As I reported in my minute of 17 May, the Electricity Supply Industry's offer to their manual workers was rejected in a ballot. The unions threatened an overtime ban from 31 May with further action from mid-June.

2. Initially, the Electricity Council planned to stand firm since the offer put to ballot had been described as "final". For their part, the union leadership had seemed to be aiming for low key action to put financial pressure on the industry but not to affect the public, at least early on.

3. However, the Council's Chairman, Austin Bunch, told me today that events were moving faster than expected. The power engineers (EPEA), who are not at present in dispute, and the manual unions have devised a plan to cut the output of large, efficient coal-fired stations to one third of normal. This is intended to avoid the loss of overtime earnings, and of supplies to the public, while forcing the CEGB to use less efficient, low merit order stations. The Council have rejected this proposal which they believe would result in serious and uncontrolled power cuts, as well as costing the industry money without financial penalty for the men.

4. The Council believe that there will now be confusion at the power stations as to what should happen next week. They doubt that the union leaders will retain full control of their members and they fear that unless they take some initiative, there is a serious risk of unplanned power cuts as early as next Tuesday.

5. They propose, therefore, to prompt ACAS "spontaneously" to call in both sides tomorrow. The gap between the industry's offer and the unions' aspirations is not large. The unions have described the existing offer as being between 7.6% and "just less than 8%". They have said they want "something like the miners' 9.3%". The Council think a settlement could be achieved for about an extra 1% (costing up to £20m). This would take the increase in the wage bill to about 8%, which could, in the Council's view, be accommodated within the industry's existing EFL.

CONFIDENTIAL

6. I have told the Council that their proposed course of action must not result in an increased offer which the unions simply refer to another ballot. They should rather aim for a firm settlement under ACAS' auspices.

7. The industry are setting in hand their own contingency arrangements, as are we. I will report developments.

8. I am copying this minute to members of E Committee, the Secretary of State for Scotland, Sir Robert Armstrong and Mr Sparrow.

B. D.

(Approved by the Secretary of State for Energy
and signed in his absence)

27 May 1982

27 MAY 1982

Nat Ind
PC JV

(2)

Prime Minister

MCS 25/5

01-211 6402

CONFIDENTIAL

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
London SW1

25 May 1982

Dear Chancellor,

BRITISH GAS - PAY NEGOTIATIONS

In my letter of 19 May I told you that British Gas were due to open pay negotiations on 20 May with their Gas Staffs and Senior Officers (GSSO). BGC offered salary increases ranging from 4% for the most junior staff to a plateau of 6% starting about half way up the grade structure. The effect on average earnings would be an increase of 5% - 5.1%.

The Unions made it clear that they were not happy with the offer and took it away to consider it in detail. The negotiations will be resumed at a special meeting next month: the date has not yet been agreed but BGC intend to hold it before the NALGO Conference which is due to start on 14 June.

BGC are due to open negotiations with their Higher Management on 3 June (settlement date is 1 June). The Corporation have not yet decided on their offer but they have told my officials that it will not be out of line with their opening offer to the GSSO.

I will of course keep you and colleagues in touch with developments on both negotiations.

I am copying this to the Prime Minister, Members of 'E', George Younger, John Sparrow and Sir Robert Armstrong.

Yours sincerely

Janet Chadwick

pp NIGEL LAWSON

(Approved by the Secretary of State
and signed in his absence)

25 MAY 1982

CONFIDENTIAL

Prime Minister (2) Nat Ind.
MCS 19/5
CC. J.V

01 211 6402

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
London
SW1P 3AG

19 May 1982

Dear Chancellor,

BRITISH GAS - PAY NEGOTIATIONS

The British Gas Corporation are due to open negotiations with their Gas Staffs and Senior Officers (GSSO) tomorrow on their annual pay settlement (settlement date 1 June).

The GSSO, who are represented mainly by NALGO, have submitted a claim for:

(a) a 14% increase in salaries aimed at restoring their June 1981 living standards and providing comparability with wage levels throughout the economy;

(b) a reduction in the working week from 37 to 35 hours;

(c) an improvement in annual leave to 30 days for all grades;

and (d) some restructuring of salary scales.

They also wish to discuss a common wage settlement date throughout the industry.

The BGC management will not decide their final negotiating tactics until tomorrow morning at a meeting of regional representatives, but they have told my officials that their offer will centre on an increase in salaries (possibly weighted at the more senior levels), with the possible addition of an odd day's leave for the more junior staff. They have said that the offer is unlikely to exceed 6% on the pay bill(equivalent to virtually the same percentage increase in earnings given the structure of the package).

The GSSO will be keeping a close watch on the arbitration award for the Gas Manuals, and I now understand that the Chairman of the arbitration tribunal expects to report within 3 weeks of the hearing (which was held on 12 May).

I am copying this to the Prime Minister, Members of 'E', George Younger, John Sparrow and Sir Robert Armstrong.

Yours sincerely,

Janet Chadwick

pp NIGEL LAWSON

(Approved by the Secretary of State and signed in his absence)

MAY 1982

Prime Minister
Nat Ind
Duty Clerk 17/5

Mes seen 17/5

CONFIDENTIAL

PRIME MINISTER

ESI INDUSTRIAL WAGE NEGOTIATIONS

As David Mellor reported in his letter of 15 April to Leon Brittan, the Electricity Supply Industry's industrial staff have been ballotting on the pay offer made to them on 8 April. (The offer was equivalent to 7.1% on earnings, although this figure has not been publicly used.) The ballot paper made clear that rejection would mean taking 'industrial action'.

The result of the ballot was made known today. Out of a total workforce of some 90,000, 73,000 votes were cast. 41,000 rejected the offer - a majority of approximately 9,500. Rejection, particularly by a majority of this size, came as a surprise to the Electricity Council who are analysing the reasons for it. They believe that the fact that no increase was offered to junior staff, and that only a relatively small increase was offered to unskilled staff, may have had a powerful influence. They also believe that the unions consider that the offer was not as good as that made to the miners.

The unions have announced that they intend to ban overtime from 31 May, moving on 14 June to a selective programme of stoppages at the most efficient power stations. Collection of cash from electricity meters may also be affected. The unions have not yet decided how long this action will last, and may not finalise their plan of campaign until they have consulted area committees around the country.

The Electricity Council believe that it would be damaging to their credibility if any improvement were made by them in the immediate future to what was described to the workforce in the ballot as a 'final offer'. At the same time, they recognise that the vote will force the unions to seek a settlement that can be presented to their members as an improvement. The Council will be making informal contact with Frank Chapple and John Edmonds to establish the room for future manoeuvre, and reporting to me when they have done so. No formal meeting with the unions is planned before the next NJIC on 3 June.

At this stage it seems likely that the unions' tactics, at least initially, are to take action designed to have little effect on the supply of electricity but which will damage the industry's finances. Until we know precisely what action they propose to take it will not be possible to assess the likely effect, if any, on our build-up of power station coal stocks. A full assessment of the likely consequences of their action will of course be carried out.

The Council advise that the negotiations with the power engineers (the NJB) which were due tomorrow will almost certainly now be postponed.

I am copying this minute to members of E, George Younger, John Sparrow and Sir Robert Armstrong.

J. P. Clayton

Secretary of State for Energy
17 May 1982
(Approved by the Secretary of State and signed in his absence)

CONFIDENTIAL

Prime Minister (2)

MCS 11/5

Nat Ind

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

10 May 1982

The Rt. Hon. Nigel Lawson MP
Secretary of State for Energy

Dear Secretary of State,

POWER ENGINEERS' PAY NEGOTIATIONS

with MCS? Thank you for your letter of 28 April.

You indicate that the Electricity Council would need to offer increases amounting to 6.6 per cent throughout for engineers and managers to avoid any tapering of their pay scales. I assume that this 6.6 per cent would apply to earnings as well as to pay scales: you will recall that the offer to the industrials is worth 8 per cent on earnings at the top of the range, although only 6.6 per cent on basic rates.

But subject to this point, I agree with you that the Electricity Council can be left to balance the risk of industrial action if they make a tapered offer, against the risk of overlap with Area Board Deputy Chairmen's salaries if they do not taper the offer. Like you, I see no need to discourage the Electricity Council from using the 4 per cent assumption which they have made for the increase in the pay of Area Board Deputy Chairmen, which will exercise a useful discipline on what they offer the engineers and managers.

I am copying this letter to the Prime Minister, other members of E, George Younger, Sir Robert Armstrong, and John Sparrow.

Yours sincerely

Peter Jenkins

pp GEOFFREY HOWE
(Approved by the Chancellor of the Exchequer and signed in his absence).

10 MAY 1982

SECRET AND PERSONAL

Gov Mach

SW 6

2

Copy filed on Gov Mach Pt2 CCV

FILE

bcc: John Vereker

10 DOWNING STREET

From the Private Secretary

le

SIR ROBERT ARMSTRONG
Cabinet Office

Withstanding Strikes

The Prime Minister has seen your minute of 4 May, to which was attached a report on the priorities for further work into withstanding strikes in key sectors of the economy.

The Prime Minister agrees that the further studies referred to in Paragraph 2 of your minute should be carried out, in the order of priority they are listed; and that Ministers should review the need and scope for further studies of this sort once that programme is completed.

I am sending a copy of this minute to John Halliday (Home Office), John Kerr (Treasury), David Omand (Ministry of Defence), David Edmonds (Department of the Environment), Muir Russell (Scottish Office), Jonathan Spencer (Department of Industry), Anthony Mayer (Department of Transport), Julian West (Department of Energy), Barnaby Shaw (Department of Employment) and John Sparrow (Central Policy Review Staff).

MCS

5 May, 1982

SECRET AND PERSONAL

SECRET AND PERSONAL

Original filed on Gov Mach Pt 2 CC✓

cc JV

1A

①

Prime Minister

Content for these (at X) studies to be commissioned?

MES 4/5

Yes MT

Ref. A08301

PRIME MINISTER

Withstanding Strikes

At your meeting on 17th December 1981 to discuss withstanding a miners' strike Ministers instructed the Cabinet Office, in consultation with the Departments concerned, to prepare a report in due course on the priorities for further work into withstanding strikes in other key sectors of the economy.

2. This report is now attached. It recommends that studies of this nature should be carried out into the electricity and gas industries, oil distribution, the X ports and industrial gas production, in that order of priority; and that Ministers should review the need and scope for further studies of this sort once that work programme has been completed.

3. Last autumn officials in MISC 61 prepared a report on withstanding a strike in the water industry. This was submitted to you under cover of the Home Secretary's minute of 22nd October 1981. The attached report does not recommend that further work by MISC 61 is necessary, but suggests that the Secretary of State for the Environment might arrange for the longer-term implications of MISC 61's report to be followed up.

4. If you and your colleagues to whom I am sending copies of this minute and the report are content with the recommendations, I will put in hand the necessary arrangements for carrying out the studies proposed.

5. I am sending a copy of this minute and of the attached report to the Home Secretary, the Chancellor of the Exchequer, the Secretaries of State for Defence, the Environment, Scotland, Industry, Transport, Energy and Employment; and to Mr. Sparrow in the CPRS.

RA

ROBERT ARMSTRONG

4th May, 1982

SECRET AND PERSONAL

WITHSTANDING STRIKES IN KEY SECTORS OF THE ECONOMY: PRIORITIES FOR FURTHER WORK

Note by Officials

INTRODUCTION

1. At the Prime Minister's meeting on 17 December 1981 officials were instructed to report on the priorities for further work on withstanding strikes in key sectors of the economy. This report has been prepared by officials from the Prime Minister's Office, the Treasury, the Departments of Energy, Transport, Industry and Employment, the Home Office, the Ministry of Defence, the Central Policy Review Staff and the Cabinet Office.

WORK ALREADY COMPLETED OR UNDERWAY

2. The following work has already been completed or is underway:-

i. MISC 57 has reported to Ministers on withstanding a miners' strike and has in hand further work on this issue. It is also monitoring the progress of the measures approved so far by Ministers.

ii. In October 1981 MISC 61 reported to Ministers on withstanding a strike in the water industry. In the event major industrial action in the water industry was avoided that year. Officials do not think that further work on this topic by MISC 61 is necessary at this stage, but the report indicated a number of areas where the water authorities could take steps to make it easier for major industrial action to be withstood, if necessary with military assistance. The Secretary of State for the Environment might be invited to arrange for these to be followed up well in advance of this year's water industry pay negotiations.

iii. MISC 65 has reported to Ministers on the lessons from the 1981 Civil Service dispute. Ministers agreed that the Treasury should take the lead in following up the report's recommendations. Detailed planning to counteract industrial action in the Civil Service is also undertaken by a standing group of officials - the Steering Group on Industrial Action - under Treasury chairmanship.

iv. MISC 69 is currently preparing a report for Ministers on withstanding a telecommunications strike and this will be submitted shortly.

v. Much of the work of MISC 57 is relevant to the question of withstanding a rail strike. Separate work has also been put in hand on other aspects. MISC 72 has reported once to Ministers on the decisions which may arise following the forthcoming report from the Railways Staffs National Tribunal on the issue of flexible rostering, and will report further when the RSNT award has been received. And the Civil Contingencies Unit arranged for a report to be prepared on the likely impact on industry of an all-out rail strike, which was circulated by the Home Secretary with his minute of 30 March to the Prime Minister; and

vi. The Treasury has work in hand on serious industrial action in the banking industry, in consultation with the Bank of England and other Departments.

CRITERIA FOR FURTHER WORK

3. Officials recommend that the immediate objective should be the completion of a relatively small number of studies into key industries where an all-out strike or industrial action short of this could be expected to have an immediate and serious impact on the economy and life generally; and where there seems some prospect of industrial action in the foreseeable future. To put in hand immediately an extensive programme of studies would both significantly increase the chances of a leak, which, so far, has not occurred, and strain Departmental resources, since studies of this nature are inevitably time-consuming if radical approaches to withstanding strikes are to be fully explored. But Ministers will no doubt wish to review the need and scope for further studies of this nature once the immediate programme of work which we recommend below has been completed.

4. The Civil Contingencies Unit has already undertaken considerable work on coping with the effects of industrial action in the public services, particularly the National Health Service and the Fire Service (where there has been serious industrial action in the recent past) and public transport in London (in the context of the British Rail dispute earlier this year). We do not think that it would be profitable to repeat these studies. Nor do we think it would be worth studying other major industries where recent experience has shown that industrial action can be endured and this is now evident to the employees concerned, for example the British Steel Corporation.

5. The studies undertaken so far have all been concerned with the public sector. But there is no reason in principle why studies of this nature into key private sector operations should be ruled out, and two such studies are recommended below. However, we have been unable to identify any key private sector industries where employers are likely on their own account to prefer sustaining serious industrial action to making pay settlements at the level necessary to avert it.

RECOMMENDATIONS FOR FURTHER STUDIES

6. We recommend that the initial work programme should consist of five studies in the following order of priority.

7. The first priority should be a study of withstanding a strike in the electricity industry. An all-out strike in this industry, or industrial action approximating to an all-out strike, would quickly have a devastating impact on the economy and on life generally. There seems a good chance that a settlement will be reached in this year's pay negotiations without industrial action. But the negotiations in this industry over the last few years have been protracted and difficult and industrial action in the future cannot be ruled out.

8. Second, the gas industry. Much the same considerations apply as in the case of the electricity industry, but major industrial action in the gas industry would also give rise to safety risks on domestic and industrial premises. Moreover, there are a number of issues other than pay (for example the sale of gas showrooms) over which serious industrial action could arise in the foreseeable future; and the chances of unofficial industrial action in the gas industry seem to us to be greater than in the electricity industry.

9. Third, the oil distribution industry including industrial action directed against the delivery by pipeline of oil from the North Sea. In the past pay settlements in this industry have generally been sufficiently high to prevent serious industrial action. But the negotiations are often extremely protracted and difficult and unofficial industrial action has occurred on a number of occasions. Last autumn when there seemed a real possibility of widespread industrial action in this industry the Civil Contingencies Unit examined what might be done by way of military assistance and in other ways to mitigate the effects of industrial action. Although the continued delivery of a proportion of oil supplies sufficient for absolutely vital operations could probably be assured, the impact of widespread industrial action seemed likely to be very serious. A detailed study of withstanding a strike in this industry could well suggest means by which the consequences could be significantly mitigated.

10. Fourth, the ports. There are a number of issues which could give rise to serious industrial action in the ports although we do not think this is likely in the immediate future. These relate principally to the need to achieve a continuing high rate of severances in the industry and to the fact that the National Dock Labour Scheme requires this to be achieved by negotiation, through the payment of enhanced severance terms. Any move towards compulsory redundancies, for example, would precipitate a national dock strike. Since virtually all trade passes through the ports the impact of a strike could be serious. Plans already exist for the use of Servicemen in the event of a national dock strike, but we think that a more detailed investigation of the possibilities than has hitherto been undertaken would be profitable.

11. Fifth, industrial gases. Two companies (British Oxygen and Air Products) have a monopoly of the production and distribution of industrial gases in the UK. Industrial gases are vital to a large range of industrial processes, for power stations and for the National Health Service. Generally speaking companies do not hold large stocks of gases and the impact of a strike would therefore be felt quickly and would be serious. A study of the steps that might be taken to withstand industrial action in this industry, which may prove to be limited, would therefore seem to be worthwhile, although the scope of such a study may be circumscribed by the need for consultations with the industry on some aspects.

12. We also considered but do not recommend studies of the road haulage and oil refining industries. Road haulage is highly disaggregated and far from completely unionised. Moreover, roughly half the UK's road haulage is on "own account" and in this sector pay arrangements differ from firm to firm. The experience in the 1979 road haulage dispute was that a large proportion of traffic, including virtually all the most important loads, continued to be delivered without the need for special measures. As for oil refining, there is at present no indication that serious industrial action is a possibility in the foreseeable future.

CONCLUSIONS

13. Our recommendations may be summarised as follows:-

(i) the immediate programme of work should be short and should concentrate on key industries (in both the private and public sectors) where an all-out strike could be expected to have an immediate and serious impact on the economy and life generally and where there seems some prospect of industrial action in the foreseeable future;

(ii) on that basis studies should be carried out on the following industries:

electricity
gas
oil distribution
ports
industrial gases

in that order of priority;

(iii) Ministers should review the need and scope for further studies of this sort once the above work programme has been completed; and

(iv) the Secretary of State for the Environment should arrange for the longer-term implciations of the study of the water industry carried out by MISC 61 to be followed up.

Cabinet Office
23 April 1982

Prime Minister (4) c/c JV

MCS 20/4

DEPARTMENT OF ENERGY
THAMES HOUSE SOUTH
MILLBANK
LONDON SW1P 4QJ
01-211 3932

PARLIAMENTARY UNDER SECRETARY OF STATE

CONFIDENTIAL

Rt Hon Leon Brittan QC MP
Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
London
SW1P 3AG

19 April 1982

Dear Leon,

BGC CONSULTANCY STUDY

You and John Sparrow have both raised the question of whether the study is still to cover the Corporation's "organisation and structure".

The Corporation were unwilling to include an explicit reference to this effect in the terms of reference, on the grounds that to do so might unnecessarily antagonise the Gas Unions and thus make the Consultants' task more difficult. However we have made it quite clear to the Corporation that questions of organisation and structure are to form part of the study, and that we will expect the scope for a profit centre approach to be fully examined. As John Sparrow surmises this is covered by the second part of the terms of reference, which are very widely drawn.

I am copying this letter to the Prime Minister, other members of E(NI), John Sparrow and to Sir Robert Armstrong.

Yours ever,
John

JOHN MOORE

20 APR 1982

Prime Minister ④ Nat Ind

CC J.V. MCS 15/4

DEPARTMENT OF ENERGY
THAMES HOUSE SOUTH
MILLBANK
LONDON SW1P 4QJ

Direct Line 01-211 3390
Switchboard 01-211 3000

PARLIAMENTARY UNDER
SECRETARY OF STATE

Rt Hon Leon Brittan QC MP
Chief Secretary
to the Treasury
HM Treasury
Parliament Street
London
SW1

MT

15 April 1982

Dear Leon,

ESI INDUSTRIAL WAGE NEGOTIATIONS

In Nigel Lawson's absence I am writing to you about the meeting of the Electricity Industry's NJIC on 8 April.

The Electricity Industry made the offer described in Nigel Lawson's letter of 2 April to the Chancellor. As expected, the industrial unions said that they could not settle across the table, and would need to ballot their membership. They were not prepared to recommend acceptance of the offer, but would make it clear that if there were a majority in favour of acceptance, agreement would be reached with the Council on the basis of this offer. The ballot paper will offer a clear choice between acceptance and rejection; it will state that rejection implies industrial action. It is expected to be five weeks before the result is known. The Electricity Council believe that there is a reasonable chance of a majority in favour of settlement, though much will depend on what the unions tell their members. They expect that the unions will say that the offer is "about 9%" and comparable with what the miners got. The Electricity Council will be encouraging the various Boards to do what they can to promote acceptance. It is of course important that the unions are not recommending <u>rejection</u> of the offer.

The next formal industrial negotiating meeting is with the power engineers on 20 April when the Council will make it clear that they cannot table any offer until the position on industrial staff is known. Although they believe that this will ultimately be accepted by John Lyons, they are expecting a difficult time. The annual delegate conference of the EPEA on April 5-7 showed that there is considerable strength of feeling about differentials with industrial staff on the one hand, and downward compression from top salaries on the other.

I am copying this letter to the Prime Minister, other Members of E, George Younger, John Sparrow and Sir Robert Armstrong.

Yours ever,
David

DAVID MELLOR

15 APR 1982

CONFIDENTIAL

c/ JV

Nat Ind.

NBPM

MCS 15/4

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

15 April 1982

John Sparrow, Esq.,
CPRS,
Cabinet Office

Dear John

LONGER TERM STUDY ON ELECTRICITY PRICES

Thank you for your letter of 7 April in which you report that the CPRS is now in a position to undertake the proposed longer term study on electricity prices.

with MCS

I welcome your intention to keep in close contact with the Departments concerned during the course of the study. We are ready to do all we can to help it. I am content with the amendments suggested to the terms of reference, though I did pause over the substitution in term (ii) of "... how we could react to lower prices [abroad]..." for "... whether we should ...". But I understand that the intention of the change is to focus term (ii) on the mechanics of our reaction, if any, to lower prices abroad; it does not prejudge the findings of terms (iv) and (v) which deal with the main policy issue of the case for reducing electricity prices to industrial users. On this basis I am content.

I am sending a copy of this letter to the Prime Minister, the Secretaries of State for Energy, Industry, Scotland and Wales, and to Sir Robert Armstrong.

Yours ever
Geoffrey

GEOFFREY HOWE

15 APR 1982

Nat Ind
gas & Electric

CONFIDENTIAL

JV

(2)

Prime Minister

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

MCS 8/4

8 April 1982

The Rt. Hon. Nigel Lawson MP
Secretary of State for Energy

MT.

Dear Nigel.

Thank you for your letters of 2 April on the pay negotiations with the gas and elecricity manuals.

I hope that BGC will do all that they can to ensure that arbitration takes place on terms which are not unfavourable to them. It is important that their side of the case is heard. In this connection, they might care to look at the "issues" memorandum which we submitted to the Megaw Inquiry. (My officials can if necessary provide a copy.) We have of course also been giving a good deal of thought to arbitration evidence in the context of Civil Service pay, and we could no doubt give BGC the benefit of our experience if that would be appropriate. You might like to mention this to them.

As regards the electricity manuals, I note that the Electricity Council intend to make a final offer worth 7.1 per cent on earnings. We await developments at the 8 April meeting.

I am copying this letter to the Prime Minister, other members of E Committee, the Secretary of State for Scotland, John Sparrow and Sir Robert Armstrong.

GEOFFREY HOWE

18 APR 1982

PA

cc JV

(2)

Prime Minister

John Sparrow on the march!

MLS 8/4

And without any consultation with me! - Not good.

MT

CABINET OFFICE
Central Policy Review Staff
70 Whitehall, London SW1A 2AS Telephone 01-233 7765

From: John Sparrow

Qa 05882

CONFIDENTIAL

7 April 1982

Dear Geoffrey,

Longer Term Study on Electricity Prices

I am pleased to report that the CPRS is now in a position to undertake the proposed Longer Term Study on Electricity Prices. We expect to start work shortly after Easter when the full team will be in place.

We propose to keep in close contact with all relevant Departments, and to arrange an early discussion between the team and officials concerned to settle the approach and methods to be adopted for this important study.

We are in broad agreement with the proposed terms of reference included in your letter of 8 March to the Secretary of State for Energy although the enclosed draft includes a few minor amendments.

I am sending a copy of this letter and the enclosure to the Prime Minister, the Secretaries of State for Energy, Industry, Scotland and Wales, and to Sir Robert Armstrong.

Yours sincerely,

John.

John Sparrow

The Rt Hon Sir Geoffrey Howe QC MP
HM TREASURY
S W 1

Enc

CONFIDENTIAL

<ins>DRAFT Terms of Reference - Electricity Price Study</ins> (suggested changes underlined)

(i) To examine the extent to which the price of electricity is more expensive for industrial customers in the UK than in other major industrial countries; and to advise on the reasons, considering in particular whether this is due to unavoidably high costs, avoidable costs, such as efficiency, or to pricing policies.

(ii) To examine how the cost of electricity in the UK is likely to move relative to costs in other major industrial countries; and to consider <ins>how</ins> we <ins>could</ins> react to lower prices in those countries.

(iii) To examine the effects on industry of the continuation of the international price differentials foreseen under (ii), assuming also continuation of present <ins>UK</ins> costs and tariff structures; to consider, in particular, which industries or processes may be adversely affected to a significant extent and to advise on the consequences for the economy as a whole.

(iv) To advise on the costs, practicability and desirability of changes in the electricity pricing structure which would have the effect of reducing charges to the consumers identified in (iii), including the possibility of legislative change; and on other possible forms of assistance.

(v) To consider, in the light of (i), (ii), (iii) and (iv) the case for <ins>reducing</ins> electricity prices to industry <ins>at the expense of other customers or the PSBR</ins>.

---

8 APR 1982

Prime Minister

MLS 5/4

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

01-211-6402

CONFIDENTIAL

Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
London SW1

2 April 1982

Dear Chancellor,

ESI INDUSTRIAL WAGE NEGOTIATIONS

Further to my letter of 11 March the Electricity Council have now decided on the final offer they will make to their industrial unions at the formal meeting on 8 April.

This will amount to an average increase on earnings of industrial staff (including shift earnings) of 7.1%, though the industry will not of course use this figure publicly. Taking planned staff reductions in 1982/3 into account the paybill effect is expected to be of the order of 6%. The weekly pay increases range from a minimum of £5 for a labourer (5.1%) to £10.93 at the top of the foreman's scale (6.6%). Increases in shift payments (which affect about 25% of industrial staff) are expected to increase these figures to 6.6% and 8.0% respectively.

The Council think it unlikely that the offer will be accepted on 8 April, and expect that it will be put to a ballot in time for the meeting of the National Joint Industrial Council on 6 May. In making it clear that this is a final offer they intend that the choice is put quite starkly to the relevant workers between acceptance and some form of industrial action. There are no present signs of militancy, though the Council believe that the mood could change unless the offer is seen to be comparable with the miners' settlement. They therefore propose to make the point strongly that, in weekly pay terms, the offer bears comparison with what the miners got.

I will write to you again following the meeting on 8 April.

I am copying this letter to the Prime Minister, other members of 'E', George Younger, John Sparrow and Sir Robert Armstrong.

Yours sincerely

J. P. Clark

NIGEL LAWSON
(Approved by the Secretary of State
and signed in his absence)

Sas+
Elect
PT 6

Prime Minister (2)

mcs 2/4

JC

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon James Prior MP
Secretary of State
Northern Ireland Office
Great George Street
London SW1P 3AJ

2 April 1982

MO

Dear Secretary of State,

PROPOSED EFFICIENCY AUDIT OF
NORTHERN IRELAND ELECTRICITY SERVICE (NIES)

Thank you for your letter of 26 March. Like you I am anxious to get the study eompleted as soon as possible and as it cannot be fitted into the MMC programme for 1982 I agree we should commission a study by outside consultants, in the way you propose.

I am sending copies of this letter to the Prime Minister and other recipients of yours.

yours sincerely

PP LEON BRITTAN
[Approved by The Chief Secretary
and signed in his absence]

22 APR 19[illegible]

Fast elec pt 6

DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SW1H 0ET Telephone 01-215 7877

Prime Minister (2)

MCS 2/4

From the Secretary of State

The Rt Hon Leon Brittan QC MP
Chief Secretary
H M Treasury
Parliament Street
London SWI

2 April 1982

Dear Leon,

PROPOSED EFFICIENCY AUDIT OF NORTHERN IRELAND ELECTRICITY SERVICE (NIES)

I have seen Jim Prior's letter to you of 26 March.

I remain willing to try and find a place for the NIES in the 1983 section 11 reference programme. However, I understand the reasons why such a time-table might not be sufficiently speedy, and have no objection to a study by consultants this year.

It would be helpful if my officials could be consulted over the proposed terms of reference.

I am copying this letter to the recipients of Jim Prior's letter to you of 26 March.

Yours
John Biffen

JOHN BIFFEN

— 2 APR 1982

CONFIDENTIAL

gas 7 Elect Pt 6

cc JU

(2)

Prime Minister

MLS 2/4

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

01 211 6402

Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
H M Treasury
Parliament Street
London
SW1P 3HE

2 April 1982

Dear Chancellor,

PAY OF GAS MANUALS

In my letter of 15 March I reported BGC's revised pay offer to their manual workers. This provided for reduced increases on basic rates (between 7.5% and 8%) but with full flow-through of these increases to bonus payments: the corollary was the withdrawal of the previous package covering the restructure of bonus payments.

There was a further meeting between the two sides on 30 March at which the unions confirmed their membership's rejection of that offer because it made no progress towards reform of the wages structure, in particular some commitment towards consolidation of bonus payments into basic pay. (The bonus restructuring package previously offered by BGC had provided inter alia for a guaranteed minimum bonus payment but had not provided for consolidation). The unions said that if BGC would give a commitment on future consolidation of bonus they would be prepared to live without flow-through of basic rate increases into bonus. Alternatively they said they might agree to forgo the commitment at this stage to future consolidation and accept the package offered on 9 February (which did not include flow-through) subject to a further enhancement of basic rates.

BGC maintained their stance against consolidation but in an effort to meet the unions' alternative solution they re-tabled their 9 February offer (which I reported on 12 February) with the addition of a further 30 pence a week on the General Obligations Payment (a payment in respect of flexible working procedures which reckons for all pay purposes). Compared with the 10 March offer this would have meant slightly less for bonus workers but more for non-bonus workers; the overall increase in average earnings remaining at 7.6% in the settlement year (7.9% in a full year).

The unions rejected this offer and said that since there was such a gap between the two sides they wished to seek arbitration. The management did not accept that arbitration was the best way forward on such complex terms and conditions of service arising out of the annual pay negotiations. However, BGC cannot prevent the Trade Union Side from making a unilateral request for arbitration since this is provided for in the constitution of the National Joint Industrial Council. Any award arising out of such arbitration would be binding on both sides.

The present position, therefore, is that the unions intend to seek arbitration, probably using the services of ACAS. BGC have told my officials that the unions have said they will consult them on the terms of reference for the arbitration: the management's involvement in the request for arbitration is at present uncertain, but I understand that they will expect to give evidence to the tribunal in due course.

We have as yet no indication about the timing of further developments but I will, of course, keep you and colleagues in touch.

I am copying this to the Prime Minister, the other members of 'E' Committee, George Younger, John Sparrow and Sir Robert Armstrong.

Yours sincerely

J.P. Clayton

NIGEL LAWSON
(Approved by the Secretary of State
and signed in his absence)

22 APR 1982

Gas
Elec
Pt 6

✓ JC

(4)

Prime Minister

MCS 31/3

01 211 6402

Rt Hon Leon Brittan QC MP
Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
London
SW1P 3AG

31 March 1982

Dear Chief Secretary,

THE ELECTRICITY SUPPLY INDUSTRY'S EFLS

I am writing to bring up to date the estimates of the industry's outturn against its 1981/82 and 1982/83 EFLs given in my letter of 10 March, and to respond to the particular points in your letter of 16 March.

The industry now estimate an outturn in 1981/82, taking all factors into account, of about -£180m to -£185m, which is £15-£20m better than their EFL. For 1982/83, the industry expect to achieve their EFL as fixed, on the assumption that the cost of accelerated coal delivery does not affect their finances (I am writing to you separately on this). Thus, the 1981/82 position is close to that indicated in my letter of 10 March and the 1982/83 position is unchanged.

Turning to the particular questions in your letter of 16 March:

- the effect on profitability and on cash flow of extra oil burnt in 1981/82 is estimated to be £21m. In addition, higher oil stocks at the end of the year will add £15m to costs;
- extra electricity bought in from Scotland has cost about £2m;
- the effect of the cold weather in December and January was partly offset by milder than normal weather at other times of the year. For the year as a whole, the industry estimate that the net effect of the weather was to improve profitability by about £15-£20m, taking into account slightly higher average fuel costs;
- the costs of the special oil measures taken in 1981/82 will all be met during this financial year;

- the industry expect, if normal schedules for payment are followed, to have paid for about 72½m tonnes of coal in 1981/82 as compared with a forecast of 75m tonnes. This would save about £100m, which would have to be made up in 1982/83. I should add that these payment figures do not correspond with delivery figures over the same period. It is expected that 74m tonnes of coal will actually be delivered in 1981/82; approximately half of the tonnage lost during the ASLEF dispute would then be recovered during March.

As I am sure you will recognise, it is not possible simply to sum these figures in order to arrive at the overall estimated outturn. A number of other factors have been taken into account, including the timing of payments by the industry to its suppliers.

I am sending copies of this letter to the Prime Minister, Willie Whitelaw, Patrick Jenkin, David Howell, Norman Tebbit, Sir Robert Armstrong and Robin Ibbs.

Yours sincerely

J. S. Clarke

NIGEL LAWSON
(Approved by the Secretary of State
and signed in his absence)

31 MAR 1982

Gast ~~elecPd~~ rec'd
KK

~~cc~~ JV

(2)

Prime Minister

MLS 30/3

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

01-211 6402

Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1P 3HE

30 March 1982

MS

Dear Chancellor,

PAY OF GAS MANUALS

Thank you for your letter of the 19 March. This letter reports the latest position.

While it is true that BGC's latest offer will add a further increase of nearly 1% on average earnings, BGC have made it clear to the unions that the offer is conditional on the withdrawal of the management's 1981 commitment to discuss the restructuring of earnings. This commitment could have resulted in some bonus payments being included in basic pay and its withdrawal must therefore be weighed on the credit side of the package.

The BGC have told my officials that they are careful to avoid references to comparisons with other public sector settlements (while privately, of course, bearing them very much in mind), preferring to deal with their own negotiation on its merits. However, they cannot prevent the unions from making their own comparisons and traditionally the gas manuals' unions look principally to the miners, electricity manuals and water manuals. The gas manuals will no doubt consider themselves entitled to a settlement at the top of this range although, as I have said, the management will reject this kind of argument.

BGC have assured my officials that they have spelled out very clearly to their workforce the benefits of the latest pay offer. The Corporation is fully aware of the wider implications of high settlements in any part of the public sector and do not intend to put any more cash on the table. There is a real possibility that this tough line will result in some industrial action. A further meeting between the two sides has been arranged for today and I will, of course, advise you of developments.

I am copying this letter to the recipients of yours.

Yours sincerely,

pp. NIGEL LAWSON
(Approved by the Secretary of State
and signed in his absence)

Chancellor of the Duchy of Lancaster

Management and Personnel Office
Whitehall London SW1A 2AZ
Telephone 01-273 } 4400
GTN 273 }

26 March 1982

The Rt Hon Nigel Lawson, MP
Secretary of State for Energy
Thames House South
Millbank
LONDON SW1P 4QJ

Dear Nigel,

GAS SAFETY AND STANDARDS

Thank you for copying to me your letter to Norman Tebbit of 23 March.

I am happy to proceed with a review of how licensing of gas installers should be handled, and of GSB and EMES, on the lines you suggest. I hope that our colleagues will also agree. Time is short if officials are to report back to us by mid-May, and I am asking my officials to get in touch with others likely to be concerned as soon as possible.

I am copying this letter to the Prime Minister, Patrick Jenkin, John Biffen, Norman Tebbit and Nicholas Ridley.

Yours ever,

Janet

BARONESS YOUNG

x. JV.

NBPM

SECRETARY OF STATE
FOR
NORTHERN IRELAND

NORTHERN IRELAND OFFICE
GREAT GEORGE STREET,
LONDON SW1P 3AJ

Rt Hon Leon Brittan QC MP
Chief Secretary
HM Treasury
Parliament Street
LONDON SW1

26 March 1982

Dear Leon

PROPOSED EFFICIENCY AUDIT OF NORTHERN IRELAND ELECTRICITY SERVICE (NIES)

with request if required.

As you will recall from my letter of 12 February I sought to have the Monopolies and Mergers Commission carry out an early efficiency audit of the NIES. I saw advantage in having an audit carried out by the MMC rather than private consultants particularly because of the Commission's recent work on the CEGB, which would have had considerable relevance to NIES.

John Biffen, however, took the view in his letter of 1 March that it would not be possible to find space for a study of NIES in the Commission's programme for 1982. While he has offered to consider including a study of NIES in the Commission's 1983 programme, I believe that such a course would delay for too long the commencement of a study which you and I regard as urgent. I propose therefore, with your agreement, to discuss with NIES the appointment of private consultants to carry out an efficiency audit to commence in 1982. I take it that I would have your support in adopting this course?

To ensure that a study by private consultants will carry the same authority as a study by the MMC I would hope to clear with you and others both the terms of reference of the study and the firms which are to be invited to tender for the work - which I hope will include Maynard and Barry.

I am copying this letter to the Prime Minister, John Biffen, other members of E(NI), Sir Robert Armstrong and Robin Ibbs.

Yours ever

Jim

Nat Grid

JV

WM 24/3

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Nigel Lawson MP
Secretary of State for Energy
Thames House South
Millbank
LONDON
SW1

24 March 1982

Dear Nigel

Norman Tebbit copied to me his letter to you of 20 January, in which he suggested that the Health and Safety Executive might take on the administration of a licensing scheme for gas installers, and proposed that officials from relevant Departments should prepare a report for Ministers on the options available.

I think Norman Tebbit's suggestion is helpful. It will be important to maintain public confidence in gas safety if our proposals in relation to the disposal by BGC of its appliance retailing business are to command acceptance. If it is more probable that the HSE can take on the administration of a licensing system within our overall objectives for civil service manpower than that the Department of Energy can, then this is an attractive option. I also gather from Janet Young's letter to you of 8 February that it might be possible to use the powers in the Health and Safety at Work Act and thus avoid further legislation: we clearly need to look into this because it would be a considerable advantage.

I should like my officials to be associated with the proposed study. Subject to your views, I am content with Janet Young's suggestion that the Manpower and Personnel Office should chair the discussions.

I am copying this to the Prime Minister, Patrick Jenkin, Norman Tebbit, Janet Young, John Biffen, and Gerard Vaughan.

Yours ever
Nicholas

NICHOLAS RIDLEY

24 MAR 1982

gas + electricity Pol future

CC/JV

Prime Minister 2

Nigel Lawson agrees with a proposal made by Norman Tebbit that officials should consider the possibility of transferring the work of the Gas Standards Branch, the Electricity Meter Examination Service, and the new job of licensing gas installers, to the HSE. He calls for a report by mid May.

23/3

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

01 211 6402

Rt Hon Norman Tebbit MP
Secretary of State for Employment
Dept of Employment
Caxton House
Tothill St
London
SW1H 9NA

23 March 1982

Dear Secretary of State,

GAS SAFETY

You wrote to me on 20 January suggesting that the Health and Safety Executive might take on the role of licensing gas installers (if it is decided to proceed in that way) as well as assuming the present responsibilities of Gas Standards Branch (GSB) and the Electricity Meter Examination Service (EMES). Patrick Jenkin raised the possibility of privatising these functions, in his letter of 3 February, and Janet Young drew attention to the Metrology area in her letter of 8 February and offered the help of her officials.

I am most grateful for these suggestions. Let me say first that I still believe that we should introduce statutory licensing of gas installers. As a volatile asphyxiating and inflammable substance used in the home, gas presents unique safety problems. We have also committed ourselves to ensuring that existing gas safety standards do not suffer as a result of action taken in response to the MMC report on BGC's appliance retailing despite a possible reduction in the British Gas Corporation's installation and servicing role.

We have been struggling with the problem of the future of GSB and EMES for some time. As you say, in July last year my predecessor proposed to E(EA) that these functions should be hived off to a new non-Departmental body. E(EA) concluded that we should explore the HSE option instead. My officials have since had discussions with HSE and have been awaiting the latter's final views. These interchanges are now of course overtaken by your letter. At the time of the E(EA) discussion we foresaw various difficulties with transferring GSB's functions to other private and public sector bodies. But I agree that the proposed new licensing function and its staffing implications justifies looking at this problem again.

I think, therefore, that we shall take up Janet Young's offer of MPO officials to lead a small working group. They could have an open remit to consider ideas for GSB and EMES including Patrick Jenkin's privatisation ideas, though I would have serious reservations about privatising any of GSB's or EMES's safety functions. Any move in that direction could create political difficulties. The group would need to take account of aspects such as:-

- the future licensing arrangements for gas installers;
- GSB and EMES's consumer protection responsibilities for gas and electricity metering and gas quality testing;
- GSB's work for Government and both oil and gas metering for taxation and regulatory purposes;
- links between GSB/EMES activities and this Department's policy responsibilities;
- manpower and financial implications.

Because we will have to make decisions soon on the gas safety legislation in 1982/83 it is obviously important that the working group should reach conclusions quickly. I hope that they can report back to us by, at the latest, mid-May. As to membership it seems probable that the Department of Industry, Trade and possibly the Treasury will need to take part as well as our Departments and the MPO. If you, Janet and our other colleagues are content I hope that MPO can now set this work in hand.

I am copying this letter to the Prime Minister, Geoffrey Howe, Janet Young, Patrick Jenkin and John Biffen.

Yours sincerely

J. P. Clayton

NIGEL LAWSON

(Approved by the Secretary of State
and signed in his absence)

MAR 1982

CONFIDENTIAL

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

Prime Minister

MES 19/3

19 March 1982

The Rt. Hon. Nigel Lawson MP
Secretary of State for Energy

Dear Nigel

PAY OF GAS AND ELECTRICITY MANUALS

Thank you for your further letters of 8 and 15 March about gas manuals' pay, and of 11 March about the wage negotiations for electricity industrials.

The effect of the restructuring offered by BGC at the meeting on 19 March seems to have been to add nearly another 1 per cent to the full year earnings effect of their offer, which now stands at almost 8 per cent. It is now reported in the press (where the offer has incidentally been quoted as 9 per cent) that the GMWU has rejected this.

I was glad to note from your letter that BGC have said they are maintaining a firm stand on their offer. I know you will be urging them strongly to do so. The offer is now comparable with the highest which have been made in the public trading sector in this pay round, and it would be a mistake to make further concessions simply because the unions profess not to be satisfied. It is not even clear that the workforce would be prepared to take serious action against what is a relatively generous offer. In this connection BGC will no doubt be doing all they usefully can to ensure that the size of the offer is fully appreciated by the workforce.

As regards the electricity industry, it is not too easy to judge the significance of the developments reported in your letter of 11 March without an estimate of the earnings effect of what is now being offered. If anything this effect could seem to be a bit less than the tentative figures mentioned in your letter of 1 March. It would be helpful if you could cover this aspect when there is next something further to report.

I am copying this letter to the Prime Minister, other members of 'E' Committee, the Secretary of State for Scotland, Robin Ibbs and Sir Robert Armstrong.

Geoffrey

GEOFFREY HOWE

18 MAR 1982

Prime Minister

To see

MCS 18/3

MT

(2)

MR. SCHOLAR

cc: Mr. Hoskyns

GAS MANUALS PAY

The Prime Minister will have seen reports this morning that manual workers in the gas industry (represented by the GMWU) are threatening industrial action.

These reports emanated from yesterday's Special Delegate Conference, which endorsed the position taken by the GMWU in the last round of negotiations with BGC. Mr. Lawson reported on those on 15 March: BGC have offered the equivalent of a 7.9% increase in average earnings, but are declining to include in the package consolidation of bonus payments worth some £2.50 a week. I have discussed the latest position with the Department of Energy.

Although it has for several weeks seemed as if BGC were behaving rather like the National Water Council in allowing their offer to be increased by small amounts in the course of successive negotiations, it does seem as if they have chosen a sensible point at which to stand and fight. The bonus issue, which is complicated, is at least as much an issue of productivity as of pay: BGC are saying that they will not allow bonus consolidation without a measurable productivity improvement to justify it. The GMWU are particularly strongly opposed to that, because the electricity supply industry conceded the same point last year, and GMWU negotiates for both. But BGC believe that the gas manuals themselves are less concerned: as long as they get the pay increase, they may not be worrying so much about bonus consolidation. BGC believe that the threatening noises being made by GMWU are for negotiating purposes rather than for real, and there has been no past record of readiness to take industrial action in the gas supply industry. Furthermore, a strike by gas manuals, although likely to lead to a progressive deterioration of the gas supply system, would not have a dramatic impact. Supplies would be more likely to be interrupted, and safety affected, in the event of industrial action by white collar workers, who have a long tradition of moderation.

/ There are

There are likely to be further negotiations between BGC and the GMWU in the next few days, and there seems to be at present no cause for alarm.

18 March 1982

CONFIDENTIAL

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(2)

Prime Minister

MLS 18/3

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Nigel Lawson MP
Secretary of State
Department of Energy
Thames House South
Millbank
London SW1P 4QJ

16 March 1982

D Nigel,

THE ELECTRICITY SUPPLY INDUSTRY'S EFLS

Thank you for your letter of 10 March.

While there must be a range of uncertainty attached to such figures, it is unsatisfactory that we have not yet received from the industry an assessment of the external financing that they would like us to agree to for this year and next taking full account of the effects of the ASLEF dispute and the increase in oilburn. On the basis of the figures they have provided so far it is impossible to discover, for example:

- the likely cash flow costs of the extra oil burnt;
- the costs of extra electricity bought in from Scotland as a result of the ASLEF dispute;
- the benefits to the industry's cash flow from higher electricity sales in the cold weather earlier this year;
- the extent to which the industry will be able to meet the bills for the extra oil in 1981-82, a point to which, as you know, I attach particular importance;
- the reduction in payments in 1981-82 to the NCB for coal as a result of the delay in deliveries caused by the ASLEF dispute, or the likely increase in 1982-83 as a result of catching up.

The sums involved are large and could have a marked effect on both the industry's external financing requirement and profitability.

CONFIDENTIAL

I recognise that your Department has pressed the industry for the information. It would be surprising, and disturbing if their accounting system was incapable of producing at least a preliminary assessment of the financial effects of the other factors this late in the financial year. It is therefore difficult to escape the conclusion that the industry is deliberately refusing to let us have the information.

I should be interested to know whether you interpret the position in this way and would appreciate your views on how the information might be obtained from the industry. I am especially interested to know whether action has been taken to meet the costs of oil burn in the present financial year.

I am sending copies of this letter to the Prime Minister, Willie Whitelaw, Patrick Jenkin, David Howell, Norman Tabbit, Sir Robert Armstrong and Robin Ibbs.

LEON BRITTAN

0 6 MAR 1982

fc JV

Prime Minister (2)

MES 17/3

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ
01 211 6402

CONFIDENTIAL

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3HE

15 March 1982

Dear Chancellor,

GAS MANUALS' PAY

British Gas had a further meeting with the gas manuals' unions on 10 March but were unable to reach a settlement.

In my letter of 8 March I reported that the unions had rejected BGC's previous offer because the proposed increase in basic rates did not flow through to bonus payments and because the management had given no longer-term commitment on consolidation of bonus payments into basic pay. The management told the unions that these two objectives were incompatible and that if they wanted flow-through of basic rate increases to bonus payments, the package for restructuring bonus payments which they had already tabled would have to be withdrawn.

At the meeting on 10 March BGC therefore restructured their offer, reducing the proposed increase on basic rates but allowing flow through to bonus payments. Their latest offer includes increases in basic rates from 7.5% for labourers to 8% for technicians, which would flow through in full to bonus payments. As a corollary BGC withdrew the offer to restructure bonus payments. Still included in the offer are increases in the General Obligations Payment (up to 50 pence per week), holiday pay (up to 135% of basic rates), staggered-working payment (£2.50 per week) and local holidays. All of these were offered in earlier rounds.

The revised package would increase average earnings by about 7.6% in the settlement year (about 7.9% in a full year).

The unions said that they would recommend acceptance of this offer if BGC reinstated the offer of a weekly supplement of £2.50 per week for workers not participating in bonus schemes. The management replied that this was not possible as the supplement for non-bonus workers had been part of a total package for restructuring bonus payments. This package was incompatible with the revised offer allowing flow through of basic rate increases to bonus payments. The union negotiators have therefore indicated that they cannot recommend acceptance of the offer and they are now consulting their membership on that basis. BGC do not know what form this consultation will take (it might be done through delegate conferences) or when the unions will report back to them.

For their part, BGC have told my officials that they have taken a firm stand on this offer and have made it clear that they see little room for movement.

I am copying this to the Prime Minister and to Willie Whitelaw, Michael Heseltine, Patrick Jenkin, John Biffen, David Howell and Norman Tebbit as well as to Sir Robert Armstrong and Robin Ibbs.

Yours sincerely

NIGEL LAWSON

(Approved by the Secretary of State
and signed in his absence)

16 MAR 1982

Prime Minister (2)

MLS 10/3

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ
01 211 6402

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3HE

11 March 1982

Dear Geoffrey

ESI INDUSTRIAL WAGE NEGOTIATIONS

Further to my letter of 1 March, I have now learned that in the event the Electricity Council offered £4.90 at the minimum of the labourers' scale and £10.09 at the maximum of the craftsmens' scale at the informal meeting on 2 March. This offer was rejected by the unions.

At the formal meeting on 4 March the offer was marginally increased to £4.97 (5.1%) and £10.62 (6.4%) respectively. In addition a shift enhancement of £3.73 was offered (a 75p advance on the previous offer). These two elements would represent a total of 6% on the paybill for industrial grades.

This offer was also rejected by the unions, who pressed hard for 8% on scheduled salaries. The meeting was adjourned until 8 April. However there may be informal contacts before that date. I will of course continue to keep you informed of progress.

Copies of this letter go to the Prime Minister, other members of 'E', George Younger, Robin Ibbs and Sir Robert Armstrong.

Yours

Nigel

NIGEL LAWSON

11 MAR

CC ✓

Prime Minister

MCS 10/3

01 211 6402

Rt Hon Leon Brittan QC MP
The Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

10 March 1982

THE ELECTRICITY SUPPLY INDUSTRY'S 1981/82 AND 1982/83 EFL's

- reference in Coal: Pt 6.

Your letter of 1 March asked for revised figures on the Electricity Industry's finances.

As you will recognise, the complex situation of interrupted coal deliveries, increased oil burn, a cold snap in December and January, but a mild February has made it even more difficult than usual to give a confident estimate of the Industry's expected outturn against its 1981/82 EFL of -£165m. Even now, there is a considerable range of uncertainty, related to the rate at which coal stocks can be built up and paid for, and the timing of payments for oil, in the remaining weeks of the year. That said, and subject to the qualifications indicated below, the Industry now estimate an outturn of -£225m for the current year, ie £60m better than the EFL as fixed. This estimate depends on:-

i) End year coal stocks of 14m tonnes and oil stocks of 1m tonnes (ie within the range the industry were forecasting at the end of 1981);

ii) Exclusion of net additional oil costs incurred during February and March. (I am writing to the Chancellor separately on this: it may be that the margin of £60m will be sufficient to cover these costs within the EFL, even if grant is not received until 1982/83);

iii) Total units required of 215 TWh (as compared with 212 estimated at the end of 1981).

Because of the interaction of coal stock levels and oil burn, a separate estimate of the effect of the ASLEF dispute on the industry's revenues would not be directly comparable with the effect of the dispute on the NCB's finances. However, my department is continuing to discuss with the industry the factors underlying the end-year estimate and my officials will pass on to yours further information as it becomes available.

So far as 1982/83 is concerned, the uncertainties are clearly greater. On the assumption that fuel stocks at 31 March 1983 are the same as at 31 March 1982 the industries expect to achieve the EFL as fixed, ie -£232m (-£319m, with a reduction of £87m in respect of the contracted consumer tariff arrangements agreed by Ministers).

I am sending copies of this letter to the recipients of yours of 1 March.

Yours ever
Nigel

NIGEL LAWSON

10 MAR 1982

Noted. See Electricity

Prime Minister (2)

cc JV

MLS 9/3

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

8 March 1982

The Rt. Hon. Nigel Lawson MP
Secretary of State for Energy

Dear Nigel

LONGER TERM STUDY ON ELECTRICITY PRICES

Thank you for your letter of 23 February about the proposed study. I have also seen Patrick Jenkin's letter of 2 March and Robin Ibbs' of 3 March.

It is helpful to volunteer your Department to undertake the lead in the study. Ideally, however, I think we are all agreed, as Patrick Jenkin has said, that the study is exactly the kind of study which the CPRS should undertake. I therefore hope that Robin Ibbs is successful in strengthening his resources so that the CPRS are able to take on the study. Perhaps we should consider this again when he has something more definite to report, which I hope will be soon.

I am generally content with the terms of reference which Robin Ibbs has suggested, but to make the coverage of the study absolutely clear I suggest, in the text attached, a few changes to the draft he circulated. The main change is the proposal that the study should begin with a factual study, which could draw on NEDC Task Froce material, of the extent to which industrial electricity prices are higher in the UK and if so, why.

I am sending a copy of this letter to the Prime Minister, Patrick Jenkin, George Younger, Nicholas Edwards, Robin Ibbs and Sir Robert Armstrong.

Yours

Geoffrey

GEOFFREY HOWE

DRAFT TERMS OF REFERENCE

(i) To examine the extent to which the price of electricity is more expensive for industrial custnmers in the UK than in other major industrial countries; and to advise on the reasons, considering in particular whether this is due to unavoidably high costs, avoidable costs, such as efficiency, or to pricing policies.

(ii) To examine how the cost of electricity in the UK is likely to move relative to costs in other major industrial countries; and to consider whether we should react to lower prices in those countries.

(iii) To examine the effects on industry of the continuation of the international price differentials foreseen under (ii), assuming also continuation of present costs and tariff structures; to consider, in particular, which industries or processes may be adversely affected to a significant extent and to advise on the consequences for the economy as a whole.

(iv) To advise on the costs, practicability and desirability of changes in the electricity pricing structure which would have the e ffect of reducing charges to the consumers identified in (iii), including the possibility of legislative change; and on other possible forms of assistance.

(v) To consider, in the light of (i), (ii), (iii) and (iv) the case for subsidising electricity prices to industry.

[illegible] 1982

CONFIDENTIAL

Le JV

Prime Minister (2)

MES 8/3

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ
01-211-6402

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
H M Treasury
Parliament Street
London
SW1P 3HE

8 March 1982

Dear Geoffrey

GAS MANUALS' PAY

TPM

I wrote to you on 12 February giving details of the pay offer made by the British Gas Corporation to their manual workers at the last negotiating meeting. This included a further improvement in basic rates and an increase in the General Obligations Payment (an allowance in respect of flexible working procedures), producing an estimated increase in average earnings of 6.8% in the settlement year.

The unions have now advised BGC that the offer is unacceptable on two grounds:-

1) the increase in basic rates does not flow through into bonus payments; and

2) they have been given no commitment on future consolidation of bonus payments into basic pay.

The negotiations will be resumed on 10 March, and the unions will clearly be looking for some concession on bonus payments, which has been their main objective from the start.

The management have told my officials that they have not yet decided on their tactics at next week's meeting and that they will not do so until they meet regional representatives on the morning of 10th. They have previously, as you know, emphasised the complexity of the negotiations. There are several options including the restructuring of the package so as to reduce the offer on basic rates in order to make a concession on bonus payments. BGC have told us, however, that they do not at this stage envisage offering significantly more on overall earnings. I will, of course, let you and colleagues know the outcome of this next meeting.

CONFIDENTIAL

I am copying this to the Prime Minister and to Willie Whitelaw, Michael Heseltine, Patrick Jenkin, John Biffen, David Howell and Norman Tebbitt as well as to Sir Robert Armstrong and Robin Ibbs.

Yours
Nigel

NIGEL LAWSON

8 MAR 1982

CONFIDENTIAL

Prime Minister (2)

MCS 3/3 cc JU AD

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CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Nigel Lawson MP
Secretary of State
Department of Energy
Thames House South
Millbank
London SW1P 4QJ

3 March 1982

Dear Nigel,

ENERGY CONSERVATION: ASSISTANCE FOR LARGE ENERGY USERS

Thank you for your letter of 22 February. You will have seen Patrick Jenkin's letter to the Chancellor of 16 February.

Whatever attractions the scheme you propose might have, it certainly has substantial drawbacks. First, it would cost some £56 million over the next few years and would require additional civil service manpower. Second, while firms may face cash flow constraints it is doubtful that this scheme would induce much extra investment in energy conservation rather than subsidising projects which would have gone ahead anyway. This would point to a check for additionality project by project on the lines Patrick Jenkin suggests but that would add to the administrative costs and manpower. Even with such checks, it is not clear that the scheme would stimulate net extra investment rather than lead firms to switch money from other areas into energy conservation. It was for reasons on these lines that we could not agree to the proposals you brought forward by your Department in the Public Expenditure Survey.

In addition, your new proposal would give rise to severe borderline problems. Patrick Jenkin has rightly emphasised that many private sector steelmakers would feel aggrieved by a 4,000 tonnes of coal equivalent threshold. Similar hard cases would be raised if the limit was lowered to 2,000 tce as you now suggest.

More generally, it seems difficult to justify concentrating assistance of this sort on large energy users. We would deliberately be excluding the smaller firm from any benefits which the scheme might have. It is very doubtful whether this would be a sustainable position, especially in view of our commitment to the smaller business and the fact that some of the small and medium-sized firms excluded would be in direct competition with beneficiaries of the scheme. It is relevant here that when David Howell put forward rather similar proposals in the Summer he argued that this form of assistance was particularly appropriate for small firms.

In short, there would be great pressure on Government to generalise the scheme to the rest of industry at much greater cost. If we refused to extend the scheme, any plaudits received from its original introduction would be swamped by the objections of those excluded.

On balance, therefore, the Chancellor and I do not believe a scheme on the lines you propose would be justified.

I am sending copies of this letter to the Prime Minister, Peter Carrington, George Younger, Nicholas Edwards, Patrick Jenkin, Sir Robert Armstrong and Robin Ibbs.

Ever
Leon

LEON BRITTAN

-3 MAR 1982

Prime Minister

MCS 4/3

(2)

Next Ind

J.V.

AD

CABINET OFFICE
Central Policy Review Staff
70 Whitehall, London SW1A 2AS Telephone 01-233 7765

From: J. R. Ibbs

Qa 05850

3 March 1982

Dear Secretary of State,

Longer-Term Study on Electricity Prices

Your letter of 23 February to the Chancellor proposes terms of reference for this study. There have been consultations on these at official level and I agree that they are broadly on the right lines. My experience is that it is important to strive for the utmost clarity in defining such studies; I suggest this might be helped by the minor changes included in the enclosed revised version.

The CPRS would of course wish to be associated with the study if your Department takes the lead; and I am still urgently seeking to strengthen our resources so that we could offer to take a leading role in it. I am making some progress on this.

I am sending a copy of this letter to the recipients of yours.

Yours sincerely,

J R Ibbs

The Rt Hon Nigel Lawson MP
Department of Energy
Thames House South
SW1

DRAFT TERMS OF REFERENCE

(i) To examine how the cost of electricity in the UK is likely to move relative to costs in other major industrial countries (taking account of any scope for action to make it more competitive);

(ii) To examine the effects on bulk users of electricity if the international price differentials foreseen under (i) continue, assuming also continuation of present cost and tariff structures; to consider, in particular, which industries or processes may be significantly at risk as a consequence and to assess the industrial and economic costs of losing them;

(iii) To advise on the desirability, practicability and costs of changes in the electricity pricing structure which would have the effect of reducing charges to the consumers identified in (ii), including the possibility of legislative change; and on other possible forms of assistance;

(iv) To compare the extra costs of lower electricity prices for industry, or other possibilities under (iii), against the benefits of preserving part of the industrial base.

4 MAR 1982

cc AO
JV

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

2 March 1982

(2)

Prime Minister

MLS 2/3

The Rt Hon Leon Brittan QC, MP
Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
LONDON
SW1

Dear Leon,

ENERGY CONSERVATION : ASSISTANCE TO LARGE ENERGY USERS

I have seen a copy of Nigel Lawson's letter of 22 February to you about proposals for an energy conservation scheme to assist large energy users. I strongly support the broad outlines of the scheme. We are under continuing heavy criticism over fuel prices, and there is no doubt that in some cases they are seriously damaging to competitiveness. A scheme to enhance conservation would be a desirable complement to action on electricity prices. I have, however, a number of points I would like to make on it.

2. The first is the proposal that there should be no requirement of additionality ie whether the investment would have gone ahead without Government assistance. A requirement for additionality is a feature of the schemes operated by my Department and I must say that I find arguments for there being no such requirement in this scheme unconvincing. Judgements about additionality are certainly difficult, but there is no evidence that industry reacts adversely to the principle. I do not think it right to argue that the whole scheme would be "additional" because this form of investment is generally not taking place. There may indeed be less investment in energy conservation projects than we would have liked to see, but there has nevertheless been substantial investment in energy conservation measures. Although including such a requirement could affect the staff numbers, I believe it is desirable on a number of counts. First, the broad principle that it is pointless to pay people to do what they would do anyway is hard to question. Secondly it can provide a flexibility in selecting suitable cases. Finally it allows negotiations to take place with applicants so that the level of assistance provided is kept to a minimum rather than granted automatically at a fixed rate.

3. The need for flexibility may be greater in this scheme than in some others because I see some difficulty in focussing accurately on the energy conservation aspects of major investment projects. Some of the projects mentioned in the annex would involve wholesale reconstruction or reorganisation of plants. It may well be difficult to separate out a specific energy conservation content, but it might also be anomalous to assist a whole scheme of which energy conservation is clearly only one feature.

4. Finally on the mechanics of the scheme I wonder whether the double threshold for eligibility is really necessary. Our experience with the coal fired boiler scheme was that we drew the qualifying criteria tightly specifically to limit the case load, and have now increased the coverage because take-up fell below expectations. I agree that the energy conservation scheme should focus on larger users, but I think that a single threshold of a minimum saving of 2000 tons of coal equivalent a year should be sufficient safeguard against an excessive number of applications.

5. The paper touches only briefly on administration. I think it is important to avoid the situation that arose last year over the coal fired boiler scheme. This was decided close to the Budget when very little preparatory work had been undertaken. As a consequence two months elapsed before full details could be published and this had the effect of holding up all orders on boiler makers and equipment suppliers for a considerable length of time. The Government will be severely criticised if the same occurs this year.

6. No suggestion has been made that the Department of Industry should be involved in the administration of the scheme. I should, however, make clear that if this were to be thought appropriate we should expect an appropriate adjustment to the Department's staff ceilings to cover this new work.

7. Finally I should confirm the point in paragraph 13 of the paper about the statutory ceiling under Section 8 of the Industry Act. As you know, we are close to the cumulative ceiling and any announcement of an energy conservation scheme should include appropriate qualifications.

8. I am sending a copy of this letter to the recipients of Nigel Lawson's.

- 2 MAR 1982

Yours ever

Patrick

CONFIDENTIAL

NBPM

MS 3/3

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon James Prior MP
Secretary of State
Northern Ireland Office
Great George Street
London SW1P 3AJ

2 March 1982

D Jim

NORTHERN IRELAND ELECTRICITY SERVICE.

Thank you for your letter of 23 February. I am glad you agree that the efficiency audit of the NIES might be undertaken by the MMC. You will now have seen my letter of 26 February to John Biffen supporting your request, though it is for him to determine the final composition of the programme.

I am copying this letter to John Biffen, to other members of E(NI), to Sir Robert Armstrong and Mr Ibbs.

Leon

LEON BRITTAN

CONFIDENTIAL

3 MAR 1982

Orders of the Day

SUPPLY

[14TH ALLOTTED DAY]—*considered*

Gas Price Increases

3.39 pm

Mr. Merlyn Rees (Leeds, South): I beg to move,

That this House regrets the decision of Her Majesty's Government to increase domestic gas prices by 22 per cent. in 1982 and demands that this policy be not implemented.

Mr. Speaker: I have selected the amendment in the name of the Prime Minister.

Mr. Rees: I shall try to be brief, as I believe that two Front Bench spokesmen would be inappropriate in a three-hour debate.

Rarely has more concern been expressed than on this act of Government policy. The Government have decided to increase gas prices by 22 per cent.—12 per cent. for inflation and 10 per cent. on a regular basis. The average increases in 1980 were 17 per cent. and 10 per cent., and in 1981, 15 per cent. and 10 per cent. This follows the decision of the Government—not the British Gas Corporation—in 1980 to increase gas prices by 10 per cent. more than inflation as a general act of policy. As a result of Government policy, gas prices have increased by about 100 per cent. since 1979.

All of this has occurred not because of a decision by the Gas Corporation but as a result of a firm decision by the Cabinet—and this from a Government led by a Prime Minister who has the nerve to go round the country complaining that it is the nationalised industries which put up prices. The Government have put up gas prices. It is not market forces or Gas Corporation decisions, but Government policy. The Government constantly denigrate the nationalised industries and the Gas Corporation. This is a richly successful, integrated industry and a world leader in research looking to the future. The job that it has carried out in the past 20 years with high-speed gas and North Sea gas and the pipe system throughout the country has been truly remarkable.

In exactly the same way, it was the Government who imposed a levy on the Gas Corporation, thus milking it of £1·25 billion over three years. The Government see the Gas Corporation not just as a convenient Aunt Sally in political speeches but as a means of raising taxation outwith the corporation's statutory responsibility to supply gas. A Conservative Central Office handout of 27 February had the nerve to say:

"Domestic consumers benefited at the expense of industrial consumers".

I shall return to that.

"They were benefiting also at the expense of the taxpayer".

It is the taxpayer, in the form of the British Gas Corporation, who has to pay a levy of £1·25 billion to the Exchequer. It is Government policy to put up gas prices, even without these instructions on dometic gas prices. The result of the provisions relating to gas in the Oil and Gas (Enterprise) Bill now in Standing Committee will be to raise prices. We heard this morning in that Committee that Sir Ernest Woodroofe, who had been a part-time member of the British Gas Corporation for nine years, had written:

"As a staunch Conservative, having voted solidly for the Party all my life and having rejoiced at the success at the last election . . . I see nothing in this Bill which will reduce the price of gas to the consumer and since British Gas will have to compete for supplies at higher costs to the Corporation, I see the effect of the Bill as likely to make the price of gas to the consumer higher than it would have otherwise been."

That is the view of the Gas Corporation. It is clearly the Government's intention to increase prices in the gas industry. Whether it be though raising domestic gas prices through the effects of the new Bill, it is Government policy to increase the price of gas.

In the amendment, the Government seek to put a gloss on their policy for which gas does not bear examination, and to link the level of industrial prices to the policy of hiking up domestic gas prices. The sequence was in fact quite different.

Soon after the Government came to office in 1979, they reduced the external financing limit for the Gas Corporation by £190 million and insisted to the corporation that all the increases fell upon the non-domestic consumer. The increase in the fall of 1979 consisted of a 21 per cent. increase for the non-domestic consumer and an 0 per cent increase for the domestic consumer. The policy in January 1980 for 10 per cent. more than inflation for three years was to sort out the imbalance which the Government had largely caused through their own action in the first nine months of the Conservative Administration. There was no mention of helping industrial users during those months. The change followed pressure from NEDC and large industrial gas users. As a result, industrial contract renewal prices were frozen until yesterday.

Mr. Tim Eggar (Enfield, North) *rose*——

Mr. Rees: Perhaps I may finish this point. Then, of course, I shall give in. [HON. MEMBERS: "Oh".] I always give into the hon. Gentleman.

The NEDC report states:

"The change since our last report has been due to: (i) the BGC measures which set a ceiling to renewal prices in Britain, so freezing prices which were already at the ceiling and restraining rates of increases for others; (ii) exchange rate movement during the year; and (iii) price increases on the continent reflecting movement in fuel oil prices and the higher prices now being charged for exports of Dutch gas."

I shall return to the third point in a moment.

Mr. Eggar: Does the right hon. Gentleman agree that up to that point the Government and the British Gas Corporation were following exactly the policy on pricing promulgated by the right hon. Member for Bristol, South-East (Mr. Benn) when he was Secretary of State for Energy?

Mr. Rees: That is a fair question. I shall return to that, as I investigated the subject carefully, and I shall spell out the policy of the Labour Government at that time.

The Government's sudden enthusiasm for industrial gas consumers is not matched by an enthusiasm to help industrial bulk electricity users, for whom arguments have been made for some time but very little has been done.

Despite the reference in the Government amendment to "helping the needy", the bald fact is that whatever the amount of money provided fewer people will be helped than in the last year of the Labour Government, whose scheme helped those on rent and rate rebate schemes as well as those on supplementary benefit. The Conservatives were driven to help some of those on low incomes by the

[Mr. Rees]

bad winter, not as an offset to the policy of annual gas hikes about which we are complaining today. If it was an offset, they certainly took a long time about it, as that policy was implemented in January 1980. The Government were driven to act. They should listen to the consumer on energy pricing policy. A document that I received recently from the North-Eastern gas consumers'F council in Eastgate, Leeds states that at a recent meeting of the council it repeated its view that

"all the increases should be vigorously opposed"

and that

"price increases should be based only on the financial needs of the Industry. Whilst being well aware of the Government's policy imposed on British Gas that prices should rise 10 per cent. above the rate of inflation over three years . . . they felt that the British Gas Corporation had not told them any reason why they needed the extra money."

Of course, the British Gas Corporation does not need the extra money. It is a Government decision and a method of taxation. The Government are using the British Gas Corporation to collect a poll tax, or at least to levy a tax on the basis of the amount of energy used by the British people. The Government's energy policy is incoherent. They have drifted in the wind of their own belief in free market forces, always slow to respond to the arguments of the NEDC or the large industrial users. They are motivated by a positive dislike of nationalised industry. The gas industry is successful in anybody's language. In addition the Government policy on depletion is not clean.

The fall in the price of oil—which might well drop by another $5 a barrel—is welcome because of its effect throughout the economy. We shall see whether it is welcome to the Chancellor. Surely, as a result, the price of industrial gas will fall because normally there is a straight link between the price of oil and the price of industrial gas. No one could possibly know the precise figure, but that change will surely force the Government to look again at overall prices.

The Secretary of State for Energy has far more responsibility than a shadow spokesman. However, I have been at it slightly longer than him. It strikes me as remarkable that, despite the country having all the coal, gas and oil that it needs, we make a hash of it. In contrast Canada uses its prolific supplies of energy for the benefit of its domestic and industrial consumers. We should do exactly the same.

Mr. Peter Rost (Derbyshire, South-East): The right hon. Gentleman talks about protecting the consumer. Does he not accept that industrial and commercial consumers have been penalised, particularly by the Labour Government's pricing policy, which held down the domestic price at the expense of the industrial consumer? Will the right hon. Gentleman tell us how many jobs are being lost in Britain as a result of high gas prices to the industrial sector?

Mr. Rees: The hon. Gentleman said that in Committee this morning. He is wrong. According to the NEDC report we are not at a disadvantage as far as gas prices are concerned.

Mr. John Hannam (Exeter): Not now.

Mr. Rees: Of course we are not now. That is what I read out. The Government experienced pressure last year, but the assertion of the hon. Member for Derbyshire, South-East (Mr. Rost) is wrong.

It is always pleasant to look at what a party said at the last election. In 1979, on the basis of the Labour Government's policy, the Labour Party said:

"As well as being available in large supplies, gas is also competitively priced. Some have argued that it has an unfair advantage as a source of domestic heating over electricity, and that its price should be raised to bring it more into line with that of electricity. However, gas is only relatively cheap because it has been possible to develop the gas in the southern basin of the North Sea cheaply, and because the industry has cut its workforce by over 20 per cent. in ten years. We believe that relatively cheap gas encourages its use in the premium markets—domestic and commercial—for which it is best suited. To increase its price, so that domestic consumers would want to switch to electricity, would, not be in the interests of the industry, and would in any case, cause unnecessary hardship to many gas consumers who rely on it as an inexpensive form of heating and cooking. This would be contrary to Labour's objective"—

carried out in Government—

"of providing adequate heat and light at a price that people can afford."

The Labour Government's policy was right and so was the policy that we put forward at the election. The Government's policy is to increase gas prices not because the British Gas Corporation wants that but because the Prime Minister and the Government want them to increase. The Government's policy is for gas prices to increase every year by the amount of inflation plus 10 per cent. That is their policy. I hope that Conservative Members will not say that everything is the fault of the British Gas Corporation, because that is not true. The British Gas Corporation is highly successful. We are debating Government policy and I ask my right hon. and hon. Friends to vote for the motion tonight.

3.54 pm

The Secretary of State for Energy (Mr. Nigel Lawson): I beg to move, to leave out from "That" to the end of the Question, and to add instead thereof:

"this House having endorsed on 29th January 1980 the Government's decision to tackle, over a three-year period, the serious under-pricing of domestic gas at industry's expense; recognises the need to complete that process this year; welcomes the relief which has been possible in consequence through lower real industrial gas prices; and supports the Government in making available more resources than ever before for helping the needy with their fuel bills."

The right hon. Member for Leeds, South (Mr. Rees) has—as is his custom—worked himself up into something of a lather of indignation about gas prices. However, his response was hardly shared by other Labour Members. At the beginning of his speech a full five Opposition Back Benchers supported him, but by the end of his speech he had managed to increase the number to 10. That is the sum total of his achievement. I congratulate him on doubling the number of his supporters, but perhaps it shows that the motion can be described only as being by opportunism out of hypocrisy.

The right hon. Gentleman suggested that the fall in the price of oil might have an impact on industrial gas prices. He is right to say that the fall in the price of oil—we do not know for how long it will continue—is of net benefit to the world and to this country. My right hon. and learned Friend the Chancellor of the Exchequer must grapple with certain budgetary problems. However, their magnitude depends not merely on the dollar price of oil, but on the exchange rate and the sterling price of oil. The huge increase in oil prices in 1979 inflicted immense damage on the world economy and on Britain's economy and contributed greatly to inflation and particularly to the recession. The softening of prices—assuming that it will continue—can only be of benefit to the world economy, from which we can draw some comfort and hope.

I readily grant the right hon. Member for Leeds, South the fact that gas prices have caused considerable concern throughout the country, but it is important to be clear about the reason for that concern. The problem is not caused by the absolute level of the price of gas. On the contrary, gas is still the cheapest fuel available, and will continue to be even after this year's price increases. To heat a home by oil-fired central heating costs almost half as much again as heating it by gas-fired central heating. Similarly even after the recent March increase in the price of industrial gas, firm gas costs 30½p per therm, compared with gas oil—even at today's oil prices—of 46p per therm. Therefore, the fall in oil prices must go much further before it has any impact on the competitive edge enjoyed by gas. It costs twice as much to cook by electricity—another competitive fuel—as by gs.

That has not always been so. During the past 10 to 15 years, while the price of all other fuels has risen very condsiderably in real terms, the real price of gas has fallen. I take 1968 as an example, because that was the year in which North Sea gas first took the place of the old town gas. In 1968 typical elderly couple used between six and seven therms of gas a week to cook with and to heat their home, and that cost them 10 per cent. of their old-age pension. Even after the gas price increases of the past two years, today it costs only 4 per cent. of a married couple's pension to pay for the same amount of gas.

The price of gas today to the British home is among the lowest in the world. In France and Germany, for example the householder has to pay from half to twice as much for his gas. Thus, it is not the absolute level of gas prices that is the problem, whether compared with other fuels, or with a decade ago, or with prices overseas. The problem is the sharp increase in the gas price that is due this year. That is what is at issue. It is right, therefore, that the House should understand why so large an increase is necessary, and, in particular, where the true responsibility for it lies—with the Labour Party.

Mr. Leslie Spriggs (St. Helens): Before the last increase in gas prices the Gas Corporation made a profit of £200 million, at a time when the Prime Minister said that too much gas was being used by domestic consumers. What does the right hon. Gentleman propose to do about that?

Mr. Lawson: I shall come to that a little later, but let me tell the hon. Gentleman now that that profit was coming entirely from industry, from the sale of gas to industry at a much higher price. No profit came from the domestic consumer.

Let us return to Labour Members and the time when they were in Government. The right hon. Member for Leeds, South said that he was happy to have his Government's record examined. They were in no doubt about the principles on which gas prices should be based. In their White Paper of 1978, produced under the aegis of a previous Secretary of State for Energy, the right hon. Member for Bristol, South-East (Mr. Benn)—I do not know where he is, but he is again absent, no doubt engaged in some extra-parliamentary activity—I believe that is the correct expression—they said:

"The Government considers that gas and electricity prices should be at economic levels which reflect the cost of supply, encouraging the best use of national energy resources and avoiding subsidies from public expenditure".

Fine words, but what happened in practice?

No sooner was the ink dry on that White Paper than they decided, in a futile attempt—and, my goodness, it was futile—to court electoral popularity, to freeze the price of gas to the home for the remainder of their ill-fated term of office. As a result, by the time the present Government took office in 1979, far from there being any question of prices reflecting costs, the Gas Corporation was actually losing money, as I mentioned to the hon. Member for St. Helens (Mr. Spriggs) a moment ago, on an increasing scale on the supply of gas to the home, and all its profits were being made from its sales to industry. The price of gas to industry, far from being held down in line with domestic gas prices, rose to the point where it was costing 25 per cent. more than the price of gas to the home, despite the fact that the cost of supplying gas to industry was significantly less than that of supplying it in smaller quantities to the home.

The Labour Government's Price Commission, which was scarcely in the habit of recommending that prices should go up, reported in June 1979 that domestic gas was so seriously underpriced that its price should be increased by at least 30 per cent. Incidentally, that analysis was not challenged by the Gas Corporation.

Mr. Merlyn Rees: If it is so sensible a policy—and this was the report in June 1979—why, in September 1979, did the Government of which the right hon. Gentleman was a member freeze domestic gas prices?

Mr. Lawson: The policy that we are debating is that which has been in existence since January 1980. If the right hon. Gentleman wishes to defend his Government's policy, he will have to do a great deal better than that.

What happened when the right hon. Gentleman's party was in office is clear. The under-pricing of domestic gas had led, inevitably, to a massive surge in the demand for gas for the home far in excess of the corporation's ready ability to supply it, particularly during periods of peak winter demand. As a direct result, industry was once again being penalised, this time by having to suffer the deliberate rationing of gas and being denied the supplies that it so badly needed.

That was the cockeyed position that the Government inherited from their predecessors. My predecessor, my right hon. Friend the present Secretary of State for Transport (Mr. Howell) set out to put it right.

Mr. Alex Eadie (Midlothian): The right hon. Gentleman is introducing a very important argument. He is really arguing that not only do workers receive a wage for working, but that they receive an energy wage from industry as well. Is the right hon. Gentleman aware that when the Labour Government came into office we had about £1,000 million worth of electricity price freeze debts to pay and that, for the first time in history, the Conservative Administration had managed to make the electricity industry go into deficit?

Mr. Lawson: I do not think I would be in order if I were to allow myself to be led along the highways and

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byways of electricity policy in 1974, which is what I think the hon. Gentleman was referring to. However, I am surprised that he did not understand the importance that I was attaching to the point that I made about the cost of energy generally, and gas in particular, to industry and the implications that this can have for industry's competitiveness and for jobs. I should have thought that he at least would have understood that.

My predecessor announced in January 1980 that the massive under-pricing of domestic gas would be corrected, not all at once, of course, but by a 10 per cent. increase in the real price of gas to the home in each of the three years 1980, 1981 and 1982. That was one of the most courageous decisions ever taken by a Minister. It was debated and approved by the House on 29 January 1980. What we are discussing today is the third and final instalment of that three-year correction of the follies of our predecessors.

Mr. Robert C. Brown (Newcastle upon Tyne, West): I am intervening to save the right hon. Gentleman from himself, because he said that his predecessor decided to increase the price of gas by 10 per cent. for three years. I do not want him to be accused of misleading the House. He should have added "by ten per cent. above the current rate of inflation".

Mr. Lawson: What I said was 10 per cent. in real terms, as the hon. Gentleman will find when he reads *Hansard* tomorrow morning. I am sorry that he did not understand. It is confusing sometimes. I hope that he understands now.

I understand the concern about and, in some cases, the difficulty that can be caused by sharp price increases in what for many is an essential commodity. That is why the Government have introduced the most generous scheme ever to help those in need with their fuel bills. Altogether about £250 million is being spent this year to help those in low income groups—such as the elderly, the disabled, and families with young children—with special heating needs, and about 2¼ million people are benefiting from this, of whom 1½ million are pensioners. Of course, the 7½ million pensioners who do not fall into this category of special need still have their pensions fully protected against all price increases, including the price of gas.

A lot of concern has been expressed in the House about standing charges. These reflect the fixed overhead costs of making a supply of gas available to the home, and are set by the Gas Corporation without any intervention by the Government whatever, except of course the constant Government pressure on the corporation to reduce its costs. Needless to say, the standing charge is fully taken into account in assessing eligibility for the special scheme for assistance with fuel bills.

Mr. Merlyn Rees: I wonder whether I might ask the right hon. Gentleman about the standing charge. I did not mention it and I wondered what he would say about it. If the Government insist that they can put up prices by 10 per cent. over the rate of inflation, there is no way in which an instruction can be given to the Gas Corporation to look at the standing charge, about which, I personally receive many letters.

Mr. Lawson: As I made clear, the standing charge reflects the Gas Corporation's costs. It is a matter for the corporation. It is not the Government who set the charge. What we are trying to do is to get the industry to look critically at its costs and reduce them. We recently announced a further intensification of the drive to make the nationalised industries more efficient and to cut their costs, by the introduction of a bigger role for the Monopolies and Mergers Commission in this area, and by other means.

Mr. Kenneth Lewis (Rutland and Stamford): Does my right hon. Friend agree that if the Government give an open invitation to this nationalised industry or any other to maximise its charges, there is little chance that it will then cut its costs?

Mr. Lawson: I have great respect for my hon. Friend, who now shares the same county as I do and the same local newspaper, which I am sure will faithfully reflect what he says, but I assure him that we are in no way encouraging the industry to put up its costs generally. The question that I shall come to is the balance between the domestic consumer and industry. That is crucial.

Mr. Arthur Lewis (Newham, North-West) *rose*——

Mr. Lawson: I have given way several times. If the hon. Gentleman will allow me a little more time, I shall give way to him. I know that he is concerned about standing charges.

Whether any further assistance specifically related to standing charges is needed is, as the House has already been informed, a matter for my right hon. Friend the Secretary of State for Social Services. My hon. Friend the Under-Secretary of State for Health and Social Security is conducting a review of that matter at present.

Mr. Arthur Lewis: This is not a political point. The Minister said that he had no power to instruct the Gas Corporation on the question of standing charges, because that does not come within his purview. That may well be, but he and the Department urge everyone to conserve energy. The right hon. Gentleman is running a campaign to conserve energy, but there are old people who do not receive the extra, because they are not on the supplementary benefit level, who conserve energy, and who then find that they pay more for the standing charge than they do for the gas. Ministers should not shake their heads. I have such constituents. They buy paraffin and paraffin oil lamps, conserve their gas and then find that the standing charge is more than the rest of the gas bill. Will the Minister investigate this matter?

I know of no organisation, private or public, that can, and does, draw money for nothing. Old people can go away to their relatives——

Mr. Deputy Speaker (Mr. Bryant Godman Irvine): Order. The hon. Gentleman is making an intervention, not a speech.

Mr. Lewis: The Secretary of State has given way, Mr. Deputy Speaker. I was making the point that old people go away on holiday or to see their relatives and when they return after four or five weeks find that although they have used no gas they still have to pay the standing charge.

Mr. Lawson: The standing charge is related to the costs—and there are costs. That must be accepted, and it was accepted by the previous Government. Incidentally, it is also accepted by the gas consumers council. There is a cost in connecting a house to the gas supply, in maintaining the connection and in all the safety work related to that. The consumers eventually receive bills, even if they are small bills. As I have said, my hon. Friend the Under-Secretary of State for Health and Social Security is conducting a review.

Mr. Spriggs: This is a very important matter. When the gas supply is connected the recipient pays in full, and after that he pays the quarterly standing charge. Why should people—especially pensioners and others on low incomes—continue to pay the quarterly standing charge?

Mr. Lawson: Perhaps I should not have given way, because many hon. Members wish to take part in this brief debate and I have already covered that point. There are many costs—billing, the maintenance of the connection, the safety force that the corporation must maintain, and so on. Everything except the cost of the gas itself is covered by the standing charge. Those costs exist. It is not simply a matter of a once-and-for-all connection cost.

The right hon. Gentleman alleged that we were putting up gas prices in order to cream off the resulting profits by means of the gas levy. There is no truth in that. When the levy was introduced a year ago, the corporation's financial target was reduced—to its present level of a 3½ per cent. return on current cost assets—specifically to take account of the levy.

The reason for the levy is simple. It has long been accepted by Governments of both parties that North Sea oil and gas are a legitimate tax base. The main instrument used—one that was devised and brought into being by the Labour Government—is petroleum revenue tax, which applies to oil and gas equally. No gas subject to PRT is also subject to the levy.

A large, albeit diminishing, proportion of the corporation's supplies comes from North Sea contracts signed before PRT came into being. It is this gas, and this gas alone, that is subject to the levy. In other words, the justification for the levy is precisely the same as the justification for PRT: the transfer of windfall or God-given profits to the nation as a whole. I repeat that none of this has had any bearing whatever on the level of gas prices, as can be readily seen, because my predecessor's policy was announced and was approved by the House in January 1980, long before the levy existed, and has remained unaltered by its coming into force a year ago.

If tax is a red herring, as it is, should we not subsidise domestic gas prices, as the Labour Government did? That is the proposition that has been put to us. If this is to come out of general taxation—and all subsidies must be paid for somehow—it is hard to imagine anything less fair.

There can be few of us, certainly on the Government Benches, who do not have in our constituencies villages where the people cannot obtain gas, even if they want to and many of them want to very much, since it is still cheaper than other fuels—simply because the village is not on the gas grid. Roughly a quarter of all the homes in the land are in precisely that position, and the proportion is much higher in the rural areas.

What possible justice can there be in charging those who can obtain gas less than the amount that those who cannot obtain it would be only too happy to pay, and then adding insult to injury by requiring the unlucky minority to pay out of their taxes the cost of the subsidies to the lucky majority? That is what the proposition amounts to. There is no running away from it.

That is clearly out of the question, so the real issue is as follows. I have mentioned the modest rate of return that the industry is required to earn. How is that to be secured as between the domestic consumer and the industrial consumer? We see that that is the question when we get to the bottom of it.

Under Labour, for reasons of short-term political expendiency, the supply of gas to the home was running at a loss. The entire return had to be extracted from industry, which was paying ever-higher prices to subsidise the domestic consumer. That was a fact. Had we not stepped in decisively, that imbalance would have become even worse and the burden for industry would be still greater. As it is, the increases in domestic gas prices over the past two years' have only brought the corporation to the point where it just about breaks even on this side of its business.

What those increases in domestic prices have done is to enable the corporation, with some help from my right hon. and learned Friend the Chancellor in his last Budget, to freeze industrial gas prices throughout 1981 and into the first quarter of this year. It is essential, on industrial and employment grounds alike, that we do whatever we can to help keep industry's energy costs competitive. The freeze on industry's gas contract renewal terms has been of crucial importance in this context, as the November NEDC task force report acknowledged.

That freeze, however, is now coming to an end. An increase of 3 per cent. in industrial gas prices is now due as a prelude to further increases later in the year. I am sure that hon. Members would prefer that modest rise to be followed by price stability. The Chancellor and I will look closely at this possibility, and it is clear that our freedom of manoeuvre, and indeed that of the BGC, will crucially be conditioned by whether the corporation is able to earn, pre-levy, a modest return from its domestic gas business—or whether, as before, industry is obliged to bear the entire burden on its own shoulders.

My answer to the point made by the right hon. Member for Leeds, South about bulk electricity prices is that that is also a matter that my right hon. and learned Friend and I are considering.

I do not think that I should say anything further about those two matters—industry's gas prices and bulk electricity prices—in advance of the Budget. That, at the end of the day, is what is at issue in this debate. The increase in domestic gas prices announced for this year will, for the first time, enable the Gas Corporation to earn, pre-levy, a modest but positive return on this side of the business.

Mr. Rowlands (Merthyr Tydfil): Pre-levy?

Mr. Lawson: I am talking about pre-levy. Post-levy will still be a loss. Pre-levy it will now be a modest return.

From April, the domestic running tariff will be about the same as the price of firm gas to industry. From October industry has, at long last, the prospect of paying slightly less for gas than the domestic consumer, as its competitors do abroad, and as it should do, since the cost of supplying industry is markedly less.

All that will be achieved with a domestic gas price which, as I have said, will still leave gas cheaper than alternative fuels. Of course, in the long run, the gas requirements of industry will be satisfied, both as to price and as to adequacy of supply, by the Oil and Gas (Enterprise) Bill, which the Opposition so dislike, since it

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will end the Gas Corporation's monopoly in this field and introduce genuine competition into the business of supplying industry with the gas that it so badly needs.

In the short run it was essential that we restored a proper balance between domestic and industrial gas prices if the competitiveness of British industry was to be secured and the most economic use made of this vital natural resource. That is what is now within our grasp. By October of this year the long and painful process of adjustment in domestic gas prices will be over and a real prize will have been achieved: a source of highly competitive fuel for our industry, soon to be enlarged by the fruits of competition, at the same time as the user in the home will still be paying less for gas than for other fuels.

That is the prize that the Opposition, with their foolish motion, seek to snatch from the people of this country and from British industry. I ask the House to reject that motion and to secure that prize.

4.22 pm

Mr. Robert C. Brown (Newcastle upon Tyne, West): The Government suffer from an obsession about the British Gas Corporation which, if translated into individual terms, would be classed as severely paranoid.

All last year we on this side of the House, together with most thinking people outside the House, had to beat off the attacks, based solely on doctrinaire obsessions, that the Government were making on the corporation. The House will recall the response from Conservative Members whenever the name of Dennis Rooke or the British Gas Corporation was raised. What caused that response? The British Gas Corporation destroys all the most precious tenets of the Government. Its industry is successful and the Government cannot bear success, particularly in a nationalised industry.

Thus we have seen attacks on gas showrooms, on the very structure of the corporation itself through the Oil and Gas (Enterprise) Bill, which we are considering in Committee. Now we see yet another attack through the price mechanism.

It is not good enough for the Secretary of State to say, on the one hand, that gas prices will become cheaper through the Government's privatisation measures—what I should prefer to call "piratisation"—of the British taxpayer in which the Secretary of State is engaged in Committee Room 8, when on the other hand, he is busy implementing a policy which effectively sees the domestic consumer as a milch cow to be drained to finance the public sector borrowing requirement. Thus, whatever good intentions the Secretary of State may have—I give him credit for occasionally having good intentions—in respect of gas prices, the combination of his measures will mean that the price of gas to the domestic consumer will continue to rise well beyond the planned price rises for the year.

Why are gas prices rising? It is true, and it would be foolish to deny, that it costs more for the British Gas Corporation to supply gas to the domestic consumer than it does to industry. But one of the joys of an integrated system and operation for gas is that costs can be averaged to the benefit of all. By putting up the cost to the domestic consumer, the Government are ensuring that those least able to pay will bear the heaviest cost.

Prices are rising not because the corporation needs the money—its massive profit of £350 million last year shows that clearly enough—but because the Government, having pledged themselves to cut taxes, have found it necessary to raise money in other ways. Hence the gas levy. During the Government's term of office prices in general have risen by 38 per cent. That is not a proud record for a Government who came to office with an absolutely firm commitment to fight inflation. Prices generally are 38 per cent. higher than they were two and a half years ago and inflation is still 2 per cent. higher than when the Government came into office. The price of gas for the same period has increased by a staggering 100 per cent. By that mechanism the Government have deliberately added 3 per cent. to the rate of inflation—a rise which could and should have been avoided.

Who suffers from those price rises? The gas industry and its workers certainly suffer because the public believes that they are responsible for this added imposition on an already stretched domestic budget. The consumer suffers, particularly those groups most at risk—the sick, the old, the very young and the unemployed.

It is no consolation to be told that during 1981 the rate of disconnection was the lowest for some years. That simply reflects the fact that people are choosing between heating and eating. That is clearly what has happened during the past few months. There is something obscene about a Government who put 3 million people on the dole, cut local authority expenditure so that facilities cannot be used to provide occupations and then freeze them out of their homes. There is something even more obscene when a Government cut old age pensions allegedly to claw back a small miscalculation and then force up gas prices so that the old people suffer twice for no crime at all.

The rise in gas prices is a regressive tax which hits the poorest people considerably. Those in the lowest income brackets spend 15 per cent. of their average income on gas. For those earning £250 per week or more it is only 6 per cent. There is not much equity in that. It is an impossible form of energy conservation which uses a direct and regressive tax as a substitute for a proper programme.

This is a price rise which nobody in the gas industry wants or needs and which will clearly satisfy the wild men on the Government Back Benches by creating even more unpopularity for what is, by any stretch of the imagination, a most successful industry.

4.30 pm

Mr. Anthony Nelson (Chichester): I have for some time felt a deep concern about increases in gas prices. I am sure that I represent the concern of many of my right hon. and hon. Friends over the impact that the rise in gas prices will have on the personal budgets of our individual constituents. There is no doubt that a rise substantially in excess of the rate of inflation this year will have an effect on their personal budgets, which will be to the detriment of money that they would have spent on other items in the household budget. The average rate of inflation is now about 12 per cent. and the private sector component is about 6 per cent.

It is clear that price rises in the public sector have had a direct and damaging impact on people's propensity to spend and on their net disposable incomes. That is bad for the private sector and bad for the Government's image.

The Government are rightly committed to restoring efficiency in the public sector and to reducing its size and the demands that it makes upon our constituents.

My right hon. and hon. Friends on the Front Bench will understand and share these sentiments. They, like their Back Bench colleagues, are Members of Parliament with constituencies that inevitably have within them many who are in receipt of the lowest incomes and whose personal standard of living will be hard hit. In many instances they will find themselves hard pressed by increased gas prices. It is right that we should express our concern on their behalf on this occasion.

Mr. Robert C. Brown: In the Division tonight, I hope.

Mr. Nelson: I shall make what I hope will be taken as a constructive comment in describing the direction in which I should like the British Gas Corporation to move, with the Government's influence, to correct the burden of the cost that it is placing on the consumer, who is in turn our constituent. It would be wrong for us to reinstitute price controls to hold down prices for gas or for other energy supplies. To do so is to build up a much greater problem for the future. The arguments for holding back price increases apply equally to incomes policies. They are short-term measures that are designed as political expedients, and with the benefit of experience we should not lend our weight to them. I do not support the arguments for having subsidies or restrained prices.

I accept the general thrust of the policy that the price level for gas and other energy supplies must reflect long-term production costs. I must also accept that some of the disparity that has arisen between industrial and domestic gas prices has to be reduced if we are to have an efficient pattern of demand. Judging by the way in which demand for gas was outstripping that for other energy sources a few years ago, the movement in prices has had some effect in stifling the increased demand.

Should we have a target rate of return? I believe that we should. It would be easy for me and for others who would like to see lower gas prices to say "Let us have a lower rate of return, perhaps even a negative rate of return, with the Government writing off a loss for the corporation." I understand that the former proposed rate of return of 9 per cent. was replaced after the gas levy and accounting changes with one of 3·4 per cent. That seems to be a realistic rate of return for a major corporation. It is not by any means a high rate of return. However, it is a real rate of return as it is post inflation. It is thoroughly right in the long term and we should seek a degree of bipartisanship in our modus vivendi. The industry should be well capable of achieving this target.

My second option, which is to lower the target rate of return, is one that I rule out. If we were to reduce it, it would result in the taxpayer having to write off increasing losses. It would almost certainly result in the corporation not having sufficient cash flow and reinvestment funds to fund the more costly extractive facilities of new gas fields.

There is a further option that I do not think has been mentioned enough. It is that the corporation should put its house in order. There is a great deal more to be said about the case for efficiency, economies and greater productivity within this great nationalised industry. I share with the right hon. Member for Leeds, South (Mr. Rees), who spoke on behalf of the Opposition, some degree of admiration for the improvements that the corporation has made in recent years, but I believe that it has a long way to go. What is more, many other nationalised industries have a long way to go in satisfying their customers that they are giving good value for money.

If we are to ask customers and taxpayers to shoulder the burden of much higher prices—prices that are rising by much more than the rate of inflation—they are much more likely to accept the reasoning for those higher prices if we can assure them that the corporation and other nationalised industries are putting their houses in order and making much needed economies in the same way as the private sector, which has certainly had to do so in recent years.

It is all very well to talk in general about efficiency and economy but what does one mean specifically? I shall suggest one area in which there is an opportunity for greater efficiency and economies to be achieved. A cause of great offence to many of my constituents is the many maintenance vans that circulate our districts. This applies not only to the gas industry. Probably the greatest criticism in this respect could be made of British Telecom. The criticism almost certainly applies to the other nationalised industries.

There is a great public conception—it is up to the Minister to argue that it is a great public misconception—that the productivity of maintenance workers generally is not especially high. This is something about which many of my constituents feel strongly. Many of them have written to me with allegations that maintenance vans have been parked for long periods in laybys. I have received letters suggesting that maintenance engineers from the nationalised industries call back much more frequently on a day-to-day basis than those from private sector companies that have to operate a similar service.

Mr. Eggar: Would my hon. Friend rule out the possibility of allowing the private sector to do all the maintenance work that is currently carried out by British Gas?

Mr. Nelson: I would not. My hon. Friend takes the very words from my mouth. That is an option that we should consider seriously, and it is one that the corporation should consider. If it is too traumatic to consider doing it in bulk, there is a case for proceeding on an experimental or partial basis in some of the regions.

I understand from the corporation's annual report that it employs over 120,000 people of whom over 31,000 are involved in customer service and conversion work. The wages bill is understandably enormous. If we were to achieve really tight control over the distribution of service, either by privatising it in part or in whole, or by carefully examining productivity and the way in which customer service and conversion employees operate, there would be a substantial saving. As a Member of Parliament I am not able to consider these matters in great detail. However, I suggest from the House to those in the corporation who consider these matters that a great deal of improvement could be achieved.

Last year about 15 million customer jobs were fulfilled by the customer service division of the corporation. That is a considerable number of jobs and a considerable amount of work was involved. I understand that there were about 500,000 visits to check on gas fire safety. Undoubtedly that checking is important but it appears that it could be done quite easily by the private sector. There

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is an argument for suggesting that the private sector should be allowed to tender for some of that work to ascertain whether corporation customers would get a better deal by proceeding in that way.

My criticisms should not mask the fact that there have been some improvements in targets and efficency of the customer services carried out by the British Gas Corporation. I pay tribute to those regions that have been awarded the "golden flame" and "silver flame", for maintaining high standards of customer services. I am also aware that there is a target standard of service for domestic customers, which has recently been revised. It is certainly no part of my remit to argue that the standard of service to customers should be substantially reduced. However, some pruning of costs could be conducted to the benefit of customers generally.

Finally, I eagerly look forward to the Budget Statement next week in the hope that we can give industry at least the prospect of certainty and restraint for future prices. It will be difficult for hon. Members to explain to their constituents why it will be necessary of the BGC—with its substantial liquid funds—to impose the sort of increases announced for this year. However, while I regret those increases, I support the need to move gas prices into line with others. Nevertheless, I reiterate, and cannot urge too strongly, that it would be far easier for people to accept these substantial increases if we gave them real evidence that this nationalised industry was being as active as the private sector has had to be in cutting back its own costs.

4.42 pm

Mr. David Stoddart (Swindon): In contrast with the Secretary of State's remarks, the hon. Member for Chichester (Mr. Nelson) seems to have some understanding of the problems faced by his constituents and other hon. Members' constituents throughout the country. However, I fear that he does not appreciate how small his suggested savings would be. They would be very small when compared with the 10 per cent. increase, at the Government's behest, in gas prices this year.

On privatisation, my local authority in Swindon only recently changed from using the British Gas Corporation to a private enterprise firm. Since that firm took over the maintenance contracts, there has been a huge flood of complaints, not only to me but also to members of the council. I would, therefore, beware of that route to so-called "efficiency".

The Secretary of State had a real chance to redeem himself this afternoon. He was the chappy who ratted on the Rooker-Wise-Lawson amendment on the indexation of tax allowances; he cheated taxpayers out of much money by not indexing the allowances in the previous Budget. He might somewhat have redeemed himself, as the Secretary of State for Energy, by cancelling the 10 per cent. surcharge tax on gas prices. However, he did not, and, far from doing so, showed a complete lack of sympathy for those who have to bear the increases. For the Secretary of State and his right hon. Friend the Prime Minister to tell people who are paying huge gas bills that their gas is being sold to them at too cheap a rate shows a complete lack of understanding, sympathy and compassion for those least able to bear those increases.

The Secretary of State also described the Government's decision to impose the 10 per cent. tax on gas prices, over and above inflation, as an act of courage. It was not an act of courage; it was an act of abdication of their responsibilities for proper conservation measures. It was the easy way out and they took it. The Opposition's suggestions are not the easy way out, but they are rational and decent. The Government took the easy way out by simply increasing prices over and above the necessary increases.

Mr. John H. Osborn (Sheffield, Hallam): Price is perhaps the biggest incentive to take note of on the need for conservation. If I am lucky enough to be called to speak, I shall try to explain to the hon. Gentleman how that has occured.

Mr. Stoddart: Price, while apparently being the only method of conservation known to the Government, causes hardship to a great many. If there are to be conservation measures, they ought to act directly on the flow of fuels. That is precisely what the Government failed to carry out. They had opportunities to ensure that there would be real savings of heat while maintaining comfort and reasonable conditions. That objective was swept aside by their sole aim of increasing prices.

On visiting constituents and organisations in my area during the spell of very bad weather in January, I discovered many cases of hardship; people were often afraid to turn their gas or other appliances on for fear of the subsequent bills. People suffered hardship and cold—particularly the old—because they were afraid that they would be unable to meet those bills.

The Social Services Department held special meetings to try to reassure people that the Government would not be so hard and that they would implement special measures. Indeed, I contacted the Department to obtain some reasurance. However, many people were very cold because they were frightened of the subsequent bills.

Some bills have now materialised and mine is some 50 per cent. above last year's level. Although I can afford to pay it, many poor people are devastated by receiving a bill 50 per cent. above their expectations. It is unfortunate that the Government have shown such an unsympathetic attitude towards them.

I was horrified when I heard that the gas price was to be increased in a year by 22 per cent.; 10 per cent. plus 12 per cent., which really means 23·2 per cent. over the year. Therefore, I put down early-day motion No. 239 which was signed by 169 hon. Members. Seven others signed sympathetic motions. That shows the great feeling existing that the Government ought to alter their policy on the 10 per cent. surcharge.

An amendment was proposed by the hon. Member for Bedford (Mr. Skeet) and he was the only signatory. His amendment is sympathetic to the Government's policy, but nobody else saw fit to sign it, which shows that the anti-Government feeling on this issue is far more widespread than we might think by this afternoon's attendance. The failure of hon. Members to sign the amendment proposed by the hon. Member for Bedford shows a silent and surly protest over a Government policy that hon. Members know will affect their constituencies. I hope that they will follow that silent and surly protest by failing to vote for the Government amendment tonight. Perhaps that is too much to hope for, because Conservative members are usually loyal to their Front Bench in most circumstances.

Mr. T. H. H. Skeet (Bedford): I hope that the hon. Gentleman will soon finish his speech and that I can catch your eye, Mr. Deputy Speaker, so that I can deal with some of the allegations that have been made.

Mr. Stoddart: I was not making any allegations. I was merely dealing with the facts as I see them on the Order Paper. I was making my own assumptions and comments.

The Secretary of State also talked about the long-term policy of the Government on conservation and prices. We are dealing at the moment with a specific circumstance and with matters as they now are. The Secretary of State also told us that industry is subsidising the domestic consumer and that the domestic consumer has had it easy while industry has had to pay much more. That argument needs closer examination. I understand the position of industry and the cost that it has had to bear compared with its competitors abroad. We have considered those matters in the Select Committee on Energy. I understand the argument and I sympathise with industry, but there is another side to the coin. The domestic consumer, although appearing to pay rather less than industry, pays a good part of the infrastructure costs of the industry, which would be much greater if the flow of the commodity were smaller. That argument is being put forward by the Government, but it needs more careful examination than it is being given. Even so, it is not good enough to say to the domestic consumer that under present circumstances he must be forced to pay the 10 per cent. surcharge, which neither the domestic consumer nor the gas corporation wish to have. Consumers look askance at a Government, at a time when they are suffering hardship with unemployment and other matters, who raise the price of an essential commodity to generate a tax take of about £750 million. Those consumers will not appreciate that.

This is the time for the Government to reconsider their long-range strategy, which is now in a bad way, to see how it effects people. Over 3 million people are unemployed. The Government are trying to insist to their employees that they must either take a low increase in salary or none. They say to most people that they should have an increase in salary of only 4 per cent., yet at the same time they are increasing gas prices by direct intervention by 10 per cent. over and above what the corporation feels is necessary to balance its books. The Government should now cancel that increase, which is what I sought in my early-day motion.

There have already been exchanges about the standing charge, which has caused much comment and a great spate of letters to every hon. Member. Perhaps it is not realised that, in the past two years, the standing charge has increased by more than 300 per cent. That is an enormous, unfair and inordinate increase. In equity, the Government should at least discuss the matter with the British Gas Corporation, because people—especially old people and those who use little gas—feel a great resentment that they are often paying much more in standing charge than for the commodity used. I urge the Government to take up that matter with the British Gas Corporation.

The Government, by their attitude so far, have shown an entirely unsympathetic view to the consumers. With circumstances as they are, I would expect them, if not to support the Opposition motion—it calls for a cancellation of the increase—to the hilt, at least to cancel the instruction to the corporation that it should increase prices by 10 per cent. above the rate of inflation. Nothing else will do.

Mr. Michael Morris (Northampton, South): On a point of order, Mr. Deputy Speaker. At a meeting of the Committee on the Oil and Gas (Enterprise) Bill this morning, the Chairman accepted a sittings motion following representations from Opposition Members that they wished to take part in the debate, but there is only one Member here.

Mr. Deputy Speaker: Whatever happens in a Standing Committee is not a matter for me.

4.55 pm

Mr. Michael Latham (Melton): The hon. Member for Swindon (Mr. Stoddart) put his points with his usual fluency and determination. It is a matter of regret that there are hardly any Labour Members present to listen to them, as indeed there were hardly any Labour Members here to listen to the Opposition spokesman, the right hon. Member for Leeds, South (Mr. Rees), when he opened the debate on this censure motion.

It is a matter of considerable regret to me that I take part in the debate at all. Only once before have I been unable to support the Government, and that was about the nationality of the people of Gibraltar. I am especially sorry that I cannot support my right hon. Friend and Leicestershire colleague, the Secretary of State. He has been lumbered with a policy that he did not devise. Perhaps he supports it now—whether out of duty or conviction or both. However, I am sure that his political antennae, which are considerable, would never have allowed him to devise it in the first place. This policy is born of academic unwordliness mated with producer self-interest. It does nothing for the consumer. It undermines the Government's wider economic strategy and hits hardest at some of the thriftiest members of the community. It is not even needed by the gas industry.

Of course, I understand the intellectual justifications for the policy that new gas fields will cost more, that domestic gas barely breaks even, that demand greatly exceeds supply and that higher prices may induce conservation. All those reasons are familiar. As Eliza Doolittle said in "My Fair Lady":

> "There isn't one I haven't heard".

However, I strongly blame myself for the fact that I allowed myself to be persuaded two years ago, against my better judgment, to support the Government. After all, there is a different academic argument about gas, which energy Ministers prefer not to deploy because it upsets other producers. That argument could be that gas is, in essence, a cheap and popular product. The customers wish to use it extensively. Competition would encourage other energy producers, especially those involved with domestic or industrial heating and cooking, to hold down their costs and prices.

But instead we have a Conservative Government imposing a deliberate price surcharge on this popular product and then countering with an excess profits tax to cream off the results of that levy. That is producer-dominated economics in any language. The only justification for it is along the lines of the experts who favour the artificial restriction of energy sources in the alleged interests of guaranteeing supplies for future generations.

What hogwash those predictions have turned out to be. If every producer-dominated forecasting organisation had its computers thrown down an oil well and its slide rules

[Mr. Michael Latham]

turned into the sails of a windmill, not a bird would fall from the trees. My right hon. Friend, with his fine sceptical mind, should find out what the energy experts want and do the opposite. In a literal sense, as far as energy is concerned, sufficient unto the day is the evil thereof.

Of course, this not just an arcane academic issue, as the great Bishop Latimer once called it,

"for school-doctors and such fooleries".

It is directly contrary to the Government's counter-inflation policy. Nothing is more important to the success of the Chancellor's wider economic aims than sensible wage settlements in the current pay round. Ministers continually tell the public, quite rightly, that job prospects depend vitally on keeping down unit costs in our factories. No one doubts that. Hundreds of thousands of jobs have been lost because we failed to stay competitive. There were some suicidal settlements from 1979 to 1980 and we are all paying for them now.

It is unreasonable to expect negotiators to ignore externally imposed costs. From September 1980 to September 1981 the level of inflation in the public sector—the nationalised industries—was double that of the retail prices index. It was around 22 per cent. against 11 per cent. In many parts of the retail trade prices actually fell and the rate of inflation was negative. This high level of public sector prices cannot be reasonable or sensible. For this wage round, it is little short of suicidal.

Private sector wage settlements continue to be modest and sensible, public sector ones less so. We all know that nothing would make for an easier and quieter pay round than if there were a price standstill for 12 months in public sector charges. For some of them, such as steel or the railways this is patently impossible without massive Government subsidies, as happened in 1972 and 1973. None of us would welcome such subsidies, which were introduced by a Conservative Government and abolished by a Labour one. But the profit-making nationalised industries, such as gas and telecommunications, do not need sharp price increases this year. Their prices could be held steady without financial harm to those nationalised industries as a whole. There need not be a penny of Government subsidies and the help to wage negotiators would be enormous.

The effect on the public would be considerable. My right hon. Friends would be well advised to appreciate the strength of public feeling on this matter. Although the April gas price increase will be the fifth in a series of six announced two years ago, it comes at a time of extreme public exasperation at rising public charges. It will need to be paid at the same time as sharply increased rate and rent bills and rising telephone bills.

Most people are seeing their standard of living fall as wage increases fail to reach the level of inflation. That is inevitable and, unfortunately, necessary, if economic stability is to be achieved, but there is no need to add to the problem unnecessarily.

People could understand gas price increases if gas were making a loss. They might even accept an increase in line with inflation, if they were persuaded that it was necessary in the interest of conservation of supply. But to persuade them that a product that is in such substantial profit that it merits an excess profits levy should be raised in price by 10 per cent. more than the rate of inflation at a time when standards of living are falling, requires a combination of the reasoning of Socrates and the oratory of Demosthenes. Even my right hon. Friend the Secretary of State might find that a hard act to follow.

Mr. Skeet: I am concerned about my hon. Friend's approach to the levy. The British Gas Corporation never paid petroleum revenue tax on its earlier gas, and unfortunately it did not pay the producers a large sum. Therefore the corporation bought cheaply and sold expensively, and it is on that and that alone that the levy is imposed.

Mr. Latham: My hon. Friend can go over the technicalities as much as he wishes. I am trying to think of the consumer on this occasion.

I accept at once that there is a new generous heating allowance, helping 2½ million people. I welcome this innovation by Ministers, but it is of no help to the modestly paid and it is particularly galling to the recently retired with some modest savings and occupational pensions. These are the people who most resent the gas price increases—elderly people who do not qualify for supplementary benefit or other means-tested assistance, and who pride themselves on their thrift and personal independence. I am sure that Ministers recognise immediately the type of people to whom I am referring. They are a vital bulwark of the Conservative Party and we ignore their annoyance and dissatisfaction at our peril. They have no unions to fight for them. They have only this House. We should listen to their voice.

Ministers argue, as did my hon. Friend the Under-Secretary of State in two answers to me on 23 February, that it is essential that the three-year programme to correct "imbalances in the gas market" be completed and that this is the last year of the programme. As for 1983, no decisions have yet been taken. If Ministers want my support tonight they will have to go further.

I accept that the April increase will have to go ahead; it is probably too late to stop it now. That alone could raise prices by nearly 13 per cent. in 1982, above the current rate of inflation. We do not need the further 10 per cent. increase in October. That should be cancelled forthwith. As for 1983, my right hon. Friend should say tonight that the wider interests of counter-inflation policy lead him to believe that the correct gas increase for next year is nil, or, at the very most, 3 per cent. below the rate of inflation. If the Government listen to their supporters in the country, they will take action along those lines.

I did not want to have to make this speech, but I make an appeal to my right hon. Friend, whose intellect and shrewdness I greatly respect, which I hope will register with him. He should ask himself whether artificially high gas price increases, accompanied by excess profit levies, are a natural policy for the Conservative Party. Do they meet any basic Conservative criteria? Do they help consumers? Do they reduce inflation? Do they minimise public sector burdens? Do they, in any way, feel right from a Conservative point of view? The answer to those questions is "No". We still have time to get things right, but we should start tonight.

5.7 pm

Mr. David Penhaligon (Truro): In the debate on the original legislation, I expressed little sympathy for what was being proposed. I feel that past increases make the argument for cancellation of the future increases even stronger, as the hon. Member for Melton (Mr. Latham) has just said. Gas is the cheapest fuel, and some areas do not have access to it. That means that there is a considerable disparity between those areas that have gas and those that do not. I am as aware of this, in my part of the country, as any hon. Member. I should be surprised to learn that even half of my constituents have access to gas, although I have never investigated the matter.

Therefore, I repeat the argument that I presented the last time we discussed this. The Government could have proposed this legislation originally on the basis that gas is the cheapest fuel and that that it is unfair to some consumers, and that the enormous sums being raised by this tax on gas will be used to promote a massive conservation programme throughout the United Kingdom, or as some form of help for those obliged to use other forms of fuel. Had that been done, I could have seen the object of the proposals.

The Government propose to do neither. People in some of the more remote parts of the country have yet to enjoy the delights of electricity, let alone the delights of gas. Their fuel bills are a tremendous embarrassment to them. Therefore, I support the Opposition motion. I do it for once with the real conviction that they are promoting something that is right and proper, and good for the general interest.

If the Government tonight said that the Budget will announce that the massive sum being raised is to be used to help people with other fuels or to encourage conservation, insulation or draught proofing I would see the logic of the Government's stance. However, it is clear that their only interest is the amount of money produced for the PSBR. As one who believes that the PSBR is not one tenth as important as the Government tell us that it is, I can see little good reason why anybody on the Liberal Bench should support the Government tonight. I hope that Conservative Members, who have said things tonight that I rather admire, will go into the Division Lobby to show Government that there is not universal support on their side for this motion. Certainly, from reading comments in the local press it seems that there is not universal support. Government Members seem to interpret all these price increases as sheer incompetence on the part of British Gas—which, clearly, is not true.

I hope, therefore, that Conservative Back Benchers will push the Government in this respect. The power to persuade the Government to change their minds is totally in their hands. I suspect that the Opposition will be united against the Government proposals. I would settle for a clear statement from the Government that the money will be used to help people with their fuel bills because that is the logic of the argument that they have adduced. Until we get an assurance on that, I see no reason why I should persuade my colleagues to support the Government.

5.10 pm

Mr. John H. Osborn (Sheffield, Hallam): My hon. Friend the Member for Melton (Mr. Latham) lucidly expressed the concern of many Government supporters, and I have immense sympathy with what he said. Nevertheless, this debate is about the price that the housewife, pensioner, the aged and the infirm have to pay for their hot water, house heating, and cooking. I cannot accept the "opportunism out of hypocrisy"—to use the words of my right hon. Friend the Secretary of State in his accurate description of the speech of the right hon. Member for Leeds, South (Mr. Rees).

The Opposition motion says

"That this House regrets the decision of Her Majesty's Government to increase domestic gas prices by 22 per cent."

In fact, this matter should not be the concern of Governments. That is why the Government are in a mess. The tragedy today is that even a Conservative Government, because of the inheritance of three periods of Socialist Government, cannot escape some responsibility for the gas industry and British Gas. As I have said before, and I do not hesitate to reiterate now, after every Socialist Government, Conservative Ministers find themselves presiding over the legacy of their predecessors. That is what is happening to my right hon. Friend today. One of the direct causes of the muddle over gas prices is that for too many decades in energy production and distribution, true market forces and pressures have been absent. Perhaps this is the catastrophe of nationalisation. It is one more instance in which it is difficult for Members of Parliament to do other than describe the ills as opposed to finding the solutions.

What can we do about the problem? There are political and technological aspects to it. Many of us, including myself, both in European Committees and in the energy studies committee and other committees, are concerned and hope that Governments can pick their way out of the mess and find a solution.

First, I shall deal with some of the political aspects of the situation. In Sheffield, where I live, let alone other cities and towns, three generations of people have been nurtured on the Welfare State. Those people believe, as of right, that they should have cheap and subsidised housing, bus fares—this is typical of South Yorkshire—and education. To all intents and purposes, in an economic sense they live in a type of Communist society parallel to that which prevails in the Soviet Union and Warsaw Pact countries. This approach extends to energy—the heating of the home, heating for cooking, and lighting.

This debate is about gas prices and gas policy. Therefore I shall seek to confine my observations to gas. However, the production and the marketing of gas cannot be isolated from the production and marketing of oil. Gas and oil tend to be found together, and gas is often the by-product of oil extraction. Oil is a market-oriented product. It is more readily transportable. Regrettably, it has a world price, which is normally set by OPEC countries. However, in the long term—in spite of short term distortions—the price of gas, given free market forces, cannot be isolated or unconnected from the price of oil, which is now so expensive that we as consumers are learning to do without it. Indeed, that is why the price of petrol has come down. Today, if oil, because of political manipulation of its prices for political reasons by OPEC, is to too great an extent subject to obscure market forces, the long-term situation of rising scarcity cannot be avoided. Thus real pressures face gas, electricity and coal, and I shall deal with three aspects of the problem.

First, 22 years ago, I made my maiden speech on gas. As an industrialist, I was aware that the cost of heating in the factory that I was about to build, let alone that in my home, would depend on adequate standards of insulation and adequate heat conservation. Unfortunately, what were high standards 22 years ago are indequate today. It is even

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more unfortunate that we have a large stock of housing which is damp and is subject to uneconomic heating because of the poor insulation. Perhaps it would be right to have a grant, subsidy or some form of tax assistance for more heat conservation measures, in spite of what the hon. Member for Swindon (Mr. Stoddart) said.

In the last 10 years, the price of gas has fallen, while the price of oil has more than doubled. I had to decide how to heat my house. In 1960 I thought that electricity would be the answer. In a country that has hydro-electric power—Norway is still such a country, in spite of its gas—electric heating makes sense. I chose oil, but oil is now expensive, and when I was forced to bring in a new form of heating when replacing my existing system, I chose to be dual-fired. Eventually, gas and oil prices per therm must balance, and to depend on one is false economy. I come back to the point that heat conservation is all important and that we should take steps in this direction, including double glazing, insulation, and better building standards.

Second, since the Yom-Kippur war in 1973, Members of Parliament have been aware of the growing scarcity, but there are many people in the country who do not want to know about it. My right hon. Friend talked about the Price Commission report in June 1979 and the need to increase gas prices by 30 per cent. in equal increments, the last of which is the 22 per cent. that faces us now. Industrial consumers feel that they are subsidising domestic consumers. The balance between industrial and domestic prices should be explained, not only in this country but throughout the Community. In Germany and France, the domestic consumer pays half as much again for his gas as his counterpart in this country. I hope that my right hon. Friend will take care when he answers my questions next Monday. We hope that something can be done. The Oil and Gas (Enterprise) Bill is a move in the right direction, but could the announcement about this latest tranche of price increases already agreed to not have been made more tactfully, and could not the situation have been explained by my right hon. Friend? I suspect that the chairman of the Gas Board has not been very helpful. I hope that my right hon. Friends will explain the situation.

My third point is a political one. I have Conservative supporters in my constituency who cannot accept these increases. It is not only political opponents who cannot accept them. Yet when I say to industrialists that energy is scarce and that the price is bound to increase in one form or another, they still expect the Government to do something about it. That is the difficulty in which my right hon. Friend finds himself.

I shall conclude my speech by making one or two technical observations. Some hon. Members were with one of the oil companies today. I am concerned about the production companies who are members of the United Kingdom Offshore Oil Association. They are concerned that the petroleum revenue tax and other taxes are taking 85 to 95 per cent. of the balance between the cost of production and extraction and the sale price. Unless the market prices are high enough for the gas that they produce, it will not be worth while extracting the gas in the marginal fields. In fact, it is hardly worth while building the pipeline.

That has been my right hon. Friend's trouble with the gas-gathering pipeline. At the end of the day, there is a monopoly buyer for gas. Even the Oil and Gas (Enterprise) Bill leaves a monopoly with regard to the domestic market, which probably accounts for 75 per cent. of total sales of gas. Therefore, my right hon. Friend has nibbled in the right direction, but I doubt whether he has gone far enough.

The problem of the price of energy, whether to the domestic user or the industrialist, is still great in Sheffield. Recently my right hon. Friend enabled some of us to have a presentation of a tariff structure from the Electricity Council. It is reassuring to note that in the steel industry in Sheffield it is beginning to make sense for electricity, but the renegotiation of gas tariffs is agony for the members of the British Independent Steel Producers Association and the steel industry of Sheffield.

As a Conservative Member of Parliament, over the past 12 months I have had to account for Government decisions in this area which I fully support. I should have liked to see the National Coal Board, the British Gas Corporation and the Central Electricity Generating Board explain to their users and to their customers, as I have had to do, as do salesmen of other products in a free enterprise world, more of what their problems are and more of what their policies are. But because they are State monopolies they can turn to Governments and Members of Parliament supporting the Government to do it for them.

I turn briefly to a long-term strategy. there is oil in the North Sea, and the British and the Norwegians have it. There is also gas in the North Sea. In a different sense altogether, the Germans and French find that because of a lack of entrepreneurial flair in Britain they are not able to get the gas. If they can obtain gas more cheaply, let the British have access to that gas. If they cannot, let us have the opportunity of selling it. I hope that Britain, Norway and other EEC countries will join together on gas as they are beginning to do with electricity, so that European countries can tackle the problems together. The consumer wants to be treated fairly, and because of the circumstances of the past 30 years, he rightly bears a grudge and the Government must face that.

5.22 pm

Mr. Arthur Lewis (Newham, North-West): I congratulate the hon. Member for Melton (Mr. Latham) on a courageous and honest speech. I have been in the House of Commons for a long time—too long, no doubt. I have been in the House for 37 years and I can tell the hon. Member to stand up for his convictions and for what he believes and to vote for what he believes because——

Mr. Russell Kerr (Feltham and Heston): My hon. Friend has voted against the Government and the Whips.

Mr. Lewis: I have done that many times. The hon. Member will find that in time, when he is proved right, he will be pleased. He will also find that some, if not the greatest, parliamentarians were in the same position as he is in today. The hon. Gentleman should take no notice of Ministers who try to talk him out of standing up for his convictions. They all do that. I was one of the original Heinz 57 varieties. I am proud of that.

Other Conservative Members should understand that this is not a political issue, but a humanitarian issue that affects every one of our constituents. There is not an hon. Member here, irrespective of whether his views are Right, Left or Centre, who can find anything to complain about or contradict in the motion, which states:

"That this House regrets the decision of Her Majesty's Government to increase domestic gas prices by 22 per cent. in 1982".

Will anyone tell me that he does not regret that decision? If so, let him tell his constituents and the House, or let him get in the local press. The motion also states:

"and demands that this policy be not implemented."

It might have been better if the word "requests" had been used. The only wrong word that any hon. Member can find in the motion is "demands" instead of "requests".

Every hon. Member is concerned with the matter. I am not concerned whether he is rich or poor or whether he represents an industrial or a rural constituency. In our constituencies old age pensioners, the sick, the disabled, the blind, the infirm and so on cannot meet their bills. We receive letters from those people telling us that they cannot meet their bills.

Many people receive pensions today who have saved a little money and have been thrifty. They have gone without holidays or colour television so that they can put by a little money. However, they find that someone else who has not been so thrifty, who has a colour television and has been on holiday in Majorca can receive help with his gas bills. Therefore, the people who have saved money feel hurt. They ask: "Why am I told that my gas bill will go up again by 22 per cent? What have I done to deserve this?"

Those people might have an old black and white television and turn it on only to see that a Government Department says that we should save energy. Those people have cut down, however, and might not have used any gas in one quarter, but they still must pay the standing charge, which has also risen.

The Minister says that he cannot interfere. Of course he can. The late, great Aneurin Bevan once said in the House that the House could do anything except give a man a baby. If the Minister wanted to act, he could do so tomorrow. He could see that the gas prices are reduced and that the standing charge is stopped. A special regulation or Bill might be required, but I am sure that if the Minister came to the House and said that both sides of the House were asking him to stop standing charges, so he would have to introduce a Bill, he would get it through on the nod.

Mr. Dennis Skinner (Bolsover): If the Tory Government are concerned about where they would get the money, I can tell them that there are plenty of areas where they are spending money unnecessarily. Billions of pounds are being spent on useless defence. In the last few days shares at Amersham International have been bought, amounting to a loss to the taxpayer of £25 million. Why should not that money be used for the standing charge?

Mr. Lewis: If my hon. Friend had heard my opening remarks he would know that I have no intention of being political. He is stirring up the political aspect, but I am serious. I do not want to do that. This matter is above politics.

I have heard the Prime Minister say that she feels sorry for the nurses. I believe her. I think that she does. She says that she cannot interfere, but she is increasing the price of gas, and nurses use gas. The hon. Member for Macclesfield (Mr. Winterton) is fighting like billy-o for the textile workers. Many textile workers are unemployed, but they also have gas bills.

The Government have told the nurses that they cannot have more than a 4 per cent. pay rise. The textile workers dare not ask for anything because of unemployment. However, the Government are increasing the price of gas by 10 per cent. above the rate of inflation. How can the Government say to people such as Mr. Arthur Scargill, "Your miners must not ask for much in the way of wage increases, but we are going to increase gas prices by 22 per cent."? I know what Mr. Scargill will say.

The Government are deliberately causing inflation. They are deliberately exacerbating the industrial problems that confront the trade unions and employers. Their actions are making things difficult for the poorer paid sections of the community. The Government's amendment states that they will tackle the under-pricing

"over a three-year period".

The Government do not say what will happen at the end of three years. Is the process to cease, or will there be an annual revision?

Mr. Geoffrey Lofthouse (Pontefract and Castleford): Will my hon. Friend agree that Mr. Arthur Scargill will be very upset with his members if he catches them burning gas?

Mr. Lewis: The point I seek to make is that if the trade union leaders—coal miners or anyone else—see the Government deliberately increasing the weekly expenditure of their members, they will naturally use that as support for further wage claims.

The nurses, the civil servants, public service workers and local government officers have all been told that they cannot have more than 4 per cent. I do not argue whether the Government are right or wrong—they may be right—but the Government are setting this limit of 4 per cent. and at the same time deliberately increasing gas prices by 12 per cent., whether those workers like it or not. Even the gas boards do not want the higher prices.

That is a ludicrous approach. The Government are deliberately causing inflation and harming the poorer sections of our population. They are deliberately causing difficulties for industrial peace. How can anyone support the Government in that?

Some Conservative Members might feel that they should not support the Government. They should not worry about threats of the Government falling. This situation used to happen regularly. In 1945 it was argued that the Government would fall over a proposal to increase the cheese ration by 2 oz. Never in your life.

The Government will have to accept the will of the House and find some way of meeting it. They will not call a general election merely because some of their supporters did not support them on a 22 per cent. increase in gas prices. They will find some way of putting it right. Conservative Members who supported that approach would gather the glory in their constituencies. They would be able to claim that they had achieved something good for their constituents and for the Tory party. It would be the Tory party that gained the credit.

Standing charges are a crying shame and disgrace. I know of no other industries, private or public, which charge people for something that they do not have or do not use, and that may not even exist. Those who leave their homes for some good reason, probably to look after an aged and sick father or mother, or even a girl friend, may not use a single therm of gas for the whole 13 weeks of the quarter. Yet, when the bill arrives, it still contains the standing charge. Those who are away from home for six months will face the two sets of standing charges.

[Mr. Lewis]

I am not presented with a standing charge when I take my car to be serviced or my suit to be repaired. I am charged for the work. It is a farce to say that the standing charge is for road openings and such matters. It is simply an easy way to tax the poor, the sick, the disabled and the infirm who cannot escape the charge.

Mr. Nicholas Winterton (Macclesfield): Will the hon. Gentleman not agree that the same facilities were previously provided without the standing charge and that the monopolies operated at a profit? Why is there the need to tax us through these standing charges which most people, as the hon. Gentleman says, find unacceptable? I agree with the hon. Gentleman. I am one of those hon. Members who intends to exercise his right as a Back Bencher. I shall not support the Government. I shall not support the Opposition motion. I shall, however, abstain to show my objection to my Government's energy policy.

Mr. Lewis: The hon. Gentleman has a good record. I accept that he cannot support the Opposition. He has, however declared himself. It is ludicrous, when a profit is being made, that there should be such a charge. It applies to only three undertakings, electricity, British Telecom and gas. There is no standing charge for water. [HON. MEMBERS: "Yes, there is."] I stand corrected. That makes things worse. There is nothing to stop the Government announcing tonight that they will find ways of ending this situation. I do not want to hear what the civil servants and advisers say. They rule the country. I have watched Front Benchers arguing and fighting between themselves. I have been here long enough to know that the speech read out by Ministers of one Government is the same as that read out by Ministers when the other side assumes power and that it is prepared by the same people.

The civil servants have to be told to find some means of ending this situation. The Government can say tonight that, although they have not yet found a way, they are pledged to end these pernicious standing charges.

5.38 pm

Mr. Kenneth Lewis (Rutland and Stamford): The debate so far has ranged over the economic, political and social aspects of the subject under discussion. The Opposition have placed great emphasis on the social aspects. That aspect cannot be disregarded. It is to the credit of the Government that they are spending, as the Minister stated, a very large sum, amounting, I think, to £250 million on the social aspect. I commend them for that.

I take the opposite view to the Minister on this matter because I do not want to see an escalation of the money that must be paid out on the social side. I would prefer that the price was not increased so much, so that more people could afford to pay. I agree strongly with what my hon. Friend the Member for Melton (Mr. Latham) said. He suggested that many people who do not claim social security are hard hit by price rises of this type.

Energy is an important commodity in Britain. We have long, bad winters. People have been encouraged to install central heating appliances and many have chosen gas. The Minister must know that there has been an increase in gas customers in recent years. By my book, when the number of customers rises, the price of the product should fall. We are therefore going contrary to the normal market situation and the Government are encouraging it.

For two years I have lived with the doubling of prices. I accept that the Government were right to do that. The Opposition had held back increases for political reasons. The figures are there to see. The Labour Government held back prices partly for political and partly for social reasons. They felt that there was some advantage to be gained from doing that. The present Government have had to catch up. We have lived with that process for two years.

When the Minister announced the plan for price increases two years ago, I said that I would not commit myself three years ahead. I believe it is not justifiable to double prices three years on the trot. I have no intention of voting for the Government amendment today unless the Minister will compromise. As my hon. Friend the Member for Melton said, the Minister can compromise easily by making do with one increase of 11 per cent. I do not understand the reasoning behind the assertion that this would actually entail an increase of more than 11 per cent., but if the Minister increases that figure by a further 2 per cent. or 3 per cent., I could live with that and I think that my constituents could live with it. I will not accept that it is justifiable to have a double increase again this year.

I am sick and tired of nationalised industries imposing inflationary price rises. This one, like some of the others, has been encouraged by the Government. We hear from Treasury Ministers—the Minister has just come hot-foot from the Treasury—that we must beat inflation. We have heard that for a number of years from Treasury Ministers and from the Prime Minister, who is First Lord of the Treasury. I do not disagree with that, but we have spent more than two and a half years trying to beat inflation. So far as the nationalised industries are concerned, with inflation the Government are tackling a moving target. They cannot achieve the reduction that they want because those industries increase prices and so inflation as fast as the Government try to bring it down. Nationalised industries are the Government's industries. They are not run by the Government, but the Government control them. It is the Executive, not the House of Commons, which controls them.

Every price increase stemming from the nationalised industries is an increase in the cost of living index. There is a price increase more than once a year. Tonight it is gas, but the same applies to electricity, telephones, postage, and the rest. If the industry is owned by the Government, people must pay higher price increases than for commodities produced by the private sector.

My right hon. Friend made the fair point that the Government were imposing a double increase in gas prices for the third year running because they wanted to equalise prices, as industrial users had been paying more and domestic consumers had been paying less. I have looked at the figures, and I reckon that they have already caught up. Certainly, by the time that the 11 per cent. increase has been imposed in April, the domestic users will have completely caught up. Industrial users will be better off than they were when the Government came to office, and they will be no worse off if the Government decide not to impose the extra second increase on the domestic tariff.

The aim of the Oil and Gas (Enterprise) Bill now in Standing Committee is to put the production of North Sea gas on a competitive basis. Presumably, gas will become cheaper. Otherwise, it would be pointless for a

Conservative Government to put the Bill through. We obviously believe that competition makes things cheaper. If it makes gas cheaper, as I believe that it will, there will be no need for the extra price increase in October.

I am sure that my right hon. Friend has noticed that the price of oil has been falling steadily. We know that it will not go right down, but it will fall a little further and it will stay down. That was predictable. The Government will lose a little tax, but they gain a great deal of tax from North Sea oil in any case. Gas prices must be related to the production cost of oil. So the likely effect of the Bill now in Committee and the prospective reduction in oil prices justifies the Minister saying today that the Government have been convinced by the arguments of Back Benchers, especially those of his hon. Friend the Member for Rutland and Stamford, and that the Government will therefore make a concession.

The Government are trying to keep increases in public sector wages and salaries down to about 4 per cent. I have not noticed the Gas Corporation keeping pay increases down to the Government's norm. If workers employed by the corporation see that the Government are imposing further price increases on the consumer and see the revenue of their corporation being topped up, will they not regard that as justification for seeking higher wage awards? The Government would do better to tell the corporation and those employed in it that they wish to give the consumer a fair deal and that the employee should support that fair deal by not demanding large wage and salary increases.

My right hon. Friend has said that this is the third and last year of the big increases—[HON. MEMBERS: "There is a General Election soon."]—and then there will be a concession and medals for us all. [HON. MEMBERS: "And votes."] My right hon. Friend might be promoted next year. One Minister never binds his successor. Whether or not that is so, I do not like large increases one year and small increases the next year. I thought that we were complaining about the Labour Party doing just that. I should prefer a reasonable increase in 1982 and another reasonable increase in 1983. The consumer is fed up with the swings and the roundabouts and wants a little bit of "steady as you go" on pricing, particularly with pricing where the Government are involved.

In the private sector, prices are steadying across the board. Many of them are falling. In the next few years the Government cannot afford to allow high price rises to continue in the public sector. We have had enough of that. It is the duty of Ministers—in the interests of the country—to ensure that this escalation stops.

5.51 pm

Mr. Geoffrey Lofthouse (Pontefract and Castleford): This debate is similar to that on pensioners a fortnight ago. Several hon. Members have been shedding crocodile tears. I do not mean any disrespect to the hon. Member for Melton (Mr. Latham), who made a very good speech. I hope that he and those who have expressed their concern about the increase in gas prices, will show the British people who will have to pay them that they mean what they say. If they do not do so, the debate will have been futile.

The debate has continued along the same lines as most debates in this Chamber. I do not say that other Governments have been better than this Government, but they seem to think that the main defence in such debates is to prove that the right hon. Member for Timbuktu said something a little different when he was in Government. That does not alter the problems created for our gas consumers by the vicious decision to increase gas prices by 22 per cent.

It cannot be refuted that this is purely and simply a back-door method of taxation to ensure that lower paid workers pay the same standard tax as higher paid workers and those on vast incomes. There was a similar policy behind the overall 15 per cent. increase in VAT. That is what this is all about. If it is not, the Minister should tell us what it is about, because people have a right to know.

My hon. Friend the Member for Newham, North-West (Mr. Lewis) said that politics should not be brought into such a debate. I do not know how you can divorce politics from this issue, but I appreciate the point.

In the last year's annual report of the British Gas Corporation, Sir Denis Rooke said:

> "After such a year the management of most businesses would expect the owners to want them to continue in the same vein and perhaps to ask them if extra support might add to the achievement in future years."

That is common sense. A successful business could well be expected to carry on in the same vein.

As recently as 25 February, the North Eastern Gas Consumers' Council issued a press release which is highly relevant. It states:

> "At a recent Meeting of the North Eastern Gas Consumers' Council, Members . . . repeated their views expressed on a number of occasions, that price increases should be based only on the fincancial needs of the Industry. Whilst being well aware of the Government's policy imposed on British Gas that prices should rise 10 per cent. above the rate of inflation over three years . . . they felt that British Gas Corporation had not told them any reason why they needed the extra money."

Why does the British Gas Corporation need the extra money? Does it need it, or will the money go to help the public sector borrowing requirement? If that is so, the increase is purely and simply back-door taxation. Perhaps there is something more sinister in the Government's mind. Perhaps they have a deliberate policy to inflate gas charges with a view to selling the British Gas Corporation.

Hon. Members will agree that in the past two or three years the gas industry has made colossal profits. Perhaps the profits will increase and the industry will then be privatised, just as another industry has recently been privatised. Perhaps the gas industry will be sold and will become loot for the boys. Some newspapers have suggested—I put it no higher than that—that some of those who voted for the privatisation of Amersham International were beneficiaries of loot for the boys. At the same time, through this increase the Government are taxing those who can ill afford, or cannot pay, the bills and who would prefer to freeze than to face large gas bills. If the Government are increasing prices for that reason it is criminal and unforgiveable. Only time will tell, but if that is so the British public will know.

The motion states that it "regrets the decision" that has been made. There have been some encouraging signs from Conservative Members that they regret the decision. Some of them said that although they would not vote with the Conservative Party tonight they would not vote for the motion. What hypocrisy. Is there one hon. Member in the Chamber who does not regret the increase in gas prices? If there is, will he put his hand up? If you do regret it, you should vote for the motion tonight. If you regret the decision but do not vote for the motion, you are displaying nothing but hypocrisy.

I do not want to call you "hypocrites", because that would be unparliamentary. People are sick and tired of all the speeches that try to prove that the increases are necessary. It is impossible to prove to those who will have to meet the colossal charges that there is a need for an increase when the corporation makes vast profits and when the chairman of the corporation makes statements such as those that I have cited.

If democracy means anything, if it is not a game of "kid 'em", a game of fooling the public, then I hope that you believe what you say tonight and support this motion.

Mr. Speaker: Order. I hope that in future hon. Members will not keep saying "you" because that involves me in a way that will get me into trouble.

6.1 pm

Mr. Tim Eggar (Enfield, North): I hope that the hon. Gentleman who has just spoken will forgive me if I do not follow his remarks directly.

Our gas pricing policy has developed in a most curious way. We must be the only country consciously to have set out to sell gas to domestic consumers considerably more cheaply than to industry. That has happened because Governments of both parties have, for political reasons, deliberately urged the British Gas Corporation to keep down the domestic price of gas. It is a fine tribute to this Government and to the decision of my right hon. Friend who is now the Secretary of State for Transport that he was prepared to break that cycle and take the considerable political rap that that involved.

What has been the result of this curious pricing policy over the last 10 years? First, the cost of gas to the domestic consumer has fallen both in real terms and as a percentage of wages. It is the only energy source to which that has happened. In addition, the disparity between gas and other fuel prices had become considerably greater before my right hon. Friend's decision.

I agree with my right hon. Friend the Secretary of State that it is unfair, when 40 per cent. of households have no gas, that the 60 per cent. that have it should be subsidised—because that is what it amounts to—by the rest.

Mr. Allen McKay (Penistone) *rose*——

Mr. Eggar: I am sorry, I will not give way. I am conscious of the pressure of time.

I would not make this as a constituency point, in any case, because I represent a constituency where every household can have gas if it wishes. From a national point of view, however, underpriced gas makes no sense.

We come now to industrial prices. Like all other hon. Members, I have been under considerabe pressure from industry about the level of gas prices. Why have gas prices been so high here until now when compared with those on the Continent and in the United States? It is because the British Gas Corporation has been forced by Government policy—the policy of both parties—and by its own predilection, one might add, to make all its profits out of industry. At a time when both sides agree that our major priority must be the reduction of industry's costs, we must be prepared—and I totally support the Government in this—to make a sacrifice in terms of political popularity in order to reduce industry's costs. In the long run, the country will applaud rather than criticise us for it.

I have, however, one point to make, and that is the criticism I made of the Secretary of State's decision at the time that the 10 per cent. per annum real increase was announced, namely, that it did nothing to put pressure on the British Gas Corporation to reduce its costs and increase its efficiency. I know he would argue that he is doing this through the cash limits system and the targeted rate of return. Nevertheless, I hope that when he comes to consider the pricing policy for the next and subsequent years he will put a slightly higher priority on ensuring that the real increases in gas prices are to some extent absorbed, by insisting that the BGC increases its efficiency. I fully support my hon. Friend the Member for Chichester (Mr. Nelson) on this.

One aspect of the corporation's charging policy that has been of considerable concern to me is that of standing charges. I agree with both the British Gas Corporation and the consumer councils that there must be some kind of charge built in to cover meters, fixtures, fittings and so on. That is reaasonable. It is also resonable that the charge should be collected on the basis of the true economic cost of supplying that service.

However, I understand the concern, of pensioners in my constituency when, especially in the summer months, they use small amounts of gas and find that the cost of this low consumption is dwarfed by the higher standing charge. I hope that the Minister, with my right hon. Friend the Secretary of State for Social Services will investigate the possibility of offering consumers a choice between a standing charge and lower unit cost or a higher unit cost and no standing charge because, after all, the connection charges have to paid for in any case.

That has been done, quite rightly, with water charges. One can now have a water meter installed if one wishes and pay for one's consumption. There is a choice between paying straight water rates and paying meter costs. I can see no difficulty in providing the same option for gas consumers. That is something the Government should support.

I recognise the considerable courage shown by my right hon. Friend the Secretary of State in supporting the policy put forward by his predecessor of a 10 per cent. real increase this year. It is the only way in which we can afford to keep industry's energy costs down to a reasonable level. I hope that, in recognititon of this, my right hon. and learned Friend the Chancellor of the Exchequer (Sir Geoffrey Howe) will make it clear on 9 March that gas price increases for industry will be kept within a very low limit this year.

6.7 pm

Mr. K. J. Woolmer (Batley and Morley): The gas bill increases have had a bigger impact on my constituents than anything I can remember since I came to the House two or three years ago. I can think of no other occasion when, as happened in my surgery last weekend, I saw two elderly people in tears because they did not know how they were going to pay their gas bill. The effect of the electricity and gas bills that have been coming through the letter boxes in the last week or two has been absolutely devastating on hard-working, hard-pressed and thrifty people. I hope that this House will be able to respond to the feelings and the problems of these people and to the current situation.

There is widespread concern about the problem of standing charges. I do not intend to go over an already well trodden path in this debate but it is something that causes considerable resentment amongst people who have been hit by these bills. My own hope is that the Government will reconsider whether it is advisable or necessary to press these increases at this time. For the longer term, I regard it as equally important that some Government take the whole question of energy saving and insulation much more seriously than it has been taken so far. We managed to achieve a house-by-house conversion programme to North Sea gas; it seems quite reasonable that the country should be able to have a home insulation programme on a similar basis. We must try not only to cut people's bills but genuinely to save energy and avoid having to build more power stations, which can result only in higher bills.

People do not understand some of the basic facts and figures. I should like to put before the House their reasons for that lack of understanding as they put them to me. In five years of the previous Labour Government gas prices rose by only 33 per cent. In 2½ years of Conservative Government so far they have risen by 66 per cent., and the increase this year will in effect mean, because of compound interest, an increase of 100 per cent. in three years of Conservative Government. Under the Conservatives electricity has gone up by 73 per cent. in less than three years and home coal prices have gone up by 74 per cent. The general effect of that enormous increase in fuel prices, deliberately foisted on people by the Government as a matter of policy, is hitting people very hard.

People are baffled because our wealth of energy supplies seems to be turning out to be a curse instead of a blessing. If world oil prices rise, we are told that gas and electricity prices must go up as well. We are told that we must all suffer, and we have no benefit. Yet when oil prices are falling are gas prices cut? All that we have heard from the Government so far is that as a result of world oil prices falling there is a threat that they will not be able to cut taxes or that they will lose some revenue. Therefore, while the average householder suffers rising gas prices world oil prices can go up or down with apparently no benefit to our hard-pressed people.

The other matter that people put to me is that there appears to be no real reason why the increases must be foisted on them. The Government are deliberately taxing gas in the current financial year to the extent of £420 million, and I understand that they expect to take from the Gas Corporation £750 million in tax next year. Therefore, it is clear that the corporation does not have to increase prices if the Government do not insist on putting an extra £750 million of taxes on to gas consumers.

The hon. Member for Enfield, North (Mr. Eggar) had the temerity to suggest that gas supplies were being subsidised, when his own Government put a £750 million tax on the gas consumer. He will have a great deal of explaining to do to the ordinary householder who receives the bills.

Mr. Sydney Bidwell (Ealing, Southall): It will probably cost the national Exchequer that amount of money in supplementary benefits to those who will qualify for them as a result of the increase in the cost of living resulting from this tax. That is astounding when the main plank of the Government's policy is supposed to be anti-inflation measures.

Mr. Woolmer: I entirely agree. When the Government say that they are putting all their energies into getting inflation down and are trying to convince people to take lower pay rises, to put gas prices up by 22 per cent. in one year—which means an increase of 100 per cent. in three years—is an odd way of fighting inflation.

I was making the point that in the course of the next financial year the Gas Corporation is likely to pay to the Exchequer, through the gas levy and corporation tax, petroleum revenue tax and so on, little short of £1,000 million in taxes. The Government have a choice. It is a policy decision by them whether this gas price increase is necessary. Let it not be said that the price must go up because gas is the product of a loss-making nationalised industry. We hear so often from the Conservative Benches that the nationalised industries are making huge losses, that they are making a mess of their businesses and must put up their prices to return to profit. Here is a business in effect making a profit not far short of £1½ billion. Do the Government let them use it to reduce prices? Not at all.

Mr. Eggar: Is the hon. Gentleman really saying that the Government should not be taxing an undertaking that uses natural resources in the southern basin of the North Sea belonging to the nation? If he is, is he therefore in favour of the abolition of petroleum revenue tax and other taxes on oil companies?

Mr. Woolmer: What I am saying is that in the middle of a recession people's living standards are being hit very hard. We have a Government who are willing to tolerate 3 million unemployed to try to bring inflation under control. One of the most crucial factors affecting the cost of living—the price of gas—is capable of being held down, and indeed reduced. The hon. Gentleman and his Government have a duty in those circumstances to ask whether it is right that the Government should take £1,000 million in tax from the Gas Corporation, instead of allowing it to use that money to hold gas prices down.

The corporation is being forced to put up gas prices. In effect, one family's tax cut will be financed by another family's gas bill increase. It is no accident that these enormous increases in taxes on gas are being imposed well before an election. The truth is that what gas consumers are paying for in the gas bills coming through the letter boxes today is the tax cuts that will lead up to the election next year. I have no doubt that the £1,000 million-worth of unnecessary taxes that gas consumers are having to pay will be used to finance the election bribes at the next general election.

I have never seen people so desperately upset and worried as I have seen them to be in the past two or three weeks. Honest, hard-working people have literally been in tears because of their worry and desperation over meeting the bills. Our duty is to listen to them. To say that the Government and the Gas Corporation have no option, when profits in effect are over £1 billion, is hypocrisy. Our duty is to listen to our people and to use the option to hold down the increase. I ask the Government not to proceed with it this year. At the end of the day those householders affected will not forget, and they will not forget the Government.

6.17 pm

Mr. John Hannam (Exeter): The hon. Member for Batley and Morley (Mr. Woolmer) pursued arguments which, because of the short time available, I shall refrain from taking up. He omitted one important factor—the

[Mr. John Hannam]

equation which my right hon. Friend the Secretary of State presented to the House of trying to assist in the creation of jobs through producing the right price structure for industry, as against an abnormally low, historically low level for the domestic consumer, resulting from the policies of the previous Government. I shall take up that matter later in my brief speech.

The hon. Gentleman was right to say that the third tranche of the January 1980 announcement of gas price increases of 10 per cent. above inflation per year is causing a great deal of concern among our constituents. It would be easy for any Government to adopt an easy electoral posture on such decisions and satisfy the consumer and ignore the long-term national interest by allowing gas prices to remain historically low.

Even with the present increase, the consumer will still be obtaining gas at a lower price in real terms than in 1970, whereas, following the increase and the reapportionment of costs in gas pricing, the industrial consumer at last faces the possibility of obtaining his gas at prices competitive with those charged to his overseas competitors. The Labour Party constantly argues the case for helping industry, thus creating more jobs. Here are the Government carrying out exactly that policy, and yet Labour hon. Members are cavilling.

Illusions are easy to peddle these days, especially in political terms. I found it saddening that the right hon. Member for Leeds, South (Mr. Rees) the Opposition energy spokesman, for whom I have great respect, took advantage of short-term political considerations involved in the implementation of this third and final 10 per cent. increase in prices.

We are debating the announcement made in January 1980, which was then debated. It would be easy and electorally rewarding in the short term to try to satisfy the consumer at all times. That is exactly what the Opposition did during their period of office. As the hon. Member for Batley and Morley carefully announced, they held down gas prices to the domestic consumer, despite increasing losses on domestic gas supply, which resulted in the high cost of gas and the breakdown of a guaranteed supply to the industrial consumer.

Mr. Skinner: It is correct that the Labour Government intervened in the economy and held down gas prices. That was because, by and large—not all the time— they had a philosophy based on Government intervention in the economy. The hon. Gentleman has to answer this point, as he was elected on the basis of the operation of market forces and each week his right hon. Friend the Prime Minster stands at the Dispatch Box and says that the Government cannot intervene and the market must decide. Why are the Government intervening in the market to push up gas prices 100 per cent? I am talking about the hon. Gentleman's Government, and he will presumably back them once again.

Mr. Hannam: It is easy to answer that question. That is exactly what the Government are doing. They are restoring market forces to an artifically distorted situation.

In 1979 the Price Commission advised the Government to increase domestic gas prices by 30 per cent. The Government could easily have done that in one fell swoop, but they chose to stagger the increases over three years. The point that the hon. Member for Bolsover (Mr. Skinner) makes, that the Government are intervening in a artifically created price structure, is valid. They are restoring market forces, as far as they can be restored, to a monopoly gas industry.

I return to the point I was making about the effect of the Labour Government's policies on the supply of industrial gas. Despite warnings in 1978 and 1979 that their policies would result in dangerous cut-offs of supply to British industry, and despite the Gas Corporation's failure to create new gas supplies for new industries, the Government continued to create a surge in demand by domestic gas users. They were taking advantage of an obviously attractive fall in gas prices when all other fuel prices were rising sharply and dramatically.

Despite a call by the Price Commission for a 30 per cent. rise in gas prices, the Labour Party decided to try to gain some electoral advantage—forlornly as it turned out, and forlornly as it is proving by continuing their policy now—so the Conservative Government had the rather unpleasant duty of trying to bring in a proper price level for domestic gas. That was done to ensure not only the long-term security of gas supply but to correct the imbalance between domestic and industrial prices.

The Government decided not to impose an immediate 30 per cent. increase but to spread it over three-years, 1980, 1981 and 1982. We are debating the final instalment of those three increases. The main difference between now and January 1980 is that we can begin to see the results of the change of policy by the Government in 1980. Whereas in 1979 domestic gas prices had dropped to 70 per cent. of their real value cost in 1970, compared with a real price increase in electricity of 118 per cent., of oil, 162 per cent. and of coal, 117 per cent., by the end of the third quarter of last year gas was still only 81 per cent. of the 1970 price, whereas electricity was 144 per cent., oil 198 per cent. and coal 132 per cent.

The price per therm has dropped from 10·61p in 1970 to 7·3p in 1980. In October 1981 it crept up to 8·38p, well below the 1970 level. Let the Opposition not accuse the Government of clobbering the domestic gas consumer with the increases. After the final 10 per cent. increase above inflation, gas prices to the domestic consumer will still be less than they were in 1970, and gas will be by far the cheapest of all domestic fuels.

Mr. Kenneth Lewis: I have worked the figures out and had them checked by the Library, I assure my hon. Friend if one takes the figures for 1975, one sees that price increases for gas exceed those for other fuels. That includes the first increase this year.

Mr. Hannam: I have listened to those figures. I refute that point, because I am certain that, following the holding down of gas prices, they dropped alarmingly below the prices of other fuels. I have among my papers the figures for 1970 to 1981. In 1975 the price per therm was 8·17p and at the end of 1980 it was 7·43p. It will now rise to just above the 1975 level.

In January 1980, when the crucial decision was made by the Government we were close to major cut-offs of gas supplies to industry. One of the leading members of the Shadow Cabinet, who then became the Shadow energy spokesman—he has now become a member of the the SDP—the right hon. Member for Plymouth, Devonport (Dr. Owen), when attending an energy seminar in Plymouth during the previous October, at which I was present, said:

"A proper pricing policy for energy is essential and inevitable and a special scheme of help for poorer families will be needed."

That is precisely what the Government did a few months later.

At the same conference the deputy chairman of south-west gas said:

"The demand for domestic gas has been intensified by artificially low prices and a substantial increase in gas prices is overdue. There should be more parity between domestic and industrial prices."

Sir Dennis Rooke was reported as being so concerned about the instability of gas supplies that he considered cutting off supplies to the House of Commons if the statutory requirement to connect householders living within 25 yards of gas mains was not removed. He recognised the danger of the instability of gas supplies because of the surge of demand by the domestic consumer. I imagine that he would probably like to cut off gas supplies to the House of Commons now because of the Bill that is in Committee.

This morning I received reports from my constituency of a large housing estate in the Exwick area of Exeter that is unable to have a complete gas main supply because of a general rule being applied by South-West Gas that no extensions to existing distribution networks can be made owing to instability of supply. In other words, there is still over-demand in the domestic sector and insecurity of supply to the industrial sector. We import 20 per cent. of our gas from Norway and have not developed a new major gas field for seven years.

Because of the Government's decision in 1980, our industrial gas consumers now have a price advantage over their Continental rivals. That competitive position would not last if the final increase did not take place.

Mr. Edwin Wainwright (Dearne Valley): does the hon. Gentleman realise that we would have had an ample supply of gas if the gas-gathering pipe line scheme submitted by the BGC on behalf of Norway had been backed by the Government? They refused to back it.

Mr. Speaker: Order. Before the hon. Member for Exeter (Mr. Hannam) answers, may I say tha he knows that I have no authority to ask anybody to stop speaking once he starts, but we had hoped that the winding-up speeches would start at 6.30.

Mr. Hannam: I accept your admonishment, Mr. Speaker, and confess that I have given way rather too enthusiastically. If British Gas had paid the right price for gas we would have had a gas-gathering pipeline by now.

After the increase, domestic gas will still be the cheapest of all fuels and will still be hardly profitable to British Gas. The fact that much less of the weekly budget of the pensioner or worker is now going on gas shows that we are not being unfair to those lucky enough to be within reach of gas supplies.

I challenge Labour Members to dispute my contention that my right hon. Friend is pursuing a responsible energy policy that is designed to help British industry and thereby provide jobs without unjustly penalising domestic consumers. Being in Government must mean taking responsibility for unpopular decisions that are essential in the national interest. I give my full support to my right hon. Friend.

6.30 pm

Mr. Merlyn Rees: We have heard that about half a dozen Conservative Members will not support the Government when the Division takes place. That proves that we were right to table the motion.

Mrs. Elaine Kellett-Bowman (Lancaster): What about the leave of the House?

Mr. Rees: If I require the leave of the House, Mr. Speaker, I shall ask. It seems that our visitor from Europe, the hon. Member for Lancaster (Mrs. Kellett-Bowman), mixes up the procedures in both places.

As I was saying, it seems that we were right to table the motion. If a group of Conservative Members intend not to support the Government on this occasion, it means that they are receiving many letters from their constituents. I know that I am receiving many letters on this issue from my constituents. However, the number of letters that we receive on any one issue does not necessarily mean that our constituents are right. Nevertheless, there is great concern about gas prices, especially in the type of area that I represent.

Notwithstanding the argument of the hon. Member for Rutland and Stamford (Mr. Lewis), it is said when prices increase that the responsibility lies only with nationalised industries. During the debate, when I should have had other things on my mind, I recalled a recent visit with some of my hon. Friends to a Yorkshire coalmine. As I was travelling to the pit in my car I heard the Prime Minister say on the radio that we should run nationalised industries in the same way as Marks and Spencer is run.

As I crawled along a 250 yard face in a modern pit I remembered two things: first, it struck me that my mother was right to ensure that I did not follow my father into the pit; secondly, it struck me that it was a damned silly remark—[HON. MEMBERS: "Order".] I know, Mr. Speaker, that if that is what I thought the House would want me to tell it so. In any event, it struck me that it was a silly remark to make. How can a pit be run as if it were part of the retail trade? The heavy and fixed costs of most of our nationalised industries are such that it is difficult to prevent them coming forward.

It has emerged from the debate that the 100 per cent. increase in gas prices since the Government took office has not taken place to meet the wishes of the corporation. The increase has taken place at the wish of the Government. Whoever the complaints can be directed to, they cannot be directed to the chairman of the corporation, Sir Denis Rooke.

We have heard a great deal about the Price Commission's report of June 1979, which stated that domestic prices should be increased. That is held against the previous Labour Government. However, within a month of that report the Government froze domestic gas prices. There is an argument about energy prices overall and it is no good putting the blame on one Government. I do not agree with the implications that have been drawn from the speech of the right hon. Member for Plymouth, Devonport (Dr. Owen) at the Plymouth seminar.

In January 1980 we heard that the Government were planning for three years. Does that mean that nothing will happen in a year's time? Some of my hon. Friends have been uncharitable enough to say that as next year is the run-up to a general election it will be surprising, whatever the objectivity of the Government's policy, if the Treasury

[Mr. Rees]

do not say "It does not matter very much this year. Let it ride this year. It is the run-up to the election. Let people forget what we have done in the previous year or two."

I shall take up some of the remarks of the hon. Member for Exeter (Mr. Hannam). I understand from the tape that the dollar price of oil has fallen today by $4. The spot price is lower than the dollar price. That means that it will not be long before the dollar price of oil falls.

Mr. Lawson: No.

Mr. Rees: The Secretary of State says "No". He is a brave man.

Mr. Lawson: It does not follow.

Mr. Rees: That is a different matter. It does not follow automatically but it may well happen. The fact remains that a fall in price of $4 is considerable. I do not want to anticipate the effect that this will have on budgetary policy but it will have an effect on energy pricing policy. The industrial price of gas might well fall if the pricing link continues. There will be an effect on the coal industry. However, as my hon. Friend the Member for Midlothian (Mr. Eadie) has said, coal will still have a considerable cost advantage even when the price of oil falls by $4 a barrel.

It is important that we have the right overall policy, and in this respect the Government have made a profound mistake. I am not saying that gas prices should not have increased at all in the past three years. It would be foolish to say that. Our motion does not advance that argument. However, to increase gas prices by 100 per cent. at a time of inflation and depression is an act of folly.

My hon. Friend the Member for Swindon (Mr. Stoddart) knows, as does my hon. Friend the Member for Batley and Morley (Mr. Woolmer)—I am closer to my hon. Friend the Member for Batley and Morley because our constituencies abut, but the problems are the same—of the distress that the price increases have caused in the country. I represent a low-wage area, and on Saturday, when I visit my constituency, many of my people will tell me about the problems that they face in meeting their gas and eletricity bills. There is great concern about the standing charge. It is easy enough for those of us who read our bills and pay them with a bit of a curse, but there are many who read them and shed tears. I have in mind widows, for example. I know that there is a joke in this place at Budget time about the one-eyed and one-legged widows that hon. Members design to show who suffers most, but there is a problem with energy pricing and the Government's scheme is deficient. I am glad that it helps those in receipt of supplementary benefit but those who suffer are pensioners who are not in receipt of supplementary benefit, those in low income groups and one-parent families.

Something must be done about the standing charge. The hon. Member for Enfield, North (Mr. Eggar) produced some novel ideas. Most of my constituents would prefer to pay the costs that properly fall on the standing charge weekly throughout the year, or quarterly. They do not want to be faced with a lump sum at the beginning of the year. The old person who stays with a son or daughter finds it difficult, when he or she returns to his or her home, to understand a bill that contains a standing charge that is greater than the cost of the gas or electricity that has been consumed.

The hon. Member for Chichester (Mr. Nelson) made a constructive and interesting speech. He reported allegations that have been made about the use of resources by the gas board in his area. He was generous enough to say that in general the corporation is highly efficient. However, he reported that his constituents have alleged that numerous corporation vans have been flying around his constituency. They allege that there are too many of them and that they seem to sit in laybys while corporation employees have a whiff and a puff, as it were.

I hope that these serious charges are examined. They are made against members of the General and Municipal Workers Union, a union to which I belong. By all means make the allegations, but the allegations had better stand up when they are investigated. The allegations were made to the hon. Member for Chichester and he was right to raise them in the House. However, an investigation must take place to ensure that they are not part of the sweeping allegations that are made, for example, about employees sleeping in factories, along with all the usual stories that we hear. It is important that those aspects are considered.

I turn now to the privatisation of customer services. I invariably call the chap round the corner to repair electrical faults. The last thing I should ever do would be to call a relatively untrained man to carry out gas maintenance. Gas fittings require high safety standards. The Government understand that because they are about to establish a safety code. That is the result of their policy of shutting the showrooms. Gas is different from electricity in that respect. The Department of Trade did not understand that when it advanced this scheme.

Mr. Stoddart: Speaking as a member of the electricians' trade union, I suggest to my right hon. Friend that electricity is as dangerous as gas and that he should always employ a qualified electrician.

Mr. Rees: I always call qualified electricians and trained people from the Gas Corporation. That is the difference. Gas involves safety factors of a more general nature:

The Secretary of State's speech was almost predictable. We both serve on the Oil and Gas (Enterprise) Bill in Committee and are becoming fed up to the back teeth listening to each other. There is no Government subsidy to the Gas Corporation. There may be a subsidy within the Gas Corporation's accounts, with costs applied one way or the other, but the idea that the corporation is subsidised by anybody is false. Yet that was the impression that was given.

We have heard little about depletion policy. The hon. Member for Melton gave his view of the economy. To reinforce his argument, he mentioned Bishop Latimer, for whom I have much regard and whose painting hangs in the Central Lobby.

Mr. Latham: He was burned as a heretic.

Mr. Rees: If he was burned as a heretic, that was hard luck. That just proves that if one has a good point, one should use it at the beginning, not the end. The hon. Member for Melton made a good speech, whether heretical or not. There are many heretics on the Opposition Benches. Let us have more and defeat the Government tonight.

6.42 pm

The Under-Secretary of State for Energy (Mr. John Moore): I am delighted to begin on that excellent last note. I have not left the Chamber throughout the debate. As so often in many debates over the past few years, I was struck by how often, whichever party has been in office, the nation has suffered by the inability of many of us to face reality.

Much of the debate which has flown back and forth across the Chamber has failed to face many of the harsh truths to which Britain must reconcile itself. I shall attempt to be factual, because it might help the tenor and nature of the debate.

The truth has not changed. It was well expressed in 1978 in the classic Green Paper on energy policy. The right hon. Member for Bristol, South-East (Mr. Benn), in that Green Paper, said:

"Natural gas is a high quality finite resource and its price must reflect this fact. If it is sold too cheaply, consumers will have no incentive to use it efficiently. In these circumstances the industry's prices need to be related to the expected cost of future supplies, rather than its historic cost".

Those were wise words at that time and, as I said, the truth has not changed.

The right hon. Member for Leeds, South (Mr. Rees) asked: what happened? It was the Labour Government's failure to act on their own theoritical beliefs that produced the neglect and mess that the Government inherited and had to try to sort out.

I respect the speech of my hon. Friend the Member for Melton (Mr. Latham) and his views and his company. We cannot refuse to face, handle and sort out problems caused by a previous Government's neglect. We cannot leave the matter as it is. We must tackle it.

However, the Opposition's neglect, when in Government, was compounded by the sense of hypocrisy that has surrounded much of the debate. They ignore their own past beliefs and statements expressed in Government. In such a sensitive area as this—all hon. Members' constituents are conscious of the enormous burdens and problems—the worst thing we can do is to pander falsely to hopes and feed on the fears of those who suffer more than hon. Members.

Mr. Stoddart *rose*—

Mr. Moore: I shall give way in a moment. I wish to place some facts on the record.

What are the realities that the Government had the courage to face and tackle? The first reality ought to be put clearly and concisely on the record. The domestic side was not and still is not meeting the cost of supplies.

Mr. Stoddart *rose*—

Mr. Moore: I shall give way later. First, I want to tackle the key point of the cost of supplies on the domestic side, let alone the increasing cost of future supplies to the industrial and commercial side.

The right hon. Member for Leeds, South was right in suggesting that there was no subsidy to the industry. The subsidy was within the industry. Industrial and commercial users sere subsidising domestic consumers.

My hon. Friend the Member for Rutland and Stamford (Mr. Lewis), in a courageous speech, asked whether price increases at this stage were justified. The facts about costs ought to be made clear. Two essentials costs are interconnected: the cost of transmission, supply and handling—I am referring solely to the domestic side of the industry, because that is what the Opposition's motion is about—and the cost of the product.

The Price Commission—I am not referring to statistics issued by the Government or the British Gas Corporation—analysed the figures thoroughly in 1979. Its figures, updated to today, produced 17p per therm for bringing domestic gas into the houses privileged to have it. One must add to that figure the average cost, for example, of Norwegian supplies, and 23 per cent. or more is coming across that median line. We are not self-sufficient in this area. That amounts to 37p per therm on the basic marginal cost from that area of supply. I remember the words of the right hon. Member for Bristol, South-East when he referred to future costs and supplies. I have here my gas bill I am sure that all hon. Members have considered their bills. The therm cost on my present bill is 27·2p. As we know, that is to increase in April and October. That relates to 37p per therm.

Mr. Stoddart *rose*——

Mr. Moore: I shall finish this point before giving way. Beyond the Norwegian costs, we must consider the area from the Northern Basin. The beach costs under negotiated contracts today are about 16p per therm. Added to the 17p, we are talking about 33p a therm. These are the realities with which the British Gas Corporation and everybody else must be concerned.

Mr. Stoddart: I am obliged to the Minister for giving way. Irrespective of who made the statement about current cost accounting and long run marginal costs—I do not know whether the Government are becoming Bennites—if all private industry used the same criteria, would not the Government's inflationary policy be split asunder and prices race ahead? How on earth does the Minister expect industry, which is based on a simple profit motive and usually historic cost accounting as well as the domestic consumer to pay for long run marginal costing in the public industries? That is not possible.

Mr. Moore: I was unwise to give way to the hon. Gentleman. I was talking not about long-run marginal costing but about the real cost of supplies and the specific statements of the right hon. Member for Bristol, South-East.

I mentioned the costs of supply. It was clear to the Government when they came to office that there was an exploding demand, quite understandably, for a product selling below the market price. I do not blame the corporation, which had a statutory obligation to increase supplies to that loss-making sector of the market. That meant unsatisfied industrial demand and a crucial change that those who know the problems of development in the North Sea will recognise. It was a crucial change in the mix of supplies that were coming on to the domestic and industrial markets.

In 1975, 98 per cent. of our gas came from the Southern Basin. Estimates for this year show that only 58 per cent. will come from the Southern Basin, 19 per cent. will come from the Northern Basin and 23 per cent. from across the median line. It was clear that action was needed. However, if I may suggest it to my hon. Friend the Member for Melton, the need was not for action to open up a completely free market place, but for quite the

[Mr. Moore]

reverse, because that would have led to a massive increase in prices, far beyond those that the Government have tried to introduce.

The previous Administration would have agreed theoretically, but we had to act. The only question was how. The right hon. Member for Leeds, South and others have suggested that we acted in an electioneering spirit. The hon. Member for Bolsover (Mr. Skinner) said from a sedentary position "Is that the kind of thing that gains votes?" I assume that the sedentary interruptions are designed to suggest electioneering now, but hon. Members on both sides of the House will know that the policy was introduced and approved by the House in January 1980, which is a considerable time in advance of any prospect of a general election. A three-year policy was introduced in January 1980.

Essentially, the Government had to act. They tried to introduce the policy over three years, as opposed to one year, which may have been more courageous or more foolish.

Mr. Robert C. Brown: The Minister said at least six times that the position facing the Government when they came to office was obvious. If it was so obvious, why did they freeze gas prices in 1979, when they took office, instead of increasing them?

Mr. Moore: Upon taking office, it is necessary to examine the books to try to understand what has happened. I have noticed the sort of support that we get from Opposition Members for our three-year policy. What might they have done?

The second reality, beyond the reality of the cost of gas to the domestic consumer, is that gas today is cheaper in real terms than in 1970. The hon. Member for Batley and Morley (Mr. Woolmer) legitimately said that we should give our constituents the facts. I suggest that the facts make an impact on individuals. I am aware that my hon. Friends and Opposition Members have received difficult letters from their constituents. The impact on individuals and families is valid and relevant. However, we must separate the facts from the sort of hysteria that, in part, we have heard in the debate.

The first relevant fact is that the average family with central heating has had its expenditure on gas as a proportion of its income reduced from 8 per cent. to 5 per cent. from 1968 until now. The second fact concerns the pensioner couple, with whom we are all legitimately concerned. Of course I shall deal with the point made by the hon. Member for Newham, North-West (Mr. Lewis) about standing charges. He raised that point in his usual way—constructively—to try to help the long-term needs of pensioners. The married pensioner couple living only on their pension, with a cooker and a gas fire, were spending 10 per cent. of their income on their gas supply in 1968. Happily, whatever the difficulties of facing the truth, today that percentage has more than halved. They now pay 4 per cent. of their income. However difficult it may be, it is good that we all recognise that that has been reduced. We should all welcome it, however difficult it is for them to pay.

The third fact is that gas today is 17 per cent. cheaper in real terms than in 1970—the era of cheap energy. That is in marked contrast to other fuels which people must take because they cannot be supplied with gas. It is gratifying to find out, in the face of the courageous decisions that the Government have had to take during the past two years, that disconnections have decreased radically. They are down 30 per cent. in the nine months of last year to 31 December. Despite the harsh weather in January, in that month they decreased by 23 per cent. Clearly, that has something to do with the way in which the Government have tried to introduce reality during a three-year period and to add a benefit package of over £250 million in real terms. That is the relevance of real care in trying to help those in need.

Excellent contributions were also made by my hon. Friends the Members for Chichester (Mr. Nelson), Enfield, North (Mr. Eggar) and Exeter (Mr. Hannam), who all raised the problem of containing and controlling the efficiency of the nationalised industries. I remind them that the Government made provision for the Monopolies and Mergers Commission regularly to investigate the efficiency of nationalised industries. The CEGB has recently been examined under those powers. I also remind my hon. Friends about the Government's financial targets and cash limits. They are designed to reflect the need to maintain pressure for increasing efficiency and to impose the proper commercial disciplines for effective cost control. In the case of the gas industry, we have agreed that the corporation should aim to reduce its unit costs, excluding the cost of gas purchase, by 5 per cent. in real terms by 1982-83. I know that my hon. Friends will welcome that demanding aim in such difficult times.

For those hon. Members who were not privileged to hear the full debate, I can report that my hon. Friend the Member for Exeter made an excellent speech. It was the most devastating analysis in the debate about the realities of the way in which we are trying to ensure, through our policies, that employment is made available in industry and commerce through the rational pricing of gas. My hon. Friend the Member for Sheffield, Hallam (Mr. Osborn), again in an excellent speech, asked about the method of advising on the proposed increases. I must remind him that the industries are obliged by statute to inform the national consumer council about tariff proposals, so that it, in turn, may make representations about them to the Secretary of State.

My hon. Friend the Member for Rutland and Stamford made many excellent points in his speech, although I did not agree with all of his conclusions. He wondered about the reduction in industrial gas prices. The 1 April increase will bring to an end the ridiculous position whereby the running rate on the domestic credit tariff has been below the typical price for a firm contract industrial supply, although it costs more to supply the domestic consumer than the industrial consumer. The two charges will then be almost identical. The 1 October increase will complete the process of establishing a sensible relationship between the two markets as domestic prices move slightly ahead of industrial prices for the first time in some years.

Even with the current soft oil prices I must draw the attention of Labour Members and that of some of my hon. Friends to the fact that because we were successful in ensuring a freeze in industrial gas prices there was a great deal of head room between the industrial gas price and the equivalent gasoil price. Even today, firm gases are at 30p plus per therm and gasoil is at 35·7p per therm.

The gas levy was mentioned, with a great deal of confusion and muddle by so many hon. Members. This was nothing other than a way of ensuring that the windfall profits of gas are given to the nation, not to those privileged to have a gas supply, and, more specifically, that 35 per cent. of the nation that is privileged to have gas central heating.

The hon. Member for Newham, North-West and many other hon. Members raised the difficult problem of standing charges. The sum of £500 million is roughly the revenue cost incurred by standing charges. I am conscious of many of the difficulties raised, but I point out to hon. Members on both sides of the House that while the Government are in the process of looking at this problem, standing charges reflect the overhead costs of making a supply available. These are the real costs incurred by the industry, regardless of customers' consumption.

The Government and the National Gas Consumers Council have, like the previous Labour Government, endorsed the principle of standing charges. All previous studies, including "Energy Tariffs and the Poor" which was produced when the right hon. Member for Bristol, South-East was Secretary of State for Energy, concluded that tariff restructuring, including measures on standing charges, is not a sensible way of using resources to help the poor. There are genuine and real problems, and I acknowledge the suggestions by my hon. Friend the Member for Enfield, North and will examine them with sympathy, care and understanding.

In conclusion, I can do no better than quote again, for the benefit of those who were not here earlier, the wise views of the right hon. Member for Bristol, South-East, when he had the responsibility for our nation's energy policies. He said:

> "Natural gas is a high quality finite resource and its price must reflect this fact. If it is sold too cheaply consumers will have no incentive to use it efficiently."

Wise truths can be repeated more than once—those were wise words.

Unlike the Opposition, the Government have had the courage to match their words with deeds and the courage to face reality, however painful. As we come to the end of this period of adjustment, we begin to see, in industry and commerce, the first competitive gas price advantages flowing from our determination to face that reality. I urge my hon. Friends and all other hon. Members to support the Government amendment and reject this contemptible Opposition motion.

Question put, That the original words stand part of the Question:—

The House divided: Ayes 245, Noes 301.

Division No. 80] **[7.03 pm**

AYES

Abse, Leo
Adams, Allen
Allaun, Frank
Anderson, Donald
Archer, Rt Hon Peter
Ashley, Rt Hon Jack
Ashton, Joe
Atkinson, N. *(H'gey,)*
Bagier, Gordon A.T.
Barnett, Guy *(Greenwich)*
Barnett, Rt Hon Joel *(H'wd)*
Beith, A. J.
Benn, Rt Hon Tony
Bennett, Andrew *(St'kp'tN)*
Bidwell, Sydney
Booth, Rt Hon Albert
Boothroyd, Miss Betty
Bottomley, Rt Hon A. *(M'b'ro)*
Bradley, Tom
Bray, Dr Jeremy
Brown, Hugh D. *(Provan)*
Brown, R. C. *(N'castle W)*
Brown, Ronald W. *(H'ckn'y S)*
Brown, Ron *(E'burgh, Leith)*
Buchan, Norman
Callaghan, Jim *(Midd't'n & P)*
Campbell, Ian
Campbell-Savours, Dale
Cant, R. B.
Carmichael, Neil
Carter-Jones, Lewis
Cartwright, John
Clark, Dr David *(S Shields)*
Cocks, Rt Hon M. *(B'stol S)*
Cohen, Stanley
Coleman, Donald
Concannon, Rt Hon J. D.
Conlan, Bernard
Cook, Robin F.
Cowans, Harry
Cox, T. *(W'dsw'th, Toot'g)*
Craigen, J. M. *(G'gow, M'hill)*
Cranborne, Viscount
Crowther, Stan
Cryer, Bob
Cunningham, Dr J. *(W'h'n)*
Dalyell, Tam
Davidson, Arthur
Davies, Rt Hon Denzil *(L'lli)*
Davies, Ifor *(Gower)*
Davis, Clinton *(Hackney C)*
Davis, Terry *(B'ham, Stechf'd)*
Dean, Joseph *(Leeds West)*
Dewar, Donald
Dixon, Donald
Dobson, Frank
Dormand, Jack
Douglas, Dick
Douglas-Mann, Bruce
Dubs, Alfred
Duffy, A. E. P.
Dunn, James A.
Dunnett, Jack
Dunwoody, Hon Mrs G.
Eadie, Alex
Eastham, Ken
Edwards, R. *(W'hampt'n S E)*
Ellis, R. *(NE D'bysh're)*
Ellis, Tom *(Wrexham)*
English, Michael
Evans, Ioan *(Aberdare)*
Evans, John *(Newton)*
Ewing, Harry
Faulds, Andrew
Field, Frank
Fitch, Alan
Fitt, Gerard
Flannery, Martin
Fletcher, L. R. *(Ilkeston)*
Fletcher, Ted *(Darlington)*
Foot, Rt Hon Michael
Ford, Ben
Forrester, John
Foster, Derek
Fraser, J. *(Lamb'th, N'w'd)*
Freeson, Rt Hon Reginald
Freud, Clement
Garrett, John *(Norwich S)*
George, Bruce
Gilbert, Rt Hon Dr John
Graham, Ted
Grant, George *(Morpeth)*
Grant, John *(Islington C)*
Grimond, Rt Hon J.
Hamilton, W. W. *(C'tral Fife)*
Harrison, Rt Hon Walter
Hart, Rt Hon Dame Judith
Hattersley, Rt Hon Roy
Haynes, Frank
Healey, Rt Hon Denis
Heffer, Eric S.
Hogg, N. *(E Dunb't'nshire)*
Holland, S. *(L'b'th, Vauxh'll)*
Home Robertson, John
Homewood, William
Horam, John
Howells, Geraint
Hoyle, Douglas
Huckfield, Les
Hughes, Mark *(Durham)*
Hughes, Robert *(Aberdeen N)*
Hughes, Roy *(Newport)*
Janner, Hon Greville
Jay, Rt Hon Douglas
Johnson, James *(Hull West)*
Johnson, Walter *(Derby S)*
Johnston, Russell *(Inverness)*
Jones, Rt Hon Alec *(Rh'dda)*
Jones, Barry *(East Flint)*
Jones, Dan *(Burnley)*
Kaufman, Rt Hon Gerald
Kerr, Russell
Kilfedder, James A.
Kilroy-Silk, Robert
Kinnock, Neil
Lambie, David
Lamborn, Harry
Lamond, James
Leadbitter, Ted
Leighton, Ronald
Lewis, Arthur *(N'ham NW)*
Lewis, Ron *(Carlisle)*
Litherland, Robert
Lofthouse, Geoffrey
Lyon, Alexander *(York)*
Mabon, Rt Hon Dr J. Dickson
McCartney, Hugh
McDonald, Dr Oonagh
McGuire, Michael *(Ince)*
McKay, Allen *(Penistone)*
McKelvey, William
MacKenzie, Rt Hon Gregor
McMahon, Andrew
McNally, Thomas
McNamara, Kevin
McTaggart, Robert
McWilliam, John
Marks, Kenneth
Marshall, D *(G'gow S'ton)*
Marshall, Dr Edmund *(Goole)*
Marshall, Jim *(Leicester S)*
Martin, M *(G'gow S'burn)*
Mason, Rt Hon Roy
Maxton, John
Maynard, Miss Joan
Meacher, Michael
Mellish, Rt Hon Robert
Mikardo, Ian
Millan, Rt Hon Bruce
Miller, Dr M. S. *(E Kilbride)*
Mitchell, Austin *(Grimsby)*
Mitchell, R. C. *(Soton Itchen)*
Morris, Rt Hon A. *(W'shawe)*
Morris, Rt Hon C. *(O'shaw)*
Morton, George
Moyle, Rt Hon Roland
Mulley, Rt Hon Frederick
Newens, Stanley
Oakes, Rt Hon Gordon
Ogden, Eric
O'Halloran, Michael
O'Neill, Martin
Orme, Rt Hon Stanley
Owen, Rt Hon Dr David
Palmer, Arthur
Park, George
Parker, John
Parry, Robert
Pavitt, Laurie
Penhaligon, David
Pitt, William Henry
Powell, Raymond *(Ogmore)*
Price, C. *(Lewisham W)*
Race, Reg
Radice, Giles
Rees, Rt Hon M *(Leeds S)*
Richardson, Jo
Roberts, Albert *(Normanton)*
Roberts, Allan *(Bootle)*
Roberts, Ernest *(Hackney N)*
Roberts, Gwilym *(Cannock)*
Robertson, George
Robinson, G. *(Coventry NW)*
Rodgers, Rt Hon William
Rooker, J. W.
Roper, John
Ross, Ernest *(Dundee West)*
Rowlands, Ted
Ryman, John
Sever, John

Sheerman, Barry
Sheldon, Rt Hon R.
Shore, Rt Hon Peter
Short, Mrs Renée
Silverman, Julius
Skinner, Dennis
Smith, Cyril *(Rochdale)*
Smith, Rt Hon J. *(N Lanark)*
Snape, Peter
Soley, Clive
Spriggs, Leslie
Stallard, A. W.
Steel, Rt Hon David
Stewart, Rt Hon D. *(W Isles)*
Stoddart, David
Stott, Roger
Strang, Gavin
Straw, Jack
Summerskill, Hon Dr Shirley
Thomas, Dafydd *(Merioneth)*
Thomas, Jeffrey *(Abertillery)*
Thomas, Dr R. *(Carmarthen)*
Thorne, Stan *(Preston South)*
Tilley, John
Tinn, James
Torney, Tom
Varley, Rt Hon Eric G.
Wainwright, E. *(Dearne V)*
Walker, Rt Hon H. *(D'caster)*
Watkins, David
Weetch, Ken
Wellbeloved, James
Welsh, Michael
White, J. *(G'gow Pollok)*
Whitehead, Phillip
Whitlock, William
Wigley, Dafydd
Williams, Rt Hon A. *(S'sea W)*
Wilson, Rt Hon Sir H. *(H'ton)*
Winnick, David
Woodall, Alec
Woolmer, Kenneth
Wrigglesworth, Ian
Wright, Sheila
Young, David *(Bolton E)*

Tellers for the Ayes:
Mr. James Hamilton and
Mr. Lawrence Cunliffe.

NOES

Adley, Robert
Aitken, Jonathan
Alexander, Richard
Alison, Rt Hon Michael
Amery, Rt Hon Julian
Ancram, Michael
Arnold, Tom
Aspinwall, Jack
Atkins, Rt Hon H. *(S'thorne)*
Atkins, Robert *(Preston N)*
Atkinson, David *(B'm'th, E)*
Baker, Kenneth *(St. M'bone)*
Baker, Nicholas *(N Dorset)*
Banks, Robert
Beaumont-Dark, Anthony
Bennett, Sir Frederic *(T'bay)*
Benyon, Thomas *(A'don)*
Benyon, W. *(Buckingham)*
Best, Keith
Bevan, David Gilroy
Biffen, Rt Hon John
Biggs-Davison, Sir John
Blackburn, John
Blaker, Peter
Body, Richard
Bonsor, Sir Nicholas
Boscawen, Hon Robert
Bottomley, Peter *(W'wich W)*
Boyson, Dr Rhodes
Braine, Sir Bernard
Bright, Graham
Brinton, Tim
Brittan, Rt. Hon. Leon
Brooke, Hon Peter
Brotherton, Michael
Brown, Michael *(Brigg & Sc'n)*
Bruce-Gardyne, John
Bryan, Sir Paul
Buchanan-Smith, Rt. Hon. A.
Buck, Antony
Budgen, Nick
Bulmer, Esmond
Burden, Sir Frederick
Butcher, John
Butler, Hon Adam
Cadbury, Jocelyn
Carlisle, John *(Luton West)*
Carlisle, Kenneth *(Lincoln)*
Carlisle, Rt Hon M. *(R'c'n)*
Chalker, Mrs. Lynda
Channon, Rt. Hon. Paul
Chapman, Sydney
Churchill, W. S.
Clark, Hon A. *(Plym'th, S'n)*
Clark, Sir W. *(Croydon S)*
Clarke, Kenneth *(Rushcliffe)*
Clegg, Sir Walter
Cockeram, Eric
Cope, John
Cormack, Patrick
Corrie, John
Costain, Sir Albert
Cranborne, Viscount
Critchley, Julian
Crouch, David
Dean, Paul *(North Somerset)*
Dorrell, Stephen
Douglas-Hamilton, Lord J.
Dover, Denshore
du Cann, Rt Hon Edward
Dunn, Robert *(Dartford)*
Durant, Tony
Eden, Rt Hon Sir John
Edwards, Rt Hon N. *(P'broke)*
Eggar, Tim
Elliott, Sir William
Emery, Sir Peter
Eyre, Reginald
Fairbairn, Nicholas
Fairgrieve, Sir Russell
Faith, Mrs Sheila
Farr, John
Fell, Sir Anthony
Fenner, Mrs Peggy
Finsberg, Geoffrey
Fisher, Sir Nigel
Fletcher, A. *(Ed'nb'gh N)*
Fletcher-Cooke, Sir Charles
Fookes, Miss Janet
Forman, Nigel
Fowler, Rt Hon Norman
Fox, Marcus
Fraser, Rt Hon Sir Hugh
Fraser, Peter *(South Angus)*
Fry, Peter
Gardiner, George *(Reigate)*
Gardner, Edward *(S Fylde)*
Garel-Jones, Tristan
Gilmour, Rt Hon Sir Ian
Glyn, Dr Alan
Goodhart, Sir Philip
Goodhew, Sir Victor
Goodlad, Alastair
Gow, Ian
Grant, Anthony *(Harrow C)*
Greenway, Harry
Griffiths, Peter *Portsm'th N)*
Grist, Ian
Grylls, Michael
Gummer, John Selwyn
Hamilton, Hon A.
Hamilton, Michael *(Salisbury)*
Hampson, Dr Keith
Hannam, John
Haselhurst, Alan
Hastings, Stephen
Havers, Rt Hon Sir Michael
Hawksley, Warren
Hayhoe, Barney
Heddle, John
Henderson, Barry
Heseltine, Rt Hon Michael
Hicks, Robert
Higgins, Rt Hon Terence L.
Hill, James
Hogg, Hon Douglas *(Gr'th'm)*
Hooson, Tom
Hordern, Peter
Howe, Rt Hon Sir Geoffrey
Howell, Rt Hon D. *(G'ldf'd)*
Howell, Ralph *(N Norfolk)*
Hunt, David *(Wirral)*
Hunt, John *(Ravensbourne)*
Hurd, Rt Hon Douglas
Irving, Charles *(Cheltenham)*
Jenkin, Rt Hon Patrick
Jessel, Toby
Johnson Smith, Geoffrey
Jopling, Rt Hon Michael
Joseph, Rt Hon Sir Keith
Kaberry, Sir Donald
Kellett-Bowman, Mrs Elaine
Kimball, Sir Marcus
King, Rt Hon Tom
Kitson, Sir Timothy
Knight, Mrs Jill
Knox, David
Lang, Ian
Langford-Holt, Sir John
Lawrence, Ivan
Lawson, Rt Hon Nigel
Lee, John
Le Marchant, Spencer
Lennox-Boyd, Hon Mark
Lloyd, Ian *(Havant & W'loo)*
Lloyd, Peter *(Fareham)*
Loveridge, John
Luce, Richard
Lyell, Nicholas
McCrindle, Robert
Macfarlane, Neil
MacGregor, John
MacKay, John *(Argyll)*
Macmillan, Rt Hon M.
McNair-Wilson, M. *(N'bury)*
McNair-Wilson, P. *(New F'st)*
Madel, David
Major, John
Marlow, Antony
Marshall, Michael *(Arundel)*
Marten, Rt Hon Neil
Mates, Michael
Maude, Rt Hon Sir Angus
Mawby, Ray
Mawhinney, Dr Brian
Maxwell-Hyslop, Robin
Mayhew, Patrick
Mellor, David
Meyer, Sir Anthony
Miller, Hal *(B'grove)*
Mills, Iain *(Meriden)*
Miscampbell, Norman
Mitchell, David *(Basingstoke)*
Moate, Roger
Monro, Sir Hector
Montgomery, Fergus
Moore, John
Morris, M. *(N'hampton S)*
Morrison, Hon C. *(Devizes)*
Morrison, Hon P. *(Chester)*
Mudd, David
Murphy, Christopher
Myles, David
Neale, Gerrard
Needham, Richard
Nelson, Anthony
Neubert, Michael
Newton, Tony
Normanton, Tom
Nott, Rt Hon John
Onslow, Cranley
Oppenheim, Rt Hon Mrs S.
Osborn, John
Page, John *(Harrow, West)*
Page, Richard *(SW Herts)*
Parkinson, Rt Hon Cecil
Parris, Matthew
Patten, Christopher *(Bath)*
Patten, John *(Oxford)*
Pattie, Geoffrey
Pawsey, James
Percival, Sir Ian
Peyton, Rt Hon John
Pollock, Alexander
Porter, Barry
Prentice, Rt Hon Reg
Price, Sir David *(Eastleigh)*
Proctor, K. Harvey
Pym, Rt Hon Francis
Raison, Rt Hon Timothy
Rathbone, Tim
Rees, Peter *(Dover and Deal)*
Rees-Davies, W. R.
Renton, Tim
Rhodes James, Robert
Rhys Williams, Sir Brandon
Ridley, Hon Nicholas
Ridsdale, Sir Julian
Rifkind, Malcolm
Roberts, M. *(Cardiff NW)*
Roberts, Wyn *(Conway)*
Rossi, Hugh
Rost, Peter
Royle, Sir Anthony
Sainsbury, Hon Timothy
St. John-Stevas, Rt Hon N.
Scott, Nicholas
Shaw, Giles *(Pudsey)*
Shaw, Michael *(Scarborough)*
Shelton, William *(Streatham)*
Shepherd, Colin *(Hereford)*
Shepherd, Richard
Shersby, Michael
Silvester, Fred
Sims, Roger
Skeet, T. H. H.
Smith, Dudley
Speed, Keith
Speller, Tony
Spence, John
Spicer, Jim *(West Dorset)*
Spicer, Michael *(S Worcs)*
Sproat, Iain
Squire, Robin
Stanbrook, Ivor
Stanley, John
Steen, Anthony
Stevens, Martin
Stewart, A. *(E Renfrewshire)*
Stewart, Ian *(Hitchin)*
Stokes, John
Stradling Thomas, J.
Tapsell, Peter
Taylor, Teddy *(S'end E)*
Tebbit, Rt Hon Norman
Temple-Morris, Peter

Thomas, Rt Hon Peter
Thompson, Donald
Thorne, Neil *(Ilford South)*
Thornton, Malcolm
Townend, John *(Bridlington)*
Townsend, Cyril D, *(B'heath)*
Trippier, David
Trotter, Neville
van Straubenzee, Sir W.
Vaughan, Dr Gerard
Viggers, Peter
Waddington, David
Wakeham, John
Waldegrave, Hon William
Walker, Rt Hon P. *(W'cester)*
Walker, B. *(Perth)*
Walker-Smith, Rt Hon Sir D.
Wall, Sir Patrick
Waller, Gary
Walters, Dennis
Ward, John
Warren, Kenneth
Watson, John
Wells, John *(Maidstone)*
Wheeler, John
Whitelaw, Rt Hon William
Whitney, Raymond
Wickenden, Keith
Wiggin, Jerry
Wilkinson, John
Williams, D. *(Montgomery)*
Wolfson, Mark
Young, Sir George *(Acton)*
Younger, Rt Hon George

Tellers for the Noes:
Mr. Anthony Berry and
Mr. Carol Mather.

Question accordingly negatived.

Question, That the proposed words be there added, *put forthwith pursuant to Standing Order No. 32 (Questions on amendments), and agreed to.*

Mr. Speaker *forthwith declared the main Question as amended, to be agreed to.*

Resolved,

'That this House having endorsed on 29th January 1980 the Government's decision to tackle, over a three-year period, the serious under-pricing of domestic gas at industry's expense, recognises the need to complete that process this year; welcomes the relief which has been possible in consequence through lower real industrial gas prices; and supports the Government in making available more resources than ever before helping the needy with their fuel bills.'

Central America

7.15 pm

Mr. Denis Healey (Leeds, East): I beg to move,

That this House expresses its concern about the deteriorating situation in Central America, deplores the decision of Her Majesty's Government, contrary to the views of Canada and the countries of Western Europe, to send observers to the elections to be held in El Salvador on 28th March, and calls on Her Majesty's Government to support the proposal of the Government of Mexico for a negotiated settlement of the civil war in El Salvador.

We do not often debate the affairs of the Caribbean basin these days, but it is worth recalling that 20 years ago, the Cuban missile crisis brought the world to the brink of nuclear war. What is happening now in Central America may present less urgent dangers, but in some circumstances it could prove almost as disturbing in its long term consequences.

The House knows that Central America suffers from grinding poverty as a result of centuries of colonial exploitation and misgovernment by a parasitic ruling class which handed the economy over to foreign companies which condemned the area to dependence on a few crops, whose price was highly vulnerable to events in the outside world. Last week, President Reagan pointed out that to buy the same barrel of oil, they have to sell five times more coffee today than they did five years ago.

In recent years, besides these long-standing economic problems and partly as a result of them, there has been a tidal wave of revolutionary feeling against the military dictatorships which rule most of the countries in the area. The revolution was successful in Cuba and Nicaragua, but so far it has been suppressed with appalling brutality in Guatemala and El Salvador. A country such as Costa Rica, which has just had a peaceful transfer of power in a free election, is, I fear, an exception to the rule.

I do not need to describe the appalling atrocities which have taken place in these countries in recent years. We have supped full of horrors on British television. In addition to the official forces of Government, death squads operate on a large scale in Guatemala and El Salvador. I am sorry to say that the exiled supporters of the ex-dictators are allowed to train their private armies publicly on American soil in Florida and Texas.

In El Salvador, over 30,000 people have died in the past two years as a result of the fighting—that is, about 400,000 for a country the size of Britain. Many of them were tortured and mutilated before being shot or hacked to death by the death squads. The Catholic Archbishop of El Salvador was shot while celebrating mass in March 1980, and those who went to a service in his honour were mown down by rifle fire in front of the cathedral.

The Reagan Administration recognises that there is an economic factor behind these appalling events although the programme that the President announced last week does little more than make good cuts in lending by the Inter-American Bank and the World Bank which are due to a reduction in America's contribution to them. Moreover, many of the proposals that the President made last week depend on Congressional decisions, which cannot be taken for granted. The President appears to see the political revolution in the area simply as the product of a conspiracy by the Soviet Union and Cuba, and forgets that the revolution in El Salvador is at least 50 years old.

Both the President and Secretary Haig see the possible victory of the guerrillas as a threat to their vital strategic

Nat Ind

NBPM mis 2/3

JU90

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

2 March 1982

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
London SW1

JV
AD

Dear Geoffrey,

LONGER TERM STUDY ON ELECTRICITY PRICES

I have seen a copy of Nigel Lawson's letter of 23 February to you about this study. I am content with the draft terms of reference. It seems to me to be exactly the kind of study which the CPRS ought to lead, but I agree that if they cannot then it should be led by the Department of Energy. I do, of course, wish my officials to be closely involved in the study.

I am sending copies of this letter to Nigel Lawson and to recipients of his letter.

Yours ever
Patrick

1-2 MAR 1982

Nat Ind Gas & Electric

CONFIDENTIAL

(2)

Prime Minister

MCS 2/3

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

01 211 6402

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London
SW1P 3HE

1 March 1982

Dear Chancellor

ESI INDUSTRIAL WAGE NEGOTIATIONS

In my letter of 10 February I promised to let you know about an informal discussion to be held on 2 March between the Electricity Council and Union representatives of the electricity manual workers.

I have now learned that at that meeting the Council intend to increase their pay offer to about £5.35 at the minimum of the labourers' scale (previous offer £5), and about £10.70 for a craftsman on his maximum (previous offer £8). The Council will also make a further offer on shift pay - they are prepared to increase unsocial hours payments by up to 15% in order to bring the shift premium level up to comparable levels in other industries.

The effect of the offer will be to increase average earnings by between 5½% to 7%, and increase the salary bill by about 6½%. I understand that the electricity and gas industries are in close touch on the conduct of their negotiations.

It is not known how the offer will be received but the union side will probably press for a further increase. The offer will not be made public and the union negotiators will refer it back to their full meeting on 4 March. I will continue to keep you informed of progress.

Copies of this letter go to the Prime Minister, other members of 'E', George Younger, Robin Ibbs, and Sir Robert Armstrong.

Yours sincerely

David Lumley

pp NIGEL LAWSON
(approved by the Secretary of State
and signed in his absence)

2 MAR 1982

Nat Ind
Gas & Electric

2

PRIME MINISTER

MT

Industrial Gas Prices

You raised several times earlier this week the point which had been made to you during your visit to Ruston Gas Turbines about British Gas industrial pricing policy.

I have discussed this with the Department of Energy. As I see it, Rustons have a good point; but it is not a point about the general level of industrial gas prices, but rather about the rigidity of British Gas's pricing in relation to Combined Heat and Power (CHP) schemes.

I am told that half of British Gas's sales to industry are made at fuel-oil related prices. The other half are made at gas-oil related prices. In both cases the price level is well below the equivalent oil price level. The Department of Energy argue that, at these price levels, demand is so strong that British Gas are unable to meet it; customers are switching from other forms of fuel because of the price advantage in doing so. So British Gas are in fact operating a rationing system. In a free market situation this scarce resource would be rationed by price. This is the Department of Energy's argument for a higher price for industrial gas.

The Rustons point is about the criterion which British Gas uses in deciding at what level to price gas to individual industrial users. They do so in relation to the alternative fuel in each case. For most CHP schemes this is fuel oil, and BGC would normally supply interruptible gas at a fuel oil related price. A few CHP schemes however are based on gas turbines. Because the alternative fuel in these cases is gas oil BGC are reluctant to supply interruptible gas here at a fuel oil price. This rigid policy tends to make gas turbine CHP schemes unattractive. Rustons, naturally, have objected strenuously to this policy, and the Department of Energy have taken up their point with British Gas,

/ so far

so far with no success. They are keeping up the pressure but have no powers to direct British Gas on this matter. They say that the basic answer is to make the gas market more competitive, and that the Government is doing this with the Oil and Gas (Enterprise) Bill.

MLS

26 February 1982

CONFIDENTIAL

NBPM

C.C. JV
~~AD~~

Caxton House Tothill Street London SW1H 9NA~~X~~F

Telephone Direct Line 01-213 6400 GTN 213

Switchboard 01-213 3000

Baroness Young
Chancellor of the Duchy of Lancaster
Management and Personnel Office
Whitehall
LONDON SW1A 2AZ

26 February 1982

D— Janet,

GAS SAFETY AND STANDARDS

Thank you for sending me a copy of your letter of 8 February to Nigel Lawson following on from mine of 20 January.

For my part, I should welcome your people taking a lead as honest broker in the discussions on the work of the Gas Standards Branch and the Electricity Meter Examination Service I would also be content for the discussions to range beyond the HSE's role on gas safety to take in other metrology work and the work of other Government laboratories if you think that might be useful.

Copies of this go to the recipients of the earlier letters.

Y—
Norm—

–1 MAR 1982

SECRET

SUBJECT

file VS

1

Mr Duguid
Mr. Ingham
Nat Ind

10 DOWNING STREET

From the Private Secretary

25 February 1982

cc Master

Dear Julian,

GAS PRICES

The Prime Minister had several discussions with the Chancellor and your Secretary of State yesterday about gas price increases.

The Prime Minister was at first inclined to the view that the domestic gas price increase planned for October should not go ahead. On political grounds, she was conscious of the difficulty which the Government would face in Parliament in proceeding with the two planned increases this year; and on economic grounds she was unconvinced that British Gas needed the October price increase, which seemed to her to be of the nature of a tax. In discussion, your Secretary of State produced the attached table, which indicated that, without the October increase, British Gas would scarcely break even on domestic sales in 1982/83 before taking account of the levy. It was also argued that, notwithstanding the substantial pre-levy profits which British Gas would earn on present price increase plans, both domestic and industrial prices were clearly below their desirable economic level, given that consumers had switched into gas on such a scale that British Gas was unable to meet the demand and had been obliged to use a rationing system. Your Secretary of State also revealed that British Gas had already despatched press notices announcing both domestic price increases. In the light of these points - and also on wider budgetary grounds - the Prime Minister agreed that it was desirable that both domestic price increases should go ahead.

Discussion then turned to the best way of winning political support for this course of action. Your Secretary of State proposed that a freeze on industrial gas prices should be imposed after the planned increase in March 1982. He would then be able to argue to the Government's supporters that it was only because of the domestic price increases that he had been able to afford to offer this assistance to industry's energy costs. The Chancellor said that he was prepared to accept this proposal. The presentation of the argument would need careful attention, since the industrial price freeze could not be disclosed before the Budget Statement on 9 March.

/ The Prime Minister

SECRET

The Prime Minister said that it was agreed that the Chancellor should include in his Budget Statement an announcement of a freeze on industrial gas prices after the 1 March 1982 increase and running to the end of calendar 1982. Your Secretary of State should make what use he could of this before the Budget in putting the case to the Government's supporters for upholding planned increases in domestic gas prices this year.

I am sending copies of this letter and enclosure to John Kerr (H M Treasury), Jonathan Spencer (Department of Industry) and David Wright (Cabinet Office).

Yours sincerely

Michael Scholar

Julian West, Esq.,
Department of Energy.

GAS TRADING PROFITABILITY

DOMESTIC	1981/82 £m (p/th)	1982/83 (10% real) £m (p/th)	1982/83 (Inflation only) £m p/th)
Revenue	2693 (30.4)	3452 (37.8)	3193 (34.9)
Trading costs	2708 (30.6)	3191 (34.9)	3191 (34.9)
Profit/Loss (pre levy)	-15 (-0.2)	261 (2.9)	2 (-)
Levy	177 (2.0)	366 (4.0)	366 (4.0)
Profit/Loss (post levy)	-192 (-2.2)	-105 (-1.1)	-364 (-4.0)

INDUSTRIAL		Freeze	No Freeze
Revenue	1889 (23.5)	2119 (25.6)	2219 (26.8)
Trading costs	1418 (17.6)	1741 (21.0)	1741 (21.0)
Profit/Loss (pre levy)	481 (5.9)	378 (4.6)	478 (5.8)
Levy	177 (2.0)	334 (4.0)	334 (4.0)
Profit/Loss (post levy)	304 (3.9)	44 (0.6)	144 (1.8)

TOTAL GAS TRADING			
Profit/Loss			
(pre levy)	466	639	480
(post levy)	112	-61	-220
% Return on Assets			
(pre levy)	4.3	5.3	4.0
(post levy)	1.0	-0.5	-1.8

GAS TRADING PROFITABILITY

British Gas financial posn

DOMESTIC	1981/82 £m (p/th)	1982/83 (10% real) £m (p/th)	1982/83 (Inflation only) £m (p/th)
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Trading costs	2708 (30·6)	3191 (34·9)	3191 (34·9)
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Trading costs	1418 (17·6)	1741 (21·0)	1741 (21·0)
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Levy	177 (2·0)	334 (4·0)	334 (4·0)
Profit/loss (post levy)	304 (3·9)	44 (0·6)	144 (1·8)

TOTAL GAS TRADING			
PROFIT/LOSS pre levy	466	639	480
post levy	112	-61	-220
% RETURN ON ASSETS pre levy	4·3	5·3	4·0
POST "	1·0	-0·5	-1·8

CONFIDENTIAL

Prime Minister

MHS 24/2

(2)

SECRETARY OF STATE
FOR
NORTHERN IRELAND

NORTHERN IRELAND OFFICE
GREAT GEORGE STREET,
LONDON SW1P 3AJ

Rt Hon Leon Brittan QC MP
Chief Secretary
HM Treasury
Parliament Street
LONDON SW1P 3AG

23 February 1982

Dear Chief Secretary,

NORTHERN IRELAND ELECTRICITY SERVICE - will request if required.

Thank you for your letter of 22 January in response to the part of my letter of 23 December which related to electricity tariffs. not copied to N.10

I very much agree that we need to ensure that the NIES is efficiently operated and I believe that a comprehensive and authoritative efficiency audit of the Service should be carried out as soon as possible. I have considered the possibility of using private management consultants such as Maynard and Barry, to carry out a study of NIES, but have reached the view that because inter alia of its recent report on the CEGB, much of which would carry over to the generating activities of NIES, the MMC would be better suited to carry out the study of the Service. My officials have corresponded on this point with yours and with those in the Department of Trade and the CPRS.

When E(NI) considered your memorandum of 22 January about the programme of MMC references for 1982 at their meeting on 10 February, agreement was reached on five audits for this year. I understand, however, that there may be scope for the addition of one further reference and I should be grateful if a place could be earmarked for a study of NIES to commence as soon as possible.

My officials are in close touch with yours about the financial requirements of NIES in the years 1982/83 onwards. You can be assured that I certainly accept the principle that there should generally be sufficient scope within the Northern Ireland block budget to cope with adjustments which are required in the normal course of events as forward spending plans are reviewed and translated into reality. The Northern Ireland budget has achieved such adjustments in the past and it is my firm intention that good housekeeping and careful planning will continue.

/...

CONFIDENTIAL

I shall, therefore, do my best to minimize any bid on the Contingency Reserve but I felt it only fair to alert you to the possibility that I might not be able to avoid it altogether. The problem with the Electricity subsidy is that its main determinant, the tariffs charged, is quite outside the control of the NIES and even now it is impossible to be certain about the precise sums which will be required in 1982/83 since this depends on tariffs decided for England and Wales. Proposals are now, however, emerging for the tariff increases in England and Wales for 1982/83 and when final decisions have been taken I will write to you again about the implications for the subsidy to NIES.

I am glad that you have been able to agree that our officials should look again at the case for taking Electricity outside the block. It would be wrong to prejudge the case, but a solution along these lines would at least avoid the recurring need to look at the totality of the Northern Ireland programme at almost impossible notice - with resultant difficulty for both of us.

I am copying this to John Biffen, to other members of E(NI), to Sir Robert Armstrong and to Mr Ibbs.

Yours sincerely

FP JAMES PRIOR
(Signed on behalf of the Secretary of State in his absence)

3 FEB 1982

CONFIDENTIAL

Prime Minister (2)

MLS 24/2

Nationalised Industries

01-211 6402

Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
London SW1

23 February 1982

Dear Geoffrey

LONGER TERM STUDY ON ELECTRICITY PRICES

At our meeting on 10 February we agreed that the study should go ahead on the basis of terms of reference agreed between the Departments concerned. I now enclose suggested terms of reference which my officials have drawn up in consultation with Treasury, CPRS and D/Industry officials. If you and our colleagues are content with this, we can quickly proceed to put the study in motion. If, as I understand, it may not be possible for the CPRS to undertake the study, I think it could appropriately be led by my Department, though of course with the full involvement of other Departments concerned. The group could consider whether they might usefully consult outsiders. But in view of the possible political risks in this course I think they should consult Ministers should they favour it.

I am sending copies of this letter and the draft terms of reference to the Prime Minister, Patrick Jenkin, George Younger, Nicholas Edwards, Robin Ibbs, and Sir Robert Armstrong.

Yours ever

Nigel

NIGEL LAWSON

(i) To establish in what way and in what timescale the cost of electricity in the UK may become more competitive with costs in other major industrial countries (notably in France and Germany) and to consider how we should react to lower prices in other countries;

(ii) To examine, in the light of (i), the effects on bulk users of electricity of continuation of present international price differentials for some years, assuming also continuation of present cost and tariff structures; to consider, in particular which industries or processes may be significantly at risk as a consequence and to advise on whether there are any such industries or processes that it would be undesirable to lose from the economy;

(iii) To advise, in the light of (ii), on the practicability and desirability of changes in the electricity pricing structure which would have the effect of reducing charges to large consumers, including the possibility of legislative change; and on other possible forms of assistance;

(iv) To consider how far the extra cost in public expenditure of lower electricity prices for industry might be offset by the possible benefit of saving part of the industrial base.

23 FEB 1982

Copy to Mr Duguid

2.

Prime Minister.

If — as I suspect they will — the Treasury oppose this, the quickest way of reaching a decision will probably be to bring the matter to E.

22.ii

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ
01 211 6402

Rt Hon Leon Brittan QC MP
Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
LONDON SW1

22 February 1982

Dear Chief Secretary

ENERGY CONSERVATION: ASSISTANCE FOR LARGE ENERGY USERS

It was agreed at our meeting on 10 February that I should pursue with you my proposal to assist large energy - particularly electricity - users to invest in energy conservation projects.

My officials have now prepared the attached note which develops the proposal in my letter of 1 February in the light of the points raised at our discussion. It has been prepared in consultation with officials from the Departments most concerned (including the CPRS) although your officials have reserved the right to continue to oppose the scheme.

I believe we should go ahead with the proposal on the basis outlined. We would be able to limit fairly precisely the number of takers if we specified a minimum level of energy use: the paper works on the basis of 5 million therms per year, (although I would not be averse to setting it at 2.5 million if that were helpful to George Younger). Alternatively, having established a very limited pool by setting a 5 million therm minimum for energy use, I believe we should open the scheme to projects saving a minimum of 2000 tce rather than 4,000 as initially suggested. This would meet the point in Patrick Jenkin's letter of 16 February to Geoffrey Howe and should also help George Younger.

I feel strongly that the scheme will not be attractive enough unless the assistance is given outright as proposed in para 9 of the paper. In other words the first two years of interest on loans for eligible projects would be waived entirely. This would entail a cost of £56 million in the first four years rather than £50 million in order to promote £200 million of investment (based on a 15% interest rate). The cost in the first year would still be no more than £3 million. I also now accept that the scheme will not only be seen more widely as being fair but will also avoid European Community objections if it is aimed at large energy users in general, without any explicit preference for electricity users. This accords with Patrick Jenkin's view. The big electricity users also use other fuels and would benefit from this scheme by bringing forward projects saving any form of fuel. However I consider it would be helpful to assess the potential of electricity saving projects in primary energy terms.

I hope you will now be able to agree in principle to these proposals so that we can get ahead with working out more of the details before the Budget. Subject to the results of further work, I suggest the attached form of words to announce the scheme. I would also suggest that it would be desirable to clear our lines with the Commission (as we did for the Coal Fired Boiler Scheme last year) before any announcement is made.

I am more than ever convinced that there is real merit, and substantial political mileage, in going ahead with the scheme proposed here.

I am sending copies of this letter to the Prime Minister, Peter Carrington, George Younger, Nicholas Edwards, Patrick Jenkin, Sir Robert Armstrong and Robin Ibbs.

Yours sincerely

David Lumley

pp NIGEL LAWSON

(approved by the Secretary of State
and signed in his absence)

ENERGY CONSERVATION: ASSISTANCE FOR LARGE ENERGY USERS
NOTE BY DEPARTMENT OF ENERGY

Introduction

1 The Secretary of State for Energy's letter of 1 February to the Chancellor of the Exchequer set out a proposal to give assistance to large energy users to invest in substantial energy conservation projects. This note develops the proposal in the light of the discussion with the Chancellor on Wednesday 10 February.

Scope and purpose

2 £50 million would be made available by Government as interest relief on the first two years of loans for energy saving projects. This would **assist** approximately £200 million of new investment (assuming a 15% interest rate). It would complement the new load management arrangements for large electricity users by encouraging large energy users to make some of the investments which are needed to reduce the energy demands of their industries so that they can compete more effectively in a world of increasing energy prices. The kinds of projects which might come forward are illustrated in Annex A.

3 It is proposed that the scheme should be open to all large energy users (the definition of which is considered below). The simpler approach would be to confine it to electricity users as the group whose energy cost disadvantage in relation to foreign competition is now shown to be greatest and whom there is the greatest need to placate. But to do so would inevitably lead to complaint from UK companies using other fuels and would provoke an adverse Community reaction on the grounds that favouring one form of fuel would make the scheme - in effect - a price subsidy rather than an energy conservation scheme. Moreover, many of the large electricity users could only be helped by conservation projects saving other fuels as well as electricity; nevertheless the major electricity users, **would be covered by the proposed scheme. Table 1 shows the sectors (but not the individual users) which would be helped by the load management arrangements.**

Justification

4 The proposal rests on three main arguments:

(a) heavy energy users have borne the brunt of higher fuel prices which have in some cases put them at a disadvantage in relation to foreign competitors. The assistance will encourage the necessary structural adjustment to higher energy prices, and for electricity users is a logical complement to the new flexibility on price;

(b) shortage of capital and pressure on cash flow means that companies are not giving adequate priority to major energy conservation investments. For example companies are often requiring paybacks of 18 months or less rather than of 4-5 years which would seem more reasonable even allowing for high interest rates.

(c) limited public resources mean that help should be concentrated on those who need it most and where it will have the greatest impact.

We cannot expect these arguments to silence complaints from lesser energy users who will not benefit. But we can argue that there are other Government programmes to benefit smaller firms. This and the arguments above give a reasonable basis on which to reject claims for extension. Equally, in order to avoid adverse Community reaction we need to be careful how we present the first part of the argument at (a)

Criteria of eligibility

5 Ministers were concerned that the criteria should be tightly

defined so as to limit the pool of potential takers. The best option would seem to be to define both the companies, by limiting eligibility to those consuming more than a given quantity of energy, and the projects, as those which would save more than a stated quantity of energy. If the energy consumption criterion were 5m therms of delivered energy this would limit the potential to no more than 600 establishments - and only a proportion of these would be likely to bring forward projects. (If the level were 2.5m therms about 1,000 establishments could qualify.) The letter of 1 February proposed 4,000 tce as the minimum quantity of energy to be saved by each project. However, given the suggested limitation on the total pool, this could prove too restrictive. A minimum of 2,000 tce would seem more appropriate while still preventing very large numbers of potential lower cost projects from qualifying. Attempting to taper assistance around a standard of 4,000 tce would make the scheme administratively cumbersome. In addition we believe that in order to encourage electricity-saving projects these should be judged in terms of primary energy saving. Otherwise, electricity saving projects would be at a disadvantage because they would have to save three times as much primary energy as others.

6 In any event, if it could be clearly stated at the outset that £50 million was the absolute limit of assistance available and that it would be given on a first come first served basis there should be no real difficulty in resisting pressure to exceed it.

7 There are no other criteria which could be adopted without complicating unduly the administration of the scheme. It would in particular be virtually impossible to tie assistance to firms facing heavy competition from foreign concerns benefitting from lower energy prices; not only is there a range of different energy prices between different countries and different types of user but also frequent changes in price relativity arising both from price changes and from exchange rate movements and other factors.

Form of assistance

8 Assistance would take the form of interest relief on the first two years of loans for eligible projects. This could be

given in three possible ways:

(i) deferral of interest which would then be repaid with accrued interest;

(ii) deferral of interest which would then be repaid without accrued interest;

(iii) waiver of interest ie no repayment.

Any of these methods will lead to a significant cash flow benefit in the first two years (amounting to about £250,000 for a £1 million project) after which the benefits from the investments should begin to be felt. The difference to the Exchequer would be negligible over the first four years of the scheme (option iii would cost £56 million as against £50 million for option i and ii). A comparison of the costs is set out in Table 2.

9 It will be most important to tailor the assistance so as to stimulate industry to undertake projects. The Bank of England have suggested that firms could find the prospect of repaying the deferred interest after 2 years a significant disincentive; given the relatively small expenditure implications over the first few years waiving the interest repayment might therefore be the best option. It would also make the scheme simpler to operate.

10 The attractiveness of the scheme to industry could also be adversely affected if it has to be proved in each case that the scheme would not have gone ahead without Government assistance ("additionality"). We believe there is a case for arguing that the scheme as a whole is "additional" in that it would promote a form of investment which is generally not taking place. On the other hand all other assistance for large projects currently given under S 8 of the Industry Act is assessed for additionality.

Administration

11 An essential feature of the scheme is that it would give interest relief on bank loans for eligible conservation projects

based on normal commercial criteria. Money would be channelled through the banks, which might also take on (subject to consultation) some of the work of project assessment. In any event a small unit of 8-10 people including 2 technically qualified assessors would be needed in Government to run the scheme; and there would probably need to be more if the banks could not do any of the project assessment and if additionality had to be proved in each case.

PESC implications

12 Table 2 shows the public expenditure impact. It is very difficult to estimate how quickly expenditure on such a scheme would build up. Costs will almost certainly be very small in the first year or so - and since borrowing for big projects would normally be phased over a lengthy period the build-up could well be slower than indicated.

Legal powers

13 The scheme would need to operate under section 8 of the Industry Act 1972 which provides for selective assistance to industry. The section sets a limit on the total amount of assistance and that limit has now nearly been reached. Likely expenditure on this proposed scheme would not exceed the limit during its first year but it probably would in subsequent years. DOI plan (for their own schemes) to institute the necessary legislation to raise the limit during the current session and it should be passed soon enough for our purposes. There is nevertheless some risk inherent in making a commitment to expenditure not all of which is currently authorised by existing legislation. Any budget statement will therefore need to make clear that existing powers are not sufficient and will need to be extended.

European Community

14 It should be noted that the scheme will have to be notified to the European Commission as a state aid. Given the Commission's sympathy for energy conservation schemes and the schemes which other member states have instituted, this should not be an obstacle.

Conclusion

15 We therefore conclude that the scheme should go ahead covering

(a) firms using more than 5 million therm;

and (b) for projects saving more than 2000 tce primary energy;

We also recommend that the interest relief given under the scheme should not be recovered.

Department of Energy
17 February 1982

ANNEX A

EXAMPLES OF POSSIBLE PROJECTS

The following examples have been selected to indicate the kind of projects which might come forward in certain of the main sectors we would wish to see helped. They are simply a selection of potential projects which happen to be known to D/En through the administration of the Energy Conservation Demonstration Projects Scheme. There can of course be no certainty that these particular projects would come forward under a scheme.

Company	Project	Cap Cost £M	Energy Savings (tce) (primary)
Cement			
Blue Circle (Shoreham) and	Conversion from wet to Dry Air process	£4M	20,000
Tunnel Cement	"	"	"
Blue Circle (Northfleet)	Wet to Dry process conversion	£15M	150,000
ICI Buckstone and	Conversion from Wet to Dry Air process	£4M	20,000
Ketton Cement	"	"	"
Pottery			
Staffs Potteries	Fast and once firing tableware	£1.5M	3,000
Chemicals			
Albright and Wilson	Use of Gas Turbine exhaust for spray drying	£2.0M	8,000

ICI Petrochem (Wilton)	Re-organisation and distillation train	£0.4M	10,000
Monsanto (Coleraine) (NI)	Organic Rankine Cyde project power generation from waste low grade steam	£1.5M	28,000
Food			
ABM (Airdrie)	Gas engine driven heat pumpf for malt kilning	£5.0M	20,000
Canada Dry	Heat pump for heat recovery from waste water	£0.45M	
Pedigree Petfood	CHP, coal fired, scheme (40 MW)	£6.0M	25,000
Horticulture			
Humber Growers	Geothermal heated glasshouse with heat pump	£2.0M	10,000
Consortium of Growers/ CEGB (Didcot)	Use of reject heat for horticulture	£2.0M	5,000
Paper			
East Lancs Paper Mill	Waste fired, fluidised bed, steam raising	£6.0M	29,000
Other			
Dunlop	Manufacture of building aggregate from coal waste	£1.75M	"

Simon - TR Holdings	Waste fired, fluidised bed, steam raising	£1.50M	5,000
Marley Tiles	Sand pigmenting using fluidised bed	£3.75M	2,000
<u>Aluminium</u> (recycling)			
Brit Alum Alloys Warrington or ALCAN, Enfield	Metallurgical Furnace replacement - scrap pre heating	£1.0M	20-50,000
BCL Alloys (GKN subid) Telford	New plant recycling low grade alum scrap	£0.5-1.0M	20-50,000 (National energy saving achieved in these cases by replacing virgin aluminium)

TABLE 1

SECTOR	No of establishments using over (therms)			Whether helped by electricity load management scheme
	2.5m	5m	10m	
Other mining & quarrying	7	3	1	✓
Food, drink and tobacco	121	61	24	-
Coal & Petroleum products	30	22	18	✓
Chemicals and allied industries	147	88	51	✓
Metal manufacture	224	179	38	✓
Mechanical engineering	38	10	2	✓
Investment engineering	3	1	0	
Electrical engineering	45	21	8	
Shipbuilding and marine engineering	7	4	0	✓
Vehicles	37	23	11	
Other metal goods	28	13	2	✓
Textiles	70	29	12	✓
Leather, leather goods & fur	-	-	-	-
Clothing & footwear	-	-	-	-
Bricks, pottery, glass, cement	120	62	37	✓
Timber, furniture	-	-	-	-
Paper, printing & publishing	88	54	23	✓
Other manufacturing	33	13	5	-
Gas, electricity, water	7	4	2	✓
TOTAL ALLSECTORS	1005	603	246	

Note Energy use data is derived from 1974 Business Purchases Enquiry which can still be held to be relevant at least for large firms. It is shortly to be updated to 1979. The sectors are therefore based on the 1968 Standard Industrial Classification.

TABLE 2

COMPARISON OF PUBLIC EXPENDITURE COSTS

(Actual Exchequer cash outflows less balancing in flows directly accruing from repayments, where appropriate)

YEAR

FORM OF INTEREST SUPPORT		1 1982/3 £m	2 1983/4 £m	3 1984/5 £m	4 1985/6 £m	5 1986/7 £m	6 1987/8 £m	7 1989/9 £m	8 1990/1 £m	9 1991/2 £m	10 1992/3 £m	Cost over first 4 years £m	Total cost/ benefit £m
Interest deferred for 2 years-repaid with interest over 6 years	Cash	3	14.6	23.4	4.4	+17.0	+15.6	+14.2	+12.8	+10.4	+5.4	45.4	+30
	NPV	3	12.7	17.7	2.9	+ 9.7	+ 7.8	+ 6.1	+ 4.8	+ 3.4	+1.5	36.3	3.0
Interest deferred for 2 years-repaid withaut interest over 6 years	Cash	3	14.6	24.6	8.4	+ 9.4	+ 9.4	+ 9.4	+ 9.4	+ 8.4	+4.7	50.6	0
	NPV	3	12.7	18.6	5.5	+ 5.4	+ 4.7	+ 4.1	+ 3.5	+ 2.7	+1.3	39.8	18.1
Interest waived for 2 years-not repaid	Cash	3	14.6	25.5	13.1	-	-	-	-	-	-	56.2	56.2
	NPV	3	12.7	19.3	8.6	-	-	-	-	-	-	43.6	43.6

<u>Notes</u>

(1) Assumes 15% interest rate

(2) Assumes investment takes place according to following pattern:
1982/3 £20m
1983/4 £80m
1984/5 £100m

(3) A + sign indicates an inflow. All other figures are outflows.

(4) To establish the NPV a discount rate of 15% has been used of which 5% is the Treasury's required real rate of return on public expenditure and 10% is the assumed average rate of inflation over the period.

DRAFT STATEMENT

(to follow the passage on the BST review/new load management arrangements)

ENERGY CONSERVATION: ASSISTANCE FOR LARGE ENERGY USERS

In addition, I propose to make £50 million available to assist heavy energy users to undertake substantial energy saving investments. The assistance, which will be provided under section 8 of the Industry Act 1972, will be available for projects put forward over the next 2 years. It will take the form of relief of the interest on the first 2 years of loans for projects designed to save more than 2000 tce of primary energy per year. Only the heaviest energy users will qualify: they will need to demonstrate that they use more than 5 million therms per year at the establishment where the project would be sited. The scheme will cost £3 million in 1982/3. Details will be announced as soon as possible by my RHF the SOS for Energy.

[I believe that assistance in this form will make the best use of limited public resources. It will help promote projects yielding the maximum energy savings. It will also ease the problems of the largest energy users, among whom will be those large electricity users who will be helped by the new load management terms I have announced.]

22 FEB 1982

JU42

Prime Minister

MHS 18/2

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

16 February 1982

Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
London SW1

AD
JV

Dear Geoffrey,

ENERGY CONSERVATION: ASSISTANCE FOR LARGE ELECTRICITY USERS

Nigel Lawson sent me a copy of his letter to you dated 1 February.

2 As you know, I continue to be very concerned about the difficulties faced by large energy users. The separate proposals already put forward by Nigel on load management will help some electricity users but there will inevitably be some who cannot secure much advantage from this. The fundamental reviews of energy pricing which have been proposed will take some time to complete and in the meantime it would be desirable to help large energy users to undertake energy conservation investment where they are unable to proceed without our assistance.

3 New measures to encourage investment in energy conservation should, in my view, be concentrated on large energy users, who are suffering most from competitive disadvantage compared with manufacturers abroad. Clearly this must include electricity users, but I would not be inclined to accord them a public priority within the suggested scheme. Since the second NEDC Task Force Report, it appears that the gap between UK and Continental prices for heavy fuel oil is widening and we may expect to see a price differential re-emerge on gas when the BGC price freeze ends in March. I would therefore prefer simply to set a minimum threshold for the scheme. The level of this threshold would have to be further considered by officials to take account, for example, of the fact that many private sector steelmakers might be excluded by the 4000 tons of coal equivalent suggested.

4 Likewise officials can consider the relative merits of a new loan facility and a system of grants. Either way I believe we

17 FEB 1982

should have the flexibility to tailor the degree of assistance to the circumstances or particular cases (within a stated maximum) so that we do not provide more in particular cases than is judged necessary. Officials will also need to consider how the new scheme will relate to existing support measures.

5 Finally, I think it would be helpful if Nigel Lawson would indicate soon what legislation he would propose to use for the scheme.

6 I am copying this letter to the Prime Minister, Peter Carrington, George Younger, Nicholas Edwards, Nigel Lawson and Sir Robert Armstrong.

Yours ever

Patrick

2.

Prime Minister.

For 17th

Y SWYDDFA GYMREIG
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WHITEHALL LONDON SW1A 2ER
Tel. 01-233 3000 (Switsfwrdd)
01-233 6106 (Llinell Union)

WELSH OFFICE
GWYDYR HOUSE
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Tel. 01-233 3000 (Switchboard)
01-233 6106 (Direct Line)

Oddi wrth Ysgrifennydd Gwladol Cymru The Rt Hon Nicholas Edwards MP From The Secretary of State for Wales

CONFIDENTIAL

16th February 1982

Dear Nigel

I have read with interest the exchanges on electricity prices, the BST Review and energy conservation following your letters of 29 January and 1 February.

I have made clear my interest in these issues in the past. Large scale energy users - we have many such in Wales - continue to face very considerable problems. Broadly speaking their competitive positions against the energy costs of some European counterparts are no better than when I raised the subject with your predecessor as long ago as November 1980. Whether the proposed new load management terms however welcome are sufficient to over-come the crucial problems of the intensive electricity consumer remains to be seen but the proposal has my support. So too does the proposed energy conservation scheme which I judge could bring significant benefits not only in energy usage but also in terms of employment and industrial regeneration.

I share the view already expressed that a consultancy study is not necessarily the most appropriate way of handling the BST Review but I would go along with a Whitehall study especially if it dealt with the subject on the wide ranging basis envisaged by Robin Ibbs. At the very minimum we need to be sure, as Patrick said, that the LRMC figures are fairly based.

If there is to be such a study I would hope that my officials can sit in on it. I make that request in view of my industrial responsibilities in Wales but I am very concerned too with the adverse effect on employment that failure to ensure that the BST is properly based could bring.

Finally could I ask you to keep well in mind when you discuss these measures with the Chancellor next week my concern for industrial competitiveness and the effect that progress on your proposals or the lack of it could have on an area like Wales.

I am copying this letter to recipients of your letters.

The Rt Hon Nigel Lawson MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
LONDON

Yours ever
Nick

17 FEB 1982

Not Ind
Gas/Electricity

FILE

dl

Not Ind
bf Anguish

10 DOWNING STREET

From the Private Secretary

16 February 1982

Review of Electricity Prices

The Prime Minister read with interest the Chancellor's minute of 12 February, with which were enclosed minutes of the Chancellor's meeting on 10 February.

The Prime Minister believes that the CPRS has enough to do at present, and wishes to avoid a re-arrangement of their programme of work. She accordingly would prefer this proposed study on electricity prices to be led by the Department of Energy or by the Department of Industry.

M. C. SCHOLAR

Peter Jenkins, Esq.,
HM Treasury.

CONFIDENTIAL

(1)

10 DOWNING STREET

Prime Minister

You said you thought Tsy/
Energy and not CPRS should
do this study; but I'm not
sure that you had as long as
you wanted to glance through.

MCS 15/2

CONFIDENTIAL

JAD
JV

(1)

Prime Minister

Do you wish CPRS to take this on (it would, presumably, set back their existing programme)?

MCS 15/2

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

PRIME MINISTER

The CPRS has enough to do at present. Other departments have far more people. Energy/Industry can do it. not

REVIEW OF ELECTRICITY PRICES

Your Private Secretary's letter of 8 February to mine recorded your wish to be kept in touch with the conclusions of my meeting on 10 February on electricity pricing policy and its industrial ..... implications. I attach the minutes of the discussion.

2. It was clear from the NEDC Working Party Report on energy prices that certain heavy users of industrial electricity do get more favourable prices in continental countries and North America than they do here. This is not just a temporary situation, and its continuance would seriously weaken the competitive position of hitherto important parts of British industry. There are many reasons for this: natural endowment abroad, cost inefficiencies here, different pricing policies and perhaps foreign subsidies. Our present system of prices is aimed at neutrality between industrial and domestic users; whereas in many other countries there is a bias in favour of industry and especially certain heavy users.

3. I concluded, therefore, that we ought now to take a deeper and longer-term look at policy on electricity prices in all its aspects. There are of course conflicting policy considerations here - energy pricing policy, industrial policy and public expenditure policy and the review would need to be a fundamental one.

4. As you will see from the minutes, at the meeting on 10 February, all were agreed that a review of the kind I have suggested should

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go ahead urgently. The issues involved are already to a large extent under active consideration within the Department of Energy and Nigel Lawson would be content for his Department to lead the study, which would of course be an interdepartmental one involving the CPRS.

5. My own strong preference, which you will see received support at the meeting, would be for the study to be led by the CPRS. This is partly because the issues involved go beyond energy policy to include important and long-term questions of industrial policy; and partly because I feel a more independent and fresh approach to the problem is needed than the Department of Energy is likely to offer. Those who live and breathe problems are not always best placed to take a long hard look at them, however expert they may be.

6. I also feel that because it does straddle the interests of several Departments, and because of its fundamental nature, this review would be well suited to CPRS treatment. The CPRS would of course be involved even if the review were to be led by the Department of Energy, but Robin Ibbs has said that while he would welcome the task, he could not take on the leading role in the study given his other commitments for 1982. If he were to take on this review as well it would require some adjustment to the priorities in the programme.

7. I feel the case for the CPRS taking the lead in the review of electricity prices is sufficiently important to justify such an adjustment to the programme. The aim would be to complete the study by early to mid autumn.

Peter Jenkins

for G.H. (Approved by the Chancellor of the Exchequer and signed in his absence).

12 February 1982

NOTE OF A MEETING HELD AT 11, DOWNING STREET ON WEDNESDAY, 10 FEBRUARY

Present:

Chancellor of the Exchequer
Chief Secretary
Mr. Ryrie
Mr. Wicks
Mr. Chivers
Mr. Ridley

Mr. Ibbs - CPRS

Secretary of State for Industry
Mr. Owen - Dept. of Industry

Secretary of State for Energy
Mr. D. le B. Jones) Dept. of
Mr. Morphet) Industry

Secretary of State for Scotland
Mr. Harrison - Scottish Office

The meeting had before it a letter dated 14 January and 8 February from the Secretary of State for Industry to the Chancellor about the possible widening of the application of the coal-fired boiler scheme and the Chancellor's reply of 5 February; a letter dated 25 January from the Chancellor to the Secretary of State for Energy about electricity prices, and Mr. Lawson's reply dated 29 January; and a letter dated 1 February from the Secretary of State for Energy to the Chancellor dated 1 February, and the Chancellor's reply dated 5 February; and a letter dated 1 February from the Secretary of State for Energy to the Chancellor on energy conservation and possible assistance for large electricity users.

1. Coal fired boiler scheme

2. The Secretary of State for Industry said that having seen the Chancellor's response to his proposal for an extension of the scheme to include conversions from gas to coal, he had asked for this question to be included on the agenda as he still regarded the extension as important for the success of the scheme. So far the take-up had been disappointing; and it seemed likely that on the present basis there would be a significant shortfall from the £50 million allocation, perhaps by as much as one-third. His main proposal was to extend the scheme to cover gas to coal as well as oil to coal conversion, for which there was considerable pressure. Gas should logically be regarded as an expensive premium fuel when used for boilers, rather than in cases where instant heat was needed.

Extension would help with the problem of the NCB's coal stocks, and it was neutral from the point of view of the PSBR.

3. The Chancellor, summing up a short discussion on this point, said it was agreed that the extensions proposed by Mr. Jenkin should go ahead, subject of course to the scheme remaining within the £50 million total allocation for it. A suitable sentence might be included dealing with this point in the Budget speech.

2. Review of electricity prices

3. The Chancellor, referring to his letter of 25 January, said that he had come to the conclusion that there should be a fundamental look at electricity pricing policy. His letter suggested some of the questions which might be studied. He understood that the CPRS would wish to be involved in and help with the study as far as they were able, but that their work programme had recently been settled by the Prime Minister for the year ahead, and they would not therefore have the resources to lead the study.

4. The Secretary of State for Energy said that his Department already had the issues raised by the Chancellor very much on board, but he had no objection to having an interdepartmental study if that was felt desirable. It could be led either by his Department, which in some ways seemed most appropriate, or by the CPRS. He considered the main thrust of the study should be to consider how the generation of electricity in the United Kingdom could be made more competitive.

5. In discussion there was general agreement that a fundamental study of electricity prices as proposed by the Chancellor should go ahead. It would need to consider not only how to make the industry more competitive, but the industrial and economic consequences of different pricing policies. For example an important question to consider was how far the extra cost of lower electricity prices for industry would be offset by the possibility of saving part of the industrial base. The review would also need to consider the relationship between industrial and domestic prices, and what the reaction should be to lower energy prices in other countries. It was agreed that the precise terms of reference for the review should

be agreed by officials of the Departments concerned.

6. On timing, it was suggested that there was strong arguments for seeking to complete the review by the early autumn. But thoroughness should not be sacrificed for speed.

7. The Chancellor, summing up this part of the discussion, said it had been agreed that the fundamental review of electricity prices proposed in his letter of 25 February should now go ahead on the basis of terms of reference agreed between the Departments concerned. It had also been agreed that outside consultants should be involved in the study. On the question of who should lead the review, his preference, which had received some support, would be for it to be carried out by the CPRS, and he proposed to consult the Prime Minister to see whether she would be prepared to agree to a change in the priorities in their work programme to make this possible.

3. Electricity prices: energy package for the Budget

8. Referring to his letter of 29 January, the Secretary of State for Energy said that following discussions with the electricity supply industry, he had concluded in favour of proposals for significantly increased assistance to high load factor consumers at a maximum EFL cost in 1982-83 of £87 million. This broke down between £71 million for the introduction of new load management terms, and £16 million for the retention of the flexible arrangements introduced last year.

9. The Secretary of State for Industry said he agreed very much with these proposals, which looked of considerable value to some of the more vociferous complainants, in particular the steel-makers. There were bound to be some who fell the wrong side of any side which was drawn, and until there had been consultation with all the industrial users it was difficult to predict with certainty which sectors would be helped by the scheme, and which would be left unsatisfied.

10. In discussion there was general agreement with the Secretary of State for Energy's proposals. The Secretary of State for Scotland suggested that the problem of those at the margin who might not benefit from the concessions should be paid special attention, as they were bound to feel aggrieved. To some extent there would be distortion of competition in some sectors, and any means of alleviating the position of those who were the wrong side of the borderline should be considered. The £87 EFL cost, did not include any figure for Scotland; the pro-rata increase for Scotland would be £10 million, and he was therefore seeking this.

11. The Chancellor, summing up this part of the discussion, said there was general agreement with the Secretary of State for Energy's proposal for increased assistance to high load factor consumers at a maximum EFL cost in 1982-83 of £87 million for England and Wales, and £10 million for Scotland. The concession would be announced in the Budget speech; and given the poor publicity which last year's measures had received, everything possible should be done to give the proposals the maximum effective publicity.

4. Energy conservation: assistance for large electricity users

12. Referring to his letter of 1 February, the Secretary of State for Energy said that he was proposing a scheme to promote investment in projects which would save large amounts of energy at a cost of £50 million committed over 1982-83 and the three succeeding years. The scheme would be concentrated on the same type of consumers as were being assisted through the electricity price measures, and the projects concerned would be those which saved at least 4,000 tons equivalent a year. He felt it was important to tackle the problem of heavy electricity users through the route of energy efficiency as well as price, because of the constraints which UK law and Community law placed in the way of what could be achieved through the price route alone. The scheme would cost only £3 million in 1982-83, and £14½ million in 1983-84.

13. The Secretary of State for Industry said he strongly supported the proposal. When he had seen the paper and board EDC their real complaint had been that energy conservation was desperately needed, but could not be afforded by the industry because of its cash flow problems. Our competitors abroad were developing schemes of this kind, and those who were not going to benefit from the load management concessions, would press very hard if nothing else was done.

14. In discussion, it was pointed out that the scheme would give rise to difficult borderline problems, as was the case with all forms of selective assistance. The scheme was different in kind from one which sought to adjust tariffs, because it was intended to encourage particular investment. Arguably if a firm was able to show a properly audited report to its bank to the effect that real savings could be gained through investment in energy conservation, it was difficult to see why the money could not be borrowed.

15. Against this, it was pointed out that many of the firms concerned would in present circumstances regard it as imprudent to move to the edge of their overdraft limit even for an attractive project; and others would not be able to pay the interest on more debt.

16. The Chancellor, summing up, said the Treasury did not feel able to agree to the Secretary of State for Energy's proposal for support for new investment in manufacturing industry on large scale energy conservation projects. The proposal should be examined further between the Secretary of State and the Chief Secretary before a final decision was taken. An important question would be how far it would prove possible to draw a satisfactory ring-fence round the scheme so as not to give rise to other claims.

5. Electricity prices and the review of the BST

17. Referring to his letter of 29 January on this subject, the Secretary of State for Energy said that he had noted the objections set out in the Chancellor's letter of 5 February to his proposal to appoint consultants to assist the Department in its consideration of

the BST review. He himself did not regard the review as a satisfactory document, and was convinced it needed probing in depth. But he felt it was far better to use outside consultants with precise terms of reference, rather than risk an examination by a revamped NEDC taskforce, as Mr. Utiger had suggested at the last Council. The question was bound to be raised at the March Council.

18. In discussion it was suggested that the main difficulty with the proposal to appoint consultants to assist the Department in considering the review was not so much the principle involved, as the fact that it would be made public. This would make it difficult to maintain the confidentiality of the consultants' report, and if this was adverse or embarrassing to the Government it could strengthen the demands of the energy lobby for more expensive price concessions. It should be possible at the March Council to head off any suggestion for a re-constituted taskforce to look at the review, by stressing that the issues involved were difficult and complicated issues of policy not of fact. But comments and reactions to the BST review should be welcomed.

19. The <u>Chancellor</u>, summing up this part of the discussion, said that it was agreed that while there was no objection to the appointment of consultants to assist the Department of Energy in its consideration of the BST review, this should be on a private basis, and not given an publicity.

20. It was noted that an interdepartmental report would be made shortly on the question of heavy fuel oil duty and its relationship to the Frigg contract.

Circulation:

Those present
Financial Secretary
Minister of State (C)
Sir Douglas Wass
Sir Anthony Rawlinson
Mr. Quinlan
Mr. Battishill
Mr. Burgner
Mr. Wood
Mr. Ridley
Mr. French
Mr. Harris

PSJ

P.S. JENKINS

10 February 1982

12 FEB 1982

CONFIDENTIAL

Not but c/c JU AD

Prime Minister (2)

MCS 10/2

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

01 211 6402

Rt Hon Geoffrey Howe QC MP
Chancellor of the Exchequer
H M Treasury
Parliament Street
London
SW1

10 February 1982

Dear Chancellor

ESI INDUSTRIAL WAGE NEGOTIATIONS

The Electricity Council met the Electricity Industry Industrial Negotiating Team under Frank Chapple on 4 February, and tabled the offer described in my letter to you of 29 January, but without the harmonization of holiday entitlement.

This was received calmly by the unions, who said that it was not enough but formed a starting point for discussion. It was left that there would be an informal discussion between the Council and the Union negotiators on 2 March, shortly before their next formal meeting on 4 March. The Council have not yet decided on any improved offer to be tabled at those further meetings. I will keep you informed.

Although the unions have described the offer publicly as one of 7%, the Council have not in fact mentioned any percentage figure and have told us in strict confidence that the paybill effect would be 5.6% and the effect on average earnings 5-7% depending on grade, overtime and shift pattern. They have incidentally kept in close touch with the NCB and are well aware that the estimated effect of the miners' settlement on earnings was well below the 9.3% on basic rates which has been generally publicised.

Copies of this letter go to the Prime Minister, other members of 'E', George Younger, Robin Ibbs, and Sir Robert Armstrong.

Yours sincerely

David Lumley

pp NIGEL LAWSON
(approved by the Secretary of State
and signed in his absence)

[illegible]0 FEB 1982

Not find Gas & Elect

JU17

CONFIDENTIAL

Prime Minister (2)

MCS 9/2

AD

JV.

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 February 1982

The Rt Hon Nigel Lawson MP
Secretary of State for Energy
Thames House South
Millbank
London SW1

MT

Dear Nigel,

ELECTRICITY PRICES AND THE REVIEW OF THE BST

Thank you for copying to me your letters of 29 January and 1 February to Geoffrey Howe.

2 Your proposals for improved load management terms to large industrial electricity consumers look encouraging and I very much hope that room can be found in the Budget to accommodate them. In view of the findings of the Task Force report and the expectations centred on the BST review, industry would be very disappointed to receive anything less generous than what is proposed.

3 I would have preferred it if these terms had been developed in fuller consultation with potential users. Discussions between the area Boards and their major customers are still in progress and the firms which stand to benefit will still be assessing the costs of meeting the requirements of the contracted load terms. However, the terms seem to me to be considerably more attractive than those of Category C, particularly in respect of prior notification, the limitations on the total hours involved and the provision of a minimum supply during load managed period.

4 One feature which may cause difficulties is the requirements on firms to commit themselves to load restrictions for as long as three years. I would urge that you press the Electricity Council to consider either annual contracts or provisions for annual revisions; companies which anticipate variations in their levels of activity or substantial reorganisation of their operations may feel inhibited from taking advantage of the new arrangements. I would also suggest that in view of the rather compressed consultations, the contracted load terms should be refined further for adoption in 1983/84 and that this should also form part of the Consultants' study.

CONFIDENTIAL

5 On the question of the handling of the BST review, I welcome Geoffrey Howe's suggestion for a fundamental study and would expect that my Department would make a contribution on the industrial implications of existing energy pricing polcies. I see this study as separate from that of your consultants who would, I understand, be considering the BST within the perspective of existing statutory constraints. My one observation on the guidance you propose to provide for the consultants is that in addition to the load management question, the consultants would be encouraged to address themselves to the way long run marginal costs are interpreted by the ESI. The concept is a difficult one; it admits of various interpretations and we need to be sure that the provisions which are made to cover LRMC in the BST are not overly generous.

6 I am copying this letter to the Prime Minister, Geoffrey Howe, George Younger, Nicholas Edwards, Sir Robert Armstrong and Robin Ibbs.

Yours ever

Patrick

8 FEB 1982

CONFIDENTIAL

NBPM

Chancellor of the Duchy of Lancaster

Management and Personnel Office
Whitehall London SW1A 2AZ
Telephone 01-273 } 4400
GTN 273 }

8 February 1982

The Rt Hon Nigel Lawson, MP
Secretary of State for Energy
Thames House South
Millbank
LONDON SW1P 4QJ

Dear Nigel,

GAS SAFETY AND STANDARDS

Norman Tebbit copied to me his letter to you of 20 January about arrangements for gas safety work, and in particular the proposal to set up a licensing scheme for gas installers.

I am sure that it is right that we should examine the possible role of the HSE in relation to gas safety; and the related possibility that the powers in the Health and Safety at Work Act could be used for the licensing of gas installers without requiring further primary legislation. I think too that it would also be useful to examine the work of the Gas Standards Branch and the Electricity Meter Examination Service (GSB/EMES) in relation to other metrology work and the work of other government laboratories.

I should be happy for officials in MPO's Machinery of Government Division to take part in these discussions; indeed if an "honest broker" is required to lead the discussions my people would be glad to do so, as they have done in other cases.

Copies of this go to Norman Tebbit, the recipients of his letter, and - in view of what I have suggested about metrology and the work of Government Laboratories - John Biffen.

Yours ever,

Janet

BARONESS YOUNG

CONFIDENTIAL

- 9 FEB 1982

CONFIDENTIAL

Duguid

cc. Duguid

10 DOWNING STREET

From the Private Secretary 8 February 1982

ELECTRICITY PRICES AND THE REVIEW
OF THE BULK SUPPLY TARIFF

The Prime Minister has seen a copy of the Chancellor's letter of 5 February to the Secretary of State for Energy, commenting on two recent letters from Mr. Lawson.

The Prime Minister has asked to be kept in touch with the conclusions of the meeting which the Chancellor proposes to hold on electricity pricing policy and its industrial implications.

I am sending copies of this letter to Jonathan Spencer (Department of Industry), Muir Russell (Scottish Office), John Craig (Welsh Office), David Wright (Cabinet Office) and Gerry Spence (CPRS).

M. C. SCHOLAR

John Kerr, Esq.,
HM Treasury.

CONFIDENTIAL

BUDGET - CONFIDENTIAL

cc JV
LAD

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

5 February 1982

Prime Minister

Shall I ask that you be kept in touch with the outcome of the Chancellor's meeting at X?
MLS 5/2

Yes please

The Rt. Hon. Nigel Lawson, M.P.,
Secretary of State for Energy

Dear Secretary of State,

ELECTRICITY PRICES AND THE REVIEW OF THE BULK SUPPLY TARIFF

Thank you for your letters of 29 January, in which you propose a new load management scheme, and 1 February in which you suggest that consultants should be appointed to assist the Department in its assessment of the BST Review.

The load management scheme described in your letter certainly seems to have some attractions. From what you say, it appears to avoid the problems which bedevilled the scheme considered in the follow up to the MISC 56 work and the benefits seem to be directed to the high load factor consumers which the NEDC Task Force identified as disadvantaged compared to some of their Continental competitors. But the scheme has a significant cost - put in your letter at a maximum of £87m - and I would need to consider how this should be financed. Before taking final decisions here, I wonder if we first should see the outcome of the Prime Minister's meeting next Monday at which I understand that we may have to consider proposals with considerable public expenditure consequences. We could then meet quickly both to discuss the load management proposals and the longer term study which I suggested in my letter of 25 January. My office will be in touch with yours to arrange a meeting.

It will be no surprise to you if I say that if the new load management scheme is to proceed, I would want to refer to it in the Budget Statement, perhaps with your Department or the Electricity Council giving the details later that day. I hope that the timetable described in the last but one paragraph of your letter would not prevent this. I suggest that if we do accept the load management proposals, you could tell the CEGB that while they can pass the generality of their BST proposals to the Area Boards, the Government do not want to give a final decision on the new load management scheme until nearer the Budget so that if it is agreed, it can be announced on Budget Day. Meanwhile the Generating Board could enter into contingent discussions with the Area Boards with a view to announcement then. We could emphasise to the Electricity Council and the CEGB that we attach great important to full publicity for the new proposals on Budget Day, if they are agreed, so that maximum

/presentational

presentational advantage is gained from them. You will recall that the £43m relaxation in the industry's EFL, announced in the 1981 Budget, did not secure as much early credit as it might have done because of inadequate publicity on Budget Day. It would be helpful if you could confirm that the load management proposals could be handled in this way when we meet to discuss this scheme and the longer term study.

It would also be helpful if George Younger could let me know whether the Scottish Boards would wish to make similar arrangements for their customers, and if so, at what cost.

Your proposal to appoint consultants to assist the Department in its consideration of the BST Review causes me some difficulty. My understanding is that the purpose would be to largely demonstrate to industry that the Department is examining all the options and not meekly accepting the electricity supply industry's views in what is hardly a convincing report. There are two obvious risks in this course:

(i) Your approach apparently assumes that the consultants' report would confirm the BST Review's conclusions, subject perhaps to marginal glosses. But the suggested terms of reference are wide and the report could conclude that the philosophy/accountancy/economics underlying the BST are wrong and recommend fundamental change. The industry's £7bn turnover means that even marginal changes in tariff policy could have large public expenditure consequences.

Of course, in those circumstances we could try to maintain the confidentiality of the consultant's report. But this would be virtually impossible if, as you propose, you had given it advance publicity in Parliament. We could also reject its findings. But the report's conclusions, if embarrassing to us, would have made certain sections of British industry even more pressing in their demands for expensive price concessions, which are not allowed for in the public expenditure plans.

(ii) The relationship between the consultants' work and the new load management scheme would look odd. If it is agreed, the £87m scheme would be announced on Budget Day before we, let alone industry generally, could have studied the consultants' report, even if it was ready before then. Industry would therefore tend to discount the £87m scheme when it is announced in the expectation that there might be something more to come when the consultants had produced their report and Ministers given their views on the BST Review in the light of the consultants' advice.

/Of course,

Of course, I recognise the pressure which your Department is under on energy prices generally. But I wonder whether it is essential to go as far as you suggest during Energy Questions on 8 February. You could simply repeat that the Government has received the report, is paying particular attention to the new load management scheme suggested in it (but without saying that it is going to be accepted) and would welcome rperesentations from industry on the Review. This approach would not tie us to appointing consultants, which we might consider again after the Budget if industry's reception of the £87m scheme is disappointing and in the light of representations received from industry. It is relevant here, I think, that the CBI in their Budget representations were seeking only £70m relief on energy prices so that there is a good chance that the £87m scheme, if it is agreed, would meet most of the legitimate criticism without tying ourselves to the hostage of a consultants' report.

For these reasons I could not agree to your announcing the appointment of consultants at next Energy Questions; but I should like an opportunity to discuss the whole question of electricity pricing policy and its industrial implications with you and Patrick Jenkin and George Younger, including the suggestions I made in my letter of 25 January. I shall arrange a meeting shortly.

X

I am sending a copy of this letter to the Prime Minister, Patrick Jenkin, George Younger and Nicholas Edwards as well as to Sir Robert Armstrong and Robin Ibbs.

Yours sincerely,

Jim Rutter

PP GEOFFREY HOWE

Seen and approved by the Chancellor and signed in his absence

-5 FEB 19[illegible]

CONFIDENTIAL

c/o

Prime Minister

NBPM

MLS 9/2

Foreign and Commonwealth Office
London SW1

5 February 1982

Dear Nigel,

ENERGY CONSERVATION: ASSISTANCE FOR LARGE ELECTRICITY USERS

until request both if required

Thank you for copying to Peter Carrington your letter of 1 February to the Chancellor. I have also now seen your letter of 29 January.

Both the scheme to assist certain energy intensive industries with energy saving investment and the adjustments in electricity tariffs to benefit major industrial consumers will no doubt help the industries concerned. You will appreciate I am sure the need to consider carefully how to handle the likely reactions to these schemes in both the European Community and the International Energy Agency.

Since we have hitherto strongly pressed the case for prices to be set at economic levels and for subsidies which affect energy costs to be identified and where appropriate eliminated, other Governments may ask how these proposals can be reconciled with our view that price is the key to ensuring an adequate level of investment in more rational and efficient energy use.

In particular, we shall, as you recognise, need to notify the Commission of our scheme of support to industry for energy saving investment. I agree that the fact that the scheme is aimed at encouraging energy conservation should help, as should the existence of similar schemes in other Member States. We must not take, however, the Commission's acquiescence for granted. Their concern will be to see that the scheme does not distort competition or give UK firms an unfair trading advantage and we will no doubt keep this in mind in framing the details of the scheme and in its presentation. It will be important to sound out the Commission in good time before any public announcement and to acknowledge the need for Commission clearance. Our officials should discuss how this can best be handled.

Yours ever

Humphrey

The Rt Hon Nigel Lawson MP
Secretary of State for Energy
Thames House South
Millbank
LONDON
SW1

CONFIDENTIAL

8 FEB 1982

With the Compliments of

ROBIN IBBS

CENTRAL POLICY REVIEW STAFF

MS

Cabinet Office
Whitehall London
SW1A 2AS

Telephone 01-233 7765

CC AD
JV

(2)

Prime Minister

MCS 5/2

CABINET OFFICE
Central Policy Review Staff
70 Whitehall, London SW1A 2AS Telephone 01-233 7765

From: J. R. Ibbs

Qa 05818

CONFIDENTIAL

5 February 1982

Dear Secretary of State,

Electricity Prices and the Review of the BST

Thank you for sending me copies of your letters to the Chancellor dated 29 January on Electricity Prices, and 1 February on the Review of the Bulk Supply Tariff. I have also seen the Chancellor's letter to you of 25 January on Electricity Prices.

The new load management terms proposed by the electricity industry do seem to offer a genuine way through the many constraints involved in providing assistance to high load factor consumers and will result in some alleviation of the price disparities they suffer. I would therefore support you in the view that the only practical course is to accept the industry's proposals.

From your letter of 1 February I assume that the purpose of engaging consultants would be to obtain an outside opinion on the view put forward by the industry in their review of the Bulk Supply Tariff. However, if consultants were to recommend some radically different pricing mechanism such as one based on short-run marginal costs as some consumers advocate, this could be embarrassing even though you would be free to reject the advice. I therefore would like to underline the importance of giving guidance to the consultants, as stated in your letter, on the financial constraints within which the industry needs to work.

Like the Chancellor I am concerned that the problem of electricity prices to large users is a fundamental one. I have some doubts whether it can be resolved completely within the existing confines of the BST which to a degree are imposed by legislation - e.g. the need to avoid

The Rt Hon Nigel Lawson MP
Department of Energy
THAMES HOUSE SOUTH
S W 1

discrimination. The underlying questions seem to me to be two-fold and go considerably wider than a review of the tariff structure could be expected to cover:

(i) What are the implications of the present price structure for energy-intensive industries in the UK? Are there any such industries that it would be a mistake to lose from the economy?

(ii) What are the long-term prospects for energy prices in the UK and what must be done to ensure that Britain's future electricity prices are competitive with those in other countries? What in the short-term is the electricity price structure necessary to keep any industries identified in (i) in business in Britain? How do we bridge the gap, meeting the short-term needs while moving towards the longer term goal?

These are fundamental questions of policy on which it would not be appropriate to ask consultants to advise. I would therefore support the Chancellor's suggestion that there should be a study within Whitehall of this area.

I am sending a copy of this letter to the Prime Minister, the Chancellor of the Exchequer, the Secretaries of State for Industry, Scotland and Wales, and to Sir Robert Armstrong.

Yours sincerely,

J R Ibbs

JH 244

NBPM res 5/2

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

3 February 1982

The Rt Hon Nigel Lawson MP
Secretary of State for Energy
Thames House South
Millbank
London SW1P 4QL

Nationalised Industries

cc AD
JV

Dear Nigel,

GAS SAFETY AND STANDARDS

Norman Tebbit kindly copied to me his letter to you of 20 January.

2 My concern is that the Gas Standards Branch and Electricity Meter Examination Service cannot at present meet the demands made upon them by industry because of the restrictions on the number of civil servants. If the transfer of these functions to the Health and Safety Executive helps matters in this regard I should support it but I note from Norman's letter that the HSE would also be constrained by these restrictions. I wonder therefore if officials should also be instructed to take a further look at the feasibility of privatising these functions. I wonder too whether it would also be sensible to consider whether there is a private sector solution to the licensing of gas installers - the licensing of heavy goods vehicles or, indeed, CORGI, might provide some ideas.

3 I am sending copies of this letter to the recipients of Norman's.

Yours ever

Patrick

- 5 FEB 1982

Cc 49
JL

(2)

Prime Minister

MLS 5/2

01 211 6402

Rt Hon Sir Geoffrey Howe QC MP
The Chancellor of the Exchequer
Treasury Chambers
Parliament St
London SW1

1 February 1982

Dear Chancellor

ENERGY CONSERVATION: ASSISTANCE FOR LARGE ELECTRICITY USERS

with MAP at MCS.R

In my letter of 29 January I said that I would be writing again about a scheme to promote investment in projects which would save large amounts of energy concentrated on the same types of consumers as we are assisting through the electricity price measures. I now write with my proposals.

What I have in mind is support to the tune of £50m committed over 1982/3 and 1983/4 and spent over 1982/3 and the three succeeding years for new investment in manufacturing industry on projects which would save large quantities of energy - defined as 4,000 tons of coal equivalent a year or more. Projects meeting this criterion would in most cases have a total cost of around £1m. Priority would be given to large and high intensive users of electricity and this would be openly stated. Assistance should be at a level which would give a reasonable prospect of ensuring that projects go ahead in the present difficult investment climate.

My soundings of industry suggest that the best way of achieving this would probably be a new loan facility channelled through the banks with the Government support being used to waive interest for the first two years and to defer repayments during that period (in effect a variant of the proposal David Howell put forward in MISC 56 (81)5 Revise last May but - and this is the crucial point - concentrated on a limited number of large projects). I would not rule out a grant scheme if further discussion suggested that that would be effective: but I suspect that would require grants of about 35% of the cost of projects rather than the 25% under the Boiler Substitution Scheme.

A scheme on these lines would kill two birds with one stone. It would assist the large energy users with the cost of their fuel bills and at the same time constitute a valid addition to our energy conservation programme.

We would have to notify the European Commission of our proposals. The fact that they are designed to use energy more efficiently should ensure a sympathetic hearing. In general they would be similar to arrangements already introduced by the French and German Governments.

I would also support Patrick Jenkin's proposal (Item 19 of Annex to letter of 26 January) for increased grants on energy conservation demonstration projects and a new heat pump scheme. I would like to see any additional funds allocated for the demonstration scheme also concentrated on large projects. But the best prospect of securing quick improvements in energy efficiency lies in higher investment in existing techniques rather than in demonstrating new techniques, important though that is for the future. My proposal is designed to promote that prospect.

I believe that my proposals on electricity pricing and the promotion of large energy conservation projects taken together should take most of the steam out of the political pressure on energy prices. At least they will give us a firm position on which to stand. I therefore urge you to give the proposals in this letter a sympathetic hearing. If you are in principle favourably inclined towards them I suggest that officials should get together urgently to work out the details. The aim should be to announce those details shortly after the main announcement in your Budget speech.

I am sending copies of this letter to the Prime Minister, Peter Carrington, George Younger, Nicholas Edwards, Patrick Jenkin and Sir Robert Armstrong.

Yours sincerely

David Lumley

pp NIGEL LAWSON
(Approved by the Secretary of State and signed in his absence)

1 FEB 1982

Nat Inc
Sec & Elect

AD
JV

Prime Minister (2)

MS 2/2

01 211 6402

Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
London
SW1

1 February 1982

Dear Chancellor

REVIEW OF THE BST

In my letter of 29 January I set out proposals to assist large industrial users of electricity through development of load management arrangements, as put forward by the CEGB. These proposals were in fact first set out in outline in the Electricity Council's review of the BST which I received early this month.

Copies of the review are now being made available on request by the Electricity Council and I have already been asked questions about my response. This subject is certain to arise during Energy Questions on February 8, and it will be essential for me to be able to give a clear indication of how the Government intends to handle the review.

In my letter of 8 January to you I suggested that the best way to emphasise that the Government were considering this report both comprehensively and objectively would be to appoint consultants to advise us. I do not think it either possible or desirable for us to exclude consideration of outside representations in coming to conclusions about the review; I believe that a consultants' study would make this easier to handle. I would propose to tell the CBI that the Department and the consultants would welcome any representations they wish to make. We would of course be free at the end of the study to reject the advice of the consultants and indeed I envisage the study as assisting my Department in its assessment of the review rather than having a completely free-standing status. This is made clear in the draft terms of reference, of which I attach a copy, and which I would propose to make public. My Department would also, of course, give more detailed guidance to the consultants, and in particular draw their attention to the statutory and financial constraints within which the industry works.

I would be grateful for your agreement to this in time for me to announce how we intend to handle the BST review on 8 February.

I am sending a copy of this letter to the Prime Minister, Patrick Jenkin, George Younger, Nicholas Edwards, Sir Robert Armstrong and Robin Ibbs.

Yours sincerely

David Lumley

pp NIGEL LAWSON
(Approved by the Secretary of State
and signed in his absence)

BST REVIEW CONSULTANCY

TERMS OF REFERENCE

1. To assist the Department in its assessment of the BST Review and in particular to advise on whether the conclusions of the Review are derived from a satisfactory analysis of the industry's costs and operations, and of alternative pricing structures.

2. Consultants will be free to seek information from the Electricity Council. They should also have regard to representations made by outside bodies to the Electricity Council and to the Department in connection with this study.

1 FEB 1982

Nat Ind
Gas & Elec

Prime Minister ② c/c AD JV

MLS 2/2

01 211 6402

Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON SW1

29 January 1982

Dear Geoffrey

MT

ESI INDUSTRIAL WAGE NEGOTIATIONS

Your minute of ~~25~~ 27 January to the Prime Minister asked me for a report on the current negotiations in the gas and electricity supply industries. My letter of 28 January dealt with the gas manuals' pay. This letter reports on the position in the electricity supply industry.

TPM

The Electricity Council will make a formal offer to their manual workers on 2 February. Their basic offer will be a cash increase on schedule salaries ranging from £5 for a labourer to £8 for a craftsman at the top of the salary scale. The range of increase will be between 5-6½% on basic rates and will represent something over 5% on the industrial salary bill. Further enhancement of shift payments and a harmonization of holiday entitlement between manual, clerical and junior engineering staff will also be offered.

The Electricity Council advise that the effect on average earnings would be between 5-7% depending on grade, overtime and shift pattern and that the total package would represent something under 7% on the salary bill. They will not, though, be talking about percentages either in the negotiations or publicly thereafter.

The Council expect that the offer will be formally rejected, and that further informal meetings will take place in the course of next month. They believe that they will be able to make a small advance on scheduled salaries in the course of these discussions.

I will keep you informed of developments.

Copies of this letter go to the Prime Minister, other members of 'E', George Younger, Robin Ibbs and Sir Robert Armstrong.

Yours ever
Nigel

NIGEL LAWSON

CONFIDENTIAL

Prime Minister (2)

ICA AD JV

MLS 29/1

01 211 6402

Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON SW1

29 January 1982

Dear Chancellor

ELECTRICITY PRICES

In my letter of earlier today I said that I considered development of our assistance to large industrial consumers of electricity to be the most significant energy item which might figure in this year's Budget. Following discussions with the electricity supply industry, this letter sets out proposals, at a maximum EFL cost in 1982/83 of £87m, for significantly increased assistance to high load factor consumers.

These measures are also intended to meet the remit of last August from the MISC 56 group to bring forward firm proposals for the introduction of a general scheme of assistance to certain users of industrial electricity. The proposals for 1982/83 are of course without prejudice to the longer term review you refer to in your letter of 25 January, on which we will be meeting in due course. I will also be writing to you very shortly on the handling of the Review of the Bulk Supply Tariff, on which we need urgently to establish our public position.

You will recall that last year a relaxation in the 1981/82 EFL was granted to the industry for the introduction of a new load management Category 'C' and flexibility measures to benefit a relatively small number of large electricity users. Although customers who were able to take advantage of these facilities gained benefits on average of a 5% reduction in prices, and in some cases as much as 10%, the scheme met with some criticism on grounds that some heavy users were not able to meet the conditions, and for others the cost of meeting the conditions almost eliminated the benefits.

In the BST review, submitted to me at the beginning of this month by the Electricity Council, a development of the load management approach was proposed which it was hoped would prove more attractive. The CEGB have incorporated this new load management proposal - known as contracted load - in their 1982/83 proposals.

The Electricity Council and the Area Electricity Boards have assessed, with the help of discussions with some customers who might be able to take advantage of these proposals, what the take-up and likely benefit of the contracted load terms would be. They estimate that over 100 customers would benefit as compared with 50 under this year's Category 'C'. About half of these would be customers switching from Category 'C' to contracted load. The other half would comprise customers who are not currently taking advantage of Category 'C' terms. For the first group, the average benefit in terms of overall price reduction might be about 5% - 10% in addition to the 5% average reduction which Category 'C' has given them this year; for the second group the reductions might be in the range of 10 to 16%. In some cases, this could mean an actual reduction of as much as 5% in prices as compared with present levels. These price benefits should be set against the expected rise in the general level of electricity prices in April in line with or slightly below inflation. The bulk supply tariff proposals contain other minor changes to the structure of tariffs, some of which should have the effect of reducing prices to high load factor consumers by about 1%.

Of the total benefits arising from contracted load terms, about a third would accrue to firms in the chemical industry and a third to firms in the iron and steel industry. In both these groups, the benefits could amount on average to nearly £1m per customer over the year. The majority of firms who we would expect to benefit would be in those categories which the NEDO Report last year indicated as suffering energy price disadvantages as compared with foreign, and particularly European competitors.

The industry also wish to retain the new flexibility introduced last year in the application of tariffs to important industrial customers, mostly in the high load factor category. To withdraw these arrangements in 1982/83 would produce additional price increases which could significantly reduce the value of the new proposals as a whole by leaving some customers worse off.

The general level of prices in the BST has been set at a level which would be consistent with the industry achieving their financial target. If however, the EFL is relaxed in order to pay for the new load management category, the actual rate of return earned will be slightly reduced. The Board have in fact repeated their request, which we refused last year, for a reduction in their financial target on the grounds that they are very close indeed to exceeding long run marginal cost price levels. I do not propose to grant a reduction in the financial target, but if we can agree to the relaxation in next year's EFL, the consequential reduction in the return actually earned will go some way to meeting

CONFIDENTIAL

the industry's request and should help to defuse any criticism that we are forcing prices above economically justifiable levels.

The industry have estimated that the introduction of the new load management terms would require a relaxation in 1982/83's EFL of £71m. The retention of the flexible arrangements introduced last year would cost £16m amounting to a total relaxation in the EFL of £87m. In making these estimates the industry have drawn on their experience of the actual take-up and cost of the Category 'C' terms this year and discussions with customers on the new contracted load terms. I believe that the estimates are the best that can be made at this stage and constitute a reasonable basis for decision. This year we have introduced new load management Category 'C', and the "flexibility" arrangements. Clearly we must continue with both, and we have agreed that the possibility of doing more should be examined. Given the legal constraints, highlighted by the Attorney General's advice on 3rd December on the earlier possibility we considered, we have only limited room for manoeuvre. I believe the only practical possibility is to accept the industry's proposals for development of the load management scheme.

As a separate matter, I am urgently considering whether we can supplement our assistance to industry in this area by a scheme to promote investment in projects which would save large amounts of energy and would in practice be largely concentrated on the same types of consumers as we are assisting through the BST measures. In this connection I note that in Patrick Jenkin's letter of 26 January he has also identified energy conservation projects as deserving of further support. I will be writing to you on this in the next few days.

In order for electricity price increases to be introduced on 1 April, the CEGB will need to pass its BST proposals to the Area Boards very soon. At this stage, I am therefore seeking your agreement, and that of our colleagues, to a relaxation of £87m in the industry's 1982/83 EFL, and to a small consequential reduction in the rate of return which the industry may expect to achieve, to allow the introduction of the new contracted load terms and the continuation of this year's load management and flexibility arrangements.

I am copying this letter to the Prime Minister and to Patrick Jenkin, George Younger and Nicholas Edwards as well as Sir Robert Armstrong and Robin Ibbs.

Yours sincerely

David Lumley

pp NIGEL LAWSON

(Approved by the Secretary of State and signed in his absence)

29 JAN 1982

TD

B/F → NBPM yet – await responses.

MAP

Caxton House Tothill Street London SW1H 9NA

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Switchboard 01-213 3000

The Rt Hon Nigel Lawson MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
LONDON SW1P 4QL

20 January 1982

D Nigel,

GAS SAFETY AND STANDARDS

David Waddington drew my attention to your Private Secretary's letter of 23 December to the Prime Minister's Private Secretary about the staffing requirements for a regulatory body for the licensing of gas installers. He also reminded me about the proposal which David Howell put to the E(EA) meeting on 7 July to set up a new non-Departmental body to oversee the responsibilities of what are at present your Gas Standards Branch and Electricity Meter Examination Service (GSB/EMES). As you know, E(EA) decided that Departments should explore the possibility of transferring to the Health and Safety Executive the functions of the GSB/EMES. It struck us that the same option might also be worth exploring for the licensing of gas installers. David Waddington has looked into this with the Director-General of the HSE and, at first glance, it looks as though the HSE should be able to do what is needed with some considerable savings in resources and without the need to create two new quangos. We have not worked this idea up in great detail but it certainly merits further examination.

I should say, in fairness to HSE, that this is not a case of their seeking to empire-build. The initiative has come from us and HSE have told us that this is something they would willingly take on if Ministers wished. I might also add that it is not obvious to me or HSE, on the information we presently have, that licensing - which is a comparatively expensive form of control, in terms of staff numbers and of charges - is, on any objective criteria, necessary in this area; we do not have it, for example, in relation to electrical installations or solid fuel boiler systems. However it may be that you would feel it necessary from your point of view to stick to the licensing approach.

SECRETARY OF STATE FOR EMPLOYMENT

On the licensing of gas installers your current estimate is of up to 200 extra staff for the statutory scheme to replace CORGI to deal with an increase in private sector installation work. This licensing work could be done by the HSE under the Health and Safety at Work Act, and they tell me that by using their existing organisation they estimate that they would need only about 50 extra staff to do the routine checking a licence scheme requires. The costs of the scheme would still be recouped by fees to licence holders as in your scheme but the fees could be lower.

On the GSB/EMES side the work on gas safety fits naturally with that of the HSE and there seems no reason why the HSE should not take it on and liaise with your Department on policy issues arising from your responsibilities for the Gas Act. If this work could be slotted into the HSE set up it would be likely to be more economical than setting up a new statutory body.

I am sure that this option would bring us up against some possible problems. In particular, neither this Department as a whole nor the HSE could meet the staffing for either scheme within its existing ceilings. If the HSE option is to be a runner the staff and budget (for numbers and costs) of the GSB/EMES will need to be transferred from your Department as an addition to the HSE's resources and their manpower ceiling will have to be increased also to cover the work on licensing.

Because we have not worked up all the details of this alternative approach, there may be aspects of which we are unaware which could affect the arguments, nonetheless I do not think we can afford to lose sight of what may be a cheaper and easier approach. If colleagues are content to endorse it in general terms, I think the best approach would be for my officials to get together with yours, Treasury and MPO to produce a paper we could consider collectively in the spring.

Copies of this go to the Prime Minister, Geoffrey Howe, Patrick Jenkin, Janet Young and Sally Oppenheim.

Yours
Norman

21 JAN 1982

✓cc AD
JV
Norland

(2)

Prime Minister

MLS 8/1

01 211 6402

MS

Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1

8 January 1982

Dear Chancellor

INDUSTRIAL ENERGY PRICES: REVIEW OF THE BULK SUPPLY TARIFF

I have just received from the Electricity Council the final version of the review of the Bulk Supply Tariff which David Howell asked the Industry to undertake in July 1980. As expected, the review broadly endorses the Industry's pricing policies and offers only very modest further help to large users through structural changes to the BST itself. It does mention the question of assistance to some large industrial users of electricity through a new load management scheme for 1982-83 about which I hope shortly to be able to write, substantively, to you and our MISC 56 colleagues. Meanwhile, however, there is certain to be considerable interest in the review, and I intend to ask the Electricity Council to publish it or make it available on request. The review will not satisfy the major critics among the industry's larger customers, but it will be for the Council in the first instance to defend the review's conclusions. Pressure will of course come on the Government to declare its response. Not least in view of the proposals made by Mr Utiger at the November NEDC meeting, I believe it will be vital to emphasise the independence and impartiality of our response and I therefore propose to seek an outside view by appointing consultants to assist my Department in its assessment. Their study will take in representations made to the industry and to my Department by key industrial customers. It would be my intention that the consultants' assignment would be completed in a matter of weeks, subject to discussion with them. Your officials would of course be kept closely in touch.

I am copying this to the Prime Minister, Members of MISC 56, the Secretary of State for Northern Ireland and Sir Robert Armstrong.

Yours sincerely

David Howell

pp NIGEL LAWSON
(approved by the Secretary of State
and signed in his absence.)

-8 JAN [illegible]

2.

PRIME MINISTER

When gas safety was under discussion in October, you queried the Department of Energy's assumption that over 100 new staff will be needed to regulate safety under arrangements to be introduced when BGC ceases appliance retailing.

I attach a note from the Department explaining the basis of this assumption. This covers arrangements either within the Department or through the proposed new quango.

As you will see from the covering letter, these matters are not yet ready for decision, and no action is necessary at present. Detailed proposals will be put round by Mr. Lawson in due course.

MAP

30 December 1981

Nat Ind

BF 29/XII

MP

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

01 211 6402

Mike Pattison Esq
Private Secretary to
the Prime Minister
10 Downing Street
London SW1

23 December 1981

Dear Mike

You asked in your letter of ~~19~~ October for a note for the Prime Minister on the staffing requirements for a regulatory body for the licensing of gas installers. This is enclosed.

In dealing with gas showrooms, the Government is firmly committed to maintaining safety standards. Work on how to do so is still in the early stages and there is, as you say, no need for immediate decisions. Our present view is that a regulatory body on the lines described in the enclosed note will be needed to guarantee that the commitment is met. However, this has not yet been agreed collectively and my Secretary of State will be circulating detailed proposals in due course.

I am copying this letter to recipients of your letter.

Yours ever

David Lumley

DAVID LUMLEY
Private Secretary

CONFIDENTIAL

MANPOWER REQUIREMENTS FOR A BODY TO CARRY OUT MANDATORY LICENSING OF GAS INSTALLERS

1. The Government have made clear that no action on the MMC Report on Domestic Gas Appliances would be acceptable if safety standards were not maintained. After consultation with interested parties, the Department has concluded that, if this commitment is to be met, the present regulatory system covering the installation servicing and repair of gas appliances should be replaced with a statutory scheme to license companies (including the British Gas Corporation (BGC))and their operatives. It would then be a criminal offence to carry out such work for reward unless licensed to do so.

The Existing System

2. In some respects the existing regulatory system provides a useful model for a licensing system but a number of aspects require improvement:

(a) in practice the regulatory system is heavily dependent upon self-regulation by the gas industry. BGC is the dominant influence here in respect of the training and standards required of both its own employees and of those private sector companies which wish to be members of the Confederation for the Registration of Gas Installers (CORGI), a voluntary register (with no statutory powers) which is staffed and financed by the Corporation. The Government's proposals for gas appliance retailing are expected to cause a significant shift in the domestic installation market away from BGC to the private sector. It would then be invidious if the reputable private sector were to continue to depend upon BGC to influence its safety standards, even assuming that BGC would continue to finance CORGI.

(b) CORGI is, in any case, limited in effect in a number of ways:

(i) membership is voluntary;

(ii) CORGI registers only companies and not individual installers;

(iii) only about 70% of the reputable private sector feel it worthwhile to register and it has no influence on "cowboys" from whom greatest risk to the public arises;

(iv) there is little public awareness of the existence and purpose of CORGI.

Necessary Changes

3. If gas safety standards are to be maintained, notwithstanding a large private sector share of the installation market, a system to control performance needs to be introduced which will put all companies and individual operations on an equal footing. Furthermore the present system tends to ensure only that remedial work will be carried out if an appliance has been discovered to be unsafe. If safety standards are to be maintained when BGC have a small share of the installation market there needs to be more emphasis on prevention of faulty workmanship. The existing Gas Safety Regulations (GSR) are limited in that they lay down that installation must be carried out by a "competent person" but do not define "competence"; neither do they cover servicing and repairs. It would be inadequate to try to improve this situation simply by broadening the GSR; formidable problems of enforcement would arise. A mandatory system of control is required. This should specify performance standards and training requirements and provide for the issue of licences, after inspection, to those companies and individuals whose work is satisfactory.

A licence could be refused, or withdrawn, if standards were inadequate and it would then be a criminal offence to carry out installation etc. for reward; such a sanction would require statutory backing.

Organisation and Structure of Licensing Body

4. Notwithstanding CORGI's limitations, its present system of maintaining a register of installers whose performance meets the requirements of regular inspection, provides a useful model for the mandatory scheme proposed.

5. CORGI employs 60-70 people (32 inspectors and over 30 administrative and support staff). They are responsible for monitoring 7,000 members within 12 Regions (mirroring BGC's Regions). A mandatory body would face a more comprehensive range of tasks than CORGI:

(a) administration of issue and withdrawal of licences;

(b) vetting of applications and regular inspection of licensees' work;

(c) maintenance of a register of licensed companies and individuals;

(d) contribution towards setting and monitoring of training standards.

and would cover a population of about ten times the size. Given the fragmented character of the gas servicing industry in Great Britain, it is difficult to quantify the number of individuals who are likely to seek licences, but an estimate of 60,000-70,000 seems reasonable on the basis that:

(a) BGC employ 15,000 service engineers;
(b) 12,000 private businesses employ a maximum of 48,000;
(c) an unquantified number (thought to be a few thousand) are employed as direct labour by local authorities, housing associations etc.

6. The mandatory licensing body's staffing requirements would be split broadly into inspectorate and administration:

(a) Inspectors would carry out initial investigation into prospective licensees. After licensing it would be necessary to carry out annual inspections. CORGI suggest that one inspector could cover approximately 6 operatives per day. On the basis of 160-170 man days per year, 1 inspector would cover c.1000 operatives annually. 60-70 inspectors would therefore be required (plus a small number of senior inspectors with a supervisory role).

(b) Administration would be carried out from a Headquarters through Regional offices, These could reasonably be pared down from the present 12 to 4 or 6. Headquarters staff would be perhaps 10 (including basic secretarial and clerical support) with 6 in each Regional Office.

7. Overall the greatest volume of work load for the new body would be the data processing, storage and retrieval involved in handling initial applications for licences(and subsequent monitoring of performance) from 12,000 firms and 60-70,000 operatives. Such a task should be computerised. The alternative could be to employ 50-100 clerical and secretarial staff. Any increased capital costs arising from the use of computers should be more than offset by savings on staff in the longer term. In addition further opportunity to experience the use of computers in Government-related work would be welcome.

Conclusion

8. The attached Annex sets out a range of possible staffing requirements for a mandatory body. This draws heavily on the

experience and advice of CORGI. It is not intended to be other than a rough assessment; work in greater detail remains to be done. If computers were made integral to the system, staff would number just over 100 but dependence on conventional clerical support could bring this up to 200.

Department of Energy

23 December 1981

ANNEX

MANPOWER REQUIREMENTS FOR STATUTORY BODY TO CARRY OUT MANDATORY LICENSING OF GAS INSTALLERS

Inspectorate	60 - 70
Administration	
A. Headquarters	10
Director (1)	
Secretary (1)	
Accountant (1)	
Legal Adviser (1)	
Technical Officer (1)	
+ Clerical and Secretarial (5)	
B. Regions (4/6)	24 - 36
Director (1)	
Senior Inspector (1)	
Secretary/Finance Officer (1)	
Technical Officer (1)	
Secretarial and Clerical (2)	
Key staff	94 - 116

+ Additional clerical and secretarial requirements (assuming little or no computer support) could be around 80(distributed nationwide).

JU879

c/f AD AW JV

(2)

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

21 December 1981

J D West ESq
Private Secretary to the
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
SW1

Prime Minister

MS 22/12

Dear Julian

GAS LEGISLATION

Peter Jenkins sent me a copy of his letter to you of 4 December. My Secretary of State agrees with a number of the points made by the Chancellor of the Exchequer.

2 It is not clear whether gas exporting would be commercially attractive or not but, if so, we would be most concerned at the impact this could have on the availability and price of gas for industry. It has been suggested that your Secretary of State's powers to insist on the landing of UKCS gas in the UK could be more exposed to challenge from the Commission under a competitive regime. We hope that your Department will take these points on board in the review of our future strategy.

3 My Secretary of State would support any proposals for selling off older gas fields which helped to ease the upward pressures on the PSBR and interest rates.

4 The Chancellor sought your Secretary of State's advice on whether BGC should continue to be permitted to enter into new licence commitments. Ideally there is some attraction in BGC joining private sector companies in competing for the exploitation of new fields, provided that BGC is not in a position to use its dominant buyer's bargaining strength as a means to discourage competitors from bidding for promising fields. Our overriding objective must be to ensure that development of new fields proceeds rapidly so that industry does not face gas shortages in the future, but subject to that it does not seem to be essential that BGC should continue to obtain new licences if others are willing to undertake the necessary developments.

SECRETARY OF STATE FOR INDUSTRY

5 Opening up the domestic market to competition is not primarily a matter for my Secretary of State but he assumes that any such proposal would also benefit those small firms whose use of gas falls below the minimum threshold (in Clause 16 of the Bill) of 25,000 therms per annum. He would therefore support the idea if the practical difficulties can be overcome.

6 I am copying this to the Private Secretaries to the Prime Minister, the Members of E Committee, Sir Robert Armstrong and Mr Robin Ibbs.

Yours ever

Richard

RICHARD RILEY
Private Secretary

CONFIDENTIAL

A.D
AW
JV
Nat Ind

(2)

Prime Minister

MCS 7/12

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

4 December 1981

J D West Esq.
Private Secretary
Department of Energy

Dear Julian,

GAS LEGISLATION

The Chancellor of the Exchequer read with interest your Secretary of State's letter of 20 November and your letter of the same date to No 10, commenting on certain of the points made by Ministers on the proposals in E(81)102. The Chancellor is content for there to be further consideration of gas depletion when the officials' report is available, which he notes is expected by about the end of the year. As your Secretary of State says, the consequences of the new gas policy for the North Sea fiscal regime can be considered when the report of the official Working Party is available shortly. On gas exports, your Secretary of State may be successful in emphasising that the Government's proposals have nothing to do with gas exports. But it may prove difficult to sustain that position. The Chancellor therefore thinks that officials should outline for Ministers the main considerations affecting future strategy so that these can be considered in advance of any pressure for a statement building up during the debate on the Bill.

The Chancellor accepts that now is not the time to consider the disposal of BGC's interests in the Morecambe and Rough fields which the Corporation are developing quickly in order to meet peak demand in the middle of the decade. But he is not convinced that the other main gas fields in which the Corporation have an interest should not be sold simply because they are past their prime. Presumably these fields have more than one or two year's life left in them and their sale would raise some revenue. He hopes that your Secretary of State can reconsider policy here. The Chancellor has also noted your Secretary of State's point that we will need to keep open our decisions on any future gas discoveries by the Corporation. This raises in his mind the question whether BGC should henceforth be permitted to enter into new licence

/commitments,

commitments, rather than relying on the private sector for new gas supplies. He would be grateful for your Secretary of State's views on this point.

On longer term objectives for BGC, the Chancellor entirely agrees that nothing should be done which would jeopardise the Bill's very tight timetable. Indeed, he made this point in his letter of 6 November, But he nevertheless hopes that the longer term objective of breaking BGC's monopoly of the domestic market is not lost sight of. He is not convinced by the arguments in your letter of 20 November that there would be considerable difficulties if the private sector entered the domestic gas market on any scale. For example, BGC might be confined simply to the operation of the gas transmission system, leaving it to the oil companies to supply the gas to both industrial and domestic consumers. In those circumstances BGC could be made responsible for safety, thus avoiding, as your Secretary of State wishes, the introduction of a safety regulation and inspection system. It might also be possible to avoid in such circumstances the massive regulatory bureaucracies which exist in the United States if BGC was given the statutory duty of dealing on equal terms with all its customers; ie the oil companies putting gas through its pipeline system.

The Chancellor recognises such objectives must be for the longer term, but he hopes that they can be considered when the monopsony legislation is on the Statute Book.

I am sending a copy of this letter to the Private Secretaries to the Prime Minister, the Members of E Committee, Sir Robert Armstrong and Mr Robin Ibbs.

Yours ever

Peter

P.S. JENKINS
Private Secretary

5 DEC 1981

Ou

Nat Ind Savings

With the Compliments

of the

Secretary of State

Scottish Office,
Dover House,
Whitehall,
London, S.W.1 A 2AU

CONFIDENTIAL

cc A Duguid

Prime Minister

MCS 2/12.

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

01 211 6402

Michael Scholar Esq
Private Secretary
10 Downing Street
London SW1

30 November 1981

Dear Michael,

Thank you for your letter of 24 November about the electricity discount scheme. I enclose as requested by the Prime Minister a note on the progress made in devising a workable scheme.

My Secretary of State has discussed this scheme with the Secretary of State for Industry but because of the persistence of legal problems has asked for the Law Officers' advice. This is expected shortly; my Secretary of State will then report further to the Prime Minister.

He has noted the Prime Minister's disinclination to proceed with the proposal in the light of current public expenditure difficulties.

Copies of this go to recipients of your letter and to Gareth Roscoe at the Attorney General's office.

Yours ever,

JULIAN WEST
Private Secretary

ASSISTANCE TO INDUSTRIAL ELECTRICITY USERS

1 MISC56(81) 4th meeting agreed that the electricity supply industry (esi) be invited to operate a scheme of assistance, for one year only. The esi's EFLs would be relaxed by £80/90m. Ministers also asked that the scheme be shaped to give greater help to the larger users (eg ICI Runcorn) while still helping electric arc steelmakers (eg Sheerness Steel).

2. The Electricity Council accordingly devised a scheme providing increasing discounts with rising consumptions. Two basic options were offered; one covering some 1300 consumers and providing discounts averaging about 5% (but ranging up to 13% for ICI Runcorn) and the other covering some 200 of the largest consumers giving discounts averaging 10% (ranging up to 17% for ICI Runcorn). Both would cost about £80m on a UK basis. Department of Industry have advised that the scheme covering 200 larger users would be more consistent with the findings of the latest NEDC report. This confirms that price disparities with Europe are confined to large high load factor users.

3 But the Electricity Council also advised that Area Boards could only operate the scheme if the industry were fully compensated by the Government. The industry believe that the Electricity Consultative Councils (whose Chairmen are ex-efficio Area Board members) could well challenge in the Courts any action which led to other consumers meeting extra costs. An £80/90M relaxation of EFLs would mean significant extra interest charges to be met by consumers generally. The industry made clear that relaxation of its EFL alone would not secure action.

4 Two alternative methods of financing the scheme by grant rather than by borrowing have accordingly been examined:

i) by direct grant - funded via the Appropriation Act procedure, and

ii) by indirect grant - to NCB for a supply of cheaper coal to the esi.

The first has to be rejected as immediately contravening the state aid provisions of the Treaty of Rome. The second appears to be technically feasible, though legal problems remain.

5 The discounted coal scheme would operate roughly as follows:

i) the NCB would [redacted] give £75m or so discount to CEGB through "aligning down" the price of the marginal tranche of coal to notional import prices. (This is permitted under the Treaty of Paris);

ii) Area Boards would operate the industry scheme, logging the rebates given to industrial consumers;

iii) CEGB would subsequently reimburse them in cash;

iv) Both industries would publicly justify this as a commercial action taken to preserve an important market for coal. The Government, recognising the effect of this commercial action on the NCB's finances, would increase its deficit grant (under S3 of the Coal Industry Act 1980) by £75m (plus such additional sum as might be needed to cover similar arrangements for Scotland and Northern Ireland);

6 This arrangement is not free from difficulties; the EC Commission might still challenge it (as they have challenged the Netherlands' cheap gas scheme for horticulture). The industry's legal advisers also take the view that hypothecation of the benefits of the cheaper coal to a limited number of industrial users would constitute "undue preference" under the electricity statutes. There is also a chance that the PAC might at some future stage claim, in relation to the use of NCB deficit grant, that this was "an unexpected use of the power". However, notwithstanding the legal uncertainties both the coal and electricity industries have indicated informally that they would be prepared to operate the scheme. The Law Officers' advice has been sought on these issues and is expected shortly.

cc A. Duguid
A. Walters

(2)

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

Prime Minister

You may wish to be aware.

MLS 4/12

The Rt Hon Nigel Lawson MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
LONDON
SW1P 4QJ

27 November 1981

Dear Secretary of State

INDUSTRIAL ELECTRICITY PRICES

Now that the NEDO Task Force has up-dated its report and the general terms of its findings have become public, I have come under renewed pressure from a number of large electricity users in Scotland about the continuing disparities between their charges and those available elsewhere in the EEC. I think that you and Patrick Jenkin are due to make a further report to MISC56 on a possible scheme of assistance to such users. I appreciate the issues both legal and practical which this subject raises particularly as I have myself responsibilities both for electricity and for industry in Scotland. But I have become convinced as a result of the various representations I have received, that some important industrial sectors in this country will suffer severely if they are to be permanently disadvantaged in energy costs as against their European competitors. In my view that would be a very serious outcome and I hope therefore that we can have a further collective discussion on this difficult matter before long.

I am copying this letter to the other members of MISC 56.

Yours sincerely

M Stewart (Miss)

(Approved by the Secretary of State and signed in his absence.)

30 NOV 1981

JFA

Nat Ind

10 DOWNING STREET

From the Private Secretary

27 November 1981

Gas Legislation: E(81)102

Many thanks for your letter of 20 November.

You make a point at the end of your letter that it should be recognised that private companies are unlikely to find it economically attractive to market gas to households, as opposed to the industrial consumers who use far more gas at a single site. Against this the Prime Minister commented as follows:

"But they may wish to market it to domestic consumers near the industrial site."

I am not copying this letter as in our earlier correspondence.

MS

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

CONFIDENTIAL

CONFIDENTIAL

CC HMT
DOI
8O

10 DOWNING STREET

From the Private Secretary

24 November 1981

B/F

Electricity discount scheme

During a discussion between the Prime Minister, the Chancellor and the Chief Secretary yesterday evening about public expenditure, the Prime Minister enquired about the electricity discount scheme.

The Prime Minister would be grateful for a note about the progress that has been made in devising a workable scheme. Her immediate inclination is not to go ahead with this scheme in the current difficult public expenditure situation.

I am sending copies of this letter to John Kerr (H.M. Treasury), Ian Ellison (Department of Industry) and Muir Russell (Scottish Office).

M. C. SCHOLAR

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

CONFIDENTIAL

CONFIDENTIAL

cc AO
AW
JV

(2)

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ
01 211 6402

Prime Minister

You asked why BGC's transmission system should not be used as a common carrier for private sector supplies to domestic and industrial consumers alike. The answer is here — safety and regulatory complications.

MLS 20/11

Michael Scholar Esq
Private Secretary
10 Downing Street
London SW1

20 November 1981

Dear Michael,

GAS LEGISLATION: E(81)102

Thank you for your letter of 9 November.

The point raised by the Prime Minister was also touched on in the Chancellor's letter of 6 November to my Secretary of State. I attach a copy of my Secretary of State's reply. However, it may be helpful if I comment further on the particular point raised by the Prime Minister.

My Secretary of State fully agrees that BGC's main onshore transmission system should be available for use by the private sector on a common carrier basis. The legislation will provide him with regulatory powers to ensure that BGC do not put obstacles in the way of private sector access to the system on fair terms.

Our present intention is that these 'common carrier' powers will apply to all BGC's onshore pipelines, including not just the main transmission system but also the local distribution lines which serve mainly domestic consumers. Nevertheless, there would be considerable difficulties if the private sector entered the domestic gas market on any scale. Gas safety in the home is at the moment largely and fairly effectively controlled by British Gas. If that role was taken over by the private sector, rather than a State body, we would undoubtedly be forced to introduce a strict regulation and inspection system. More generally, the entry of private firms into the domestic market could lead us towards the massive regulatory bureaucracies which exist in the United States, at both national and local level, to control the operations of private gas utilities. My Secretary of State is very much concerned to avoid the major staff increases which would be necessary to deal with these problems.

However, he is also concerned that those consumers to whom BGC has no statutory obligation to supply gas should in future have an opportunity of seeking a supply from the private sector. As well as the larger users, this is the case for some domestic and other smaller users who are more than 25 yards from a BGC main. It is largely for this reason that we intend, at least in principle, to allow private suppliers access to all BGC's lines. But at the end of the day it should be recognised that private companies are unlikely to find it economically attractive to market gas to households, as opposed to the industrial consumers who use far more gas at a single site.

I am copying this letter to the Private Secretaries to Members of E Committee and to David Wright (Cabinet Office).

Yours sincerely,

Janet Chadwick

pp J D WEST
Private Secretary

But they may wish to market it to domestic consumers near the industrial site.

mf

CONFIDENTIAL

AD
AW
JV

(2)

Prime Minister

MCS 20/11

01-211-6402

Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1

20 November 1981

Dear Geoffrey

MT

GAS LEGISLATION

I am grateful to you and my other colleagues for supporting my proposals in E(81)102. I agree that it would be helpful if our officials continue to keep in touch during the preparation of the legislation.

Both you and Robin Ibbs have raised the questions of depletion policy and exports. So far as gas depletion is concerned, I suspect that as in the case of oil we will need to adopt a flexible and pragmatic approach. I doubt whether in the event it will be possible, or indeed desirable, to give, as Robin Ibbs suggests, an indication of the intended gas depletion rate. But we can consider this further when we have the report from officials on gas depletion. This should be available by about the end of the year.

I do not believe that there is a direct connection between what we now propose to do and the question of gas exports. My proposals will not eliminate the landing requirements or change my power to waive it, so the position will in this respect remain unchanged. Nevertheless we do recognise, as Humphrey Atkins points out, our proposals may be seen as an opportunity to raise the question of gas exports and the landing requirement. My officials are therefore now developing proposals on what our future strategy in this are thought to be. The major unknown, of course, is how the UK gas market and gas exploration offshore will develop once BGC's monopoly privileges are removed. For the moment I am sure that we should continue to emphasise that our proposals have nothing to do with gas exports.

I agree that we shall need to consider the implications of our new policy for the North Sea fiscal regime and ensure that the nation obtains a fair share of the returns which are likely to accrue to the oil companies as a result of the abolition of BGC's monopsony. At the same time we will, of course, have to be careful that any changes that we may make do not discourage the exploration and development of new gas supplies. I am glad that the Official Working Party will be making recommendations to us on this area as part of their review of the fiscal regime.

You and Robin Ibbs also raised the possibility of an even more radical approach to the breaking of the BGC's monopoly. I would certainly not wish to exclude this as an aim in the longer term. But to include such far-reaching provisions within the present Bill would, among other things, seriously jeopardise its very tight timetable. We must avoid that at all costs. Failure to get the Bill this session would not only delay the BNOC flotation, which we hope will take place towards the end of next year, but would be a major political setback. I am sure you will agree that passage of the legislation must be our first priority.

You asked for my views on the possibility of disposing of BGC's gasfield interests. Morecambe and Rough are, as you know, now entering the development phase to meet demand only three years ahead. This would clearly not be an appropriate time to sell them. In any case their purpose is to enable BGC to meet peak demand from domestic consumers in the winter and they will therefore be an integral part of the Corporation's supply system. The other main gasfields in which BGC have an interest are well past their prime. But we will need to keep open our decisions on any future gas discoveries by the Corporation.

Patrick Jenkin, in his letter of 12 November, commented on the terms on which the BGC's transmission system is to be made available to the private sector. As he says, there will be considerable problems in allocating costs between users of the system. In advance of the legislation coming into effect we shall be devoting a good deal of thought to ways of ensuring that the terms charged for the transmission of 'private gas' are fair. As for interruptible supplies, I agree that there should be no question of BGC being able to insist that the private suppliers' customers should be cut off first. This point will obviously feature in the negotiations between BGC and the private gas suppliers. If the latter cannot obtain fair treatment on this (or on any other aspect) they will, under the legislation, be able to ask me to resolve the dispute and direct BGC accordingly.

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

Yours
Nigel

NIGEL LAWSON

JH 916

40 JU ② AW. Nab/w

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

12 November 1981

The Rt Hon Nigel Lawson MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
London SW1

Prime Minister

MLS 13/11

Dear Nigel,

GAS LEGISLATION

Your minute to the Prime Minister of 29 October invited comments on the proposals set out in your paper E(81)102.

2 I fully support your proposals. Major industrial users of gas are concerned about the prospective shortages of gas and will welcome the opportunity, which your proposals will provide, of entering into direct arrangements with gas suppliers in an effort to overcome this problem. Competition in the gas market can also be expected to encourage BGC to adopt a pricing structure more closely related to costs of supply. This will bring a number of benefits to industry: the underpricing of domestic gas will phase out, releasing more supplies to industry; BGC will be under pressure to offer bulk discounts and will find it less easy to adopt its own criteria on which industrial users receive firm contracts and which receive interruptible.

3 I attach particular importance to the arrangements you propose to ensure that private sector suppliers can gain access to the transmission network on fair terms. If the proposals are to succeed in injecting competition into the gas industry, it is essential that these terms of access should not constitute an entry barrier. I anticipate that, in addition to the familiar problems relating to the proper allocation of costs to users of the transmission and distribution systems, problems could also arise in relation to interruptibility. In the event that private sector suppliers' demands on the system cannot be accommodated on an uninterrupted basis, there would need to be assurances that BGC, in its role as overall manager of the

SECRETARY OF STATE FOR INDUSTRY

system, treats private gas suppliers' customers on interruptible contracts on all fours with its own.

4 I am attracted by Geoffrey Howe's suggestion that the gas transmission system should be operated on a common carrier basis and should be owned independently of BGC. This would ensure equity of treatment as between BGC's and private sector suppliers' customers. It might also open the way for far-reaching and desirable changes in the structure of the gas industry. For example, the local distribution system would be uncoupled from the purchasing end of BGC and arrangements might be made for different areas to have some freedom to deal with alternative sources of supply which would in turn open up new markets for private sector suppliers. In gas supply, as in electricity generation, the operation of an independently-owned national grid would open up the entire industry to some degree of competition.

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

Yours ever

Patrick

12 NOV 1981

CONFIDENTIAL E NAT INDS DSG

File

HO
FCO
HMT
DOI

(D/N)
CSO, HMT
Paymaster G.O.
MOD
DOE

10 DOWNING STREET

DES
D/M
MAFF
DOT

NIO
CDLO
D/Trans.
+ CO

From the Private Secretary

9 November 1981

GAS LEGISLATION: E(81)102

The Prime Minister has now had an opportunity to study your Secretary of State's paper for E Committee on Gas Legislation.

B/F 16/11/81

The Prime Minister has enquired why BGC's pipelines onshore should not be used by other suppliers of gas, so that the monopoly is confined to the transmission system, with the private sector free to use that system on a common carrier basis to sell gas in competition to both industrial and domestic consumers. The Prime Minister wonders why this arrangement cannot be included in the Bill.

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

M. C. SCHOLAR

Julian West, Esq.,
Department of Energy.

CONFIDENTIAL

SK

CONFIDENTIAL 2pm

c. Mr Sanders
A Duguid
A Walters

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000 6 November 1981

The Rt Hon Nigel Lawson MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
LONDON SW1P 4QJ

Dear Nigel

GAS LEGISLATION

In your minute of 29 October to the Prime Minister, you invited colleagues' approval of the proposals set out in your paper, E(81)102.

As you know, I fully support your proposals for BGC, announced to the House on 19 October. I have no comments on the scope for legislation proposed in your paper, though it would be helpful if my officials could continue to be kept in touch with the detailed preparation of the legislation.

The proposals for reduction in BGC's gas purchase privileges have important consequences for the Government's North Sea activities, particularly gas depletion policy, and the application of the North Sea fiscal regime to gas developments.

Until now, the British Gas Corporation has been able more or less to impose its own gas depletion policy. As we all recognise, this has distorted development decisions and acted as a general disincentive. But once the monopsony has gone, there ought to be a much freer market and Government will have to have a view on such matters as the rate of development and gas exports. We can consider policy here when the report on gas depletion is ready. I hope that this can be produced soon since you may be pressed for some explanation of our intentions in these areas when the Bill is before Parliament.

We shall also need to consider the implications of removing BGC's monopoly on the North Sea fiscal regime. In particular we shall need to consider whether the tax system will generate

/for the nation

for the nation a fair share of the returns which are likely to accrue to the oil companies as a result of the abolition of the monopsony. The Working Party of officials from the Treasury, Inland Revenue and the Department of Energy will be reporting to us on this when they make their main report on this Autumn's review of the fiscal regime following UKOOA's proposals. We shall then need to consider whether any changes need to be made in the light of their report. Meanwhile, in public discussion of the proposals, you will need to recognise the role of the North Sea fiscal regime in recouping returns to the oil companies provided by abolition of the monopsony, in terms which allow for the possible changes in this area as a result of the review now underway.

On the disposal of assets, you have referred so far only to the disposal of BGC's offshore oil assets. Cannot a case also be made out for disposing of at least some of their gas fields? I should be interested to have your views on this.

Lastly, I know that you will not regard the present package of measures, an important step forward as they are, as necessarily the conclusion to the measures to open up the operations of the British Gas Corporation to competition. Even after your proposals are implemented, the Corporation will still be a monolith, with many of its operations unaffected by direct competitive forces. In this regard, I would perhaps take issue with the suggestion in paragraph 4 of your paper that BGC's monopoly of gas supplies to the domestic market meets what you refer to as the classical argument for a public utility. Certainly there are benefits flowing from a common transmission and distribution network which might be regarded as providing a natural monopoly. But these benefits do not in themselves require that the party running the transmission system should also be a monopoly supplier of gas. Surely the planning aim for the longer term should be to confine the monopoly to the transmission system, publicly or privately owned, with the private sector free to use that system on a common carrier basis to sell gas in competition to both industrial and domestic consumers. Provided this would not complicate or delay the Bill, it would be worth bearing in mind this planning aim when drafting the legislation.

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

GEOFFREY HOWE

- 6 NOV 1981

CABINET OFFICE

Central Policy Review Staff

From: J. R. Ibbs

70 Whitehall, London SW1A 2AS

Telephone 01-233 7765

Prime Minister

Some substantial comments on Mr Lawson's paper – including one already made by yourself at X,

MCS 9/11

CABINET OFFICE
Central Policy Review Staff
70 Whitehall, London SW1A 2AS Telephone 01-233 7765

From: J. R. Ibbs

Qa 05721

CONFIDENTIAL

6 November 1981

Dear Secretary of State,

Gas Legislation

Your letter dated 29 October to the Prime Minister invited comments on your proposals for enabling gas legislation set out in E(81)102.

The CPRS sees abolition of BGC's statutory monopoly of purchase and sale of gas as a useful first step in opening up the UK gas market to competition. However, the proposal does carry implications that do not seem to be directly addressed in E(81)102. It seems to us important that policy on depletion and on the related question of gas exports, should be clearly established before the monopsony is abolished.

As you point out, one benefit from the decision to remove BGC's monopoly powers should be to increase gas exploration and production. There is therefore an implicit decision that the rate of gas depletion should be increased and it seems to the CPRS that Ministers need to consider how rapid a development of gas reserves they are prepared to accept. It is obviously desirable to avoid a situation where private sector producers, having been encouraged to explore for and develop gas reserves, are subsequently subject to development delays on depletion grounds. Thus the CPRS believes that producers should be given at the outset as clear a statement as possible of the intended gas depletion rate. A commitment on depletion policy would also be a necessary pre-condition of any extensive private sector gas gathering system proceeding.

The proposals have the effect of transferring the responsibility for implementing gas depletion policy from BGC to Government. As E(81)102

The Rt Hon Nigel Lawson MP
Department of Energy
Thames House South
SW1P 4QJ

points out the landing requirement for gas has hitherto been effective in preventing exports of gas. In this closed market, BGC has been able through its monopoly pricing powers to determine the rate and location of gas production on behalf of the Government. With the removal of BGC's statutory privileges any control of the rate of production, other than by market forces, depends directly on the Government through your powers of development approval.

However, there could be circumstances in which the proposed legislation on its own might be less than effective in introducing competition into the UK market. This might arise, for instance, if a particular producer is not able easily and quickly to find enough direct UK purchasers capable of entering into the necessary long-term contracts. The output of even a small gas field would necessitate many individual consumers and gas, unlike oil, is inflexible in that it needs long-term secure outlets prior to development. Furthermore, producers might be reluctant to enter into extensive gas marketing if this is something in which they have no expertise.

x One possibility to make the proposed legislation more effective would be to split up BGC into a central distribution grid with common carrier rights and separate regional marketing companies. The marketing companies, perhaps subsequently privatised, would provide ready made gas wholesaling outlets for which producers could compete.

Unless a better market for producers is provided by such a break-up of BGC, the only way to stimulate production may be to allow exports of gas. This should ensure that gas prices move to European market levels and that use of gas as an energy form is optimised. But whilst this would be favoured by producers it might deny the UK consumer the benefits looked for from competition. The question of exports ties back to that of depletion, because once exports are allowed there is an enormous potential increase in demand and definition of depletion policy becomes that much more important. This question of exports therefore needs to be carefully considered before legislation on the break-up of the monopsony comes into effect.

I believe therefore that Ministers need to consider now their broad policies on the questions of depletion, exports and the future shape of BGC.

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

yours sincerely,

Robin Ibbs

J R Ibbs

CONFIDENTIAL

cc JV
AD

LORD PRIVY SEAL

Foreign and Commonwealth Office
London SW1

5 November 1981

GAS LEGISLATION

– with MS?

In your minute of 29 October to the Prime Minister you asked for comments on the proposals in E(81)102 for enabling legislation to abolish BGC's statutory privileges of gas purchases and sale. I can see the need to bring forward this legislation as early as possible and I am content that you should proceed on the basis described.

In parallel with the preparation of the necessary legislation I suggest our officials might look at our attitude to the export of gas from the UKCS and the landing requirement. As your paper points out, the landing requirement is vulnerable to attack on the grounds of its possible incompatibility with the Treaty of Rome. The possibility of such a challenge as a consequence of the changes in BGC's position has already been given some publicity in the Guardian of 22 October, and I imagine that it might well be raised during Parliamentary consideration of the proposed Bill.

I am sending copies of this letter to the members of E Committee and to Sir Robert Armstrong.

The Rt Hon Nigel Lawson MP
Secretary of State for Energy
Thames House South
Millbank
London SW1P 4QJ

CONFIDENTIAL

-6 NOV 1981

Nat Ind - 2

MS

PRIME MINISTER

British Gas

I understand from Mr. Lawson's Office that British Gas are putting out a statement recording their disagreement with the measures relating to themselves announced in The Queen's Speech.

Mr. Lawson is calling in Sir Denis Rooke tomorrow, and intends to tell him how much he deplores British Gas's action; and to express hope that there will be no repetition of this kind of action.

MLS

4 November 1981

c.c. J. Vereker
A. Duguid
A. Walters
MS

(4)

PRIME MINISTER

My detailed proposals for enabling legislation to abolish BGC's statutory privileges of gas purchase and sale and to direct the Corporation to dispose of certain assets were circulated in E(81)102. In view of Francis Pym's request to have this legislation ready for introduction as early as possible, we have been pressing ahead urgently with preparatory work, in anticipation of colleagues' approval of the proposals. It would, though, be helpful to have clearance fairly soon. Since I understand that the paper cannot be put on the agenda of E Committee in the immediate future and that colleagues generally see no major objections to the proposals, I suggest, therefore, that the matter be cleared by correspondence.

Could I therefore ask colleagues for any comments by Friday, 6 November.

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

NL.

Secretary of State for Energy

29 October 1981

Prime Minister

I am not sure why what is called a 'planning aim' at X in the Chancellor's letter at flag A is not to be included in the Bill.

Subject to a satisfactory answer on this, are you content with the proposals in Mr Lawson's E paper?

MCS 6/11

I do think the Chancellor's point is important. BGC's pipelines onshore should be used by other suppliers - i.e. they should become common carriers.

MT

Energy

NBPM

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

01 211 6402

CONFIDENTIAL

Michael Scholar Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1

29 October 1981

Dear Michael,

FRIGG GAS SUPPLIES: INDUSTRIAL ACTION

My Secretary of State minuted the Prime Minister last night about the consequences of a prolonged dispute at the Frigg gas field.

As I reported by telephone this morning, the Frigg employees went back to work in the course of last night and gas supplies to this country have now resumed. British Gas have started reconnecting their interruptible customers, all of whom should soon be back to normal.

This return to work, like the start of the industrial action, seems to have caught the operating company (Elf) by surprise. As late as yesterday evening they were still saying that the outlook was poor and that the strike could last for ten days; the Norwegian Government was taking the same line. We have asked Elf to review the flow of information to us and to British Gas in this type of situation.

Both Elf and the Norwegians are now confident that renewed industrial action at Frigg is very unlikely in the near future, but their past performance suggests that we would do well to be cautious. The underlying pay dispute is not yet resolved and a related dispute at the Ekofisk oil field has worsened rather than improved. For the present, however, our gas supplies are back to normal.

I am copying this letter to the Private Secretaries of Cabinet members, as well as to James Nursaw (Attorney General's office) and David Wright (Cabinet Office).

Yours ever,

J D WEST
Private Secretary

Prime Minister

To see

[illegible] 28/10

CONFIDENTIAL

PM has seen

NAP.

PRIME MINISTER

FRIGG GAS SUPPLIES: INDUSTRIAL ACTION

The Frigg gas field has been shut down since yesterday as the result of a Norwegian labour dispute and supplies ceased being delivered to the St Fergus Terminal this morning. The dispute concerns the rejection by the Norwegian trade unions of an arbitrated pay award. (The Ekofisk oilfield has been shut down for the same reason). The companies operating Frigg (Elf/Total) attempted to keep the UK side of the field in operation but union members on the platforms prevented the necessary staff being brought in by helicopter.

2. This has had a major impact on gas supplies because Frigg provides about one third of the British Gas Corporation's total supplies of natural gas from the North Sea. They could replace these supplies for about five days from liquified natural gas (LNG) stored to meet peak winter demand. But this stored gas could not be replaced this winter and therefore they could be faced with serious shortages later in the winter. Therefore, from midday yesterday British Gas started to interrupt their large industrial consumers who get their gas at a cheaper rate in return for an undertaking to switch to alternative fuels in the event of an emergency. All such interruptible supplies have now been cut off and British Gas are at present just managing to meet firm - ie non-interruptible - demand without drawing on their stored LNG.

3. However, the position is very finely balanced and British Gas could at any time be able to meet non-interruptible demands only by drawing on their limited stocks of LNG if there were a worsening in the weather (which is inevitable as the winter

develops) or if there were other breakdowns affecting supplies. At present the Corporation are obtaining the maximum take from all their other suppliers. In the meantime, they have made it clear that consumers should not waste gas.

4. Elf Norge are making every effort to resolve the dispute with their workforce but they are unable to forecast how long this might take. We are in touch with the Norwegian Government through our Embassy and have been assured by the Norwegian Ministry of Petroleum and Energy that they are fully seized of our concerns and that they will inter alia be trying to persuade the trade unions to let the UK side of the field continue in operation. However, the prospects for this are not good. The Norwegians have indicated that the strike could continue for at least another ten days.

5. British Gas have advised that their own dispute with their shift workers on the national transmission system is having virtually no effect on their ability to maintain supplies.

6. They can hold the position for a day or two. If necessary, they could deal with a slight demand/supply imbalance by drawing on a limited amount of stored LNG, by exhorting customers to economise and by requesting some of their large industrial consumers on non-interruptible contracts to cease or reduce their gas consumption. But clearly they could not rely for very long on voluntary co-operation. We would then need to invoke the emergency powers in the Energy Act 1976 in order to over-ride their contractual obligations and to direct supplies where they are most needed.

7. These powers would enable me to make orders regulating or prohibiting the use of natural gas and to give directions as to the use of gas, and to grant authorities relaxing

statutory or contractual obligations in relation to gas. The directions to industrial users to stop using gas would therefore be given statutory force. It would not be my intention, unless the industrial action proved very protracted, to make orders restricting the use of gas in commercial or domestic premises.

8. These powers are exercisable while an Order in Council is in force because there exists in the UK an actual or threatened emergency affecting fuel or electricity supplies which in Her Majesty's opinion necessitates the temporary availability of exceptional powers for controlling energy. An Order in Council made to deal with an emergency in the UK would require approval by both Houses of Parliament within 28 days of making if it were not to cease to have effect, and would expire 12 months after making unless both Houses resolved to continue it for a further 12 months.

9. I am of course keeping in close touch with events with British Gas, the Norwegians and the producers. The purpose of this minute is to advise you of the situation now facing British Gas and to warn colleagues that I may have to seek their urgent agreement, at very little notice, to my seeking an Order in Council invoking the emergency powers in the Energy Act.

10. I am copying this to the members of the Cabinet, the Attorney General and Sir Robert Armstrong.

B. D. W

pp. SECRETARY OF STATE FOR ENERGY

28 October 1981

(Approved by the Secretary of State and signed in his absence).

Prime Minister (2)

Original to PM 29/10

You have already seen this minute but will wish to be aware of the latest position, as in my note →.

MCS 29/10

Note/ SoS/Energy Office telephoned to say gas is now flowing again — Strike is off — but the dispute continues generally and we may be back to a situation of shortage at short notice if strike resumes

MCS 29/10

CONFIDENTIAL

PRIME MINISTER

FRIGG GAS SUPPLIES: INDUSTRIAL ACTION

The Frigg gas field has been shut down since yesterday as the result of a Norwegian labour dispute and supplies ceased being delivered to the St Fergus Terminal this morning. The dispute concerns the rejection by the Norwegian trade unions of an arbitrated pay award. (The Ekofisk oilfield has been shut down for the same reason). The companies operating Frigg (Elf/Total) attempted to keep the UK side of the field in operation but union members on the platforms prevented the necessary staff being brought in by helicopter.

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3. However, the position is very finely balanced and British Gas could at any time be able to meet non-interruptible demands only by drawing on their limited stocks of LNG if there were a worsening in the weather (which is inevitable as the winter

develops) or if there were other breakdowns affecting supplies. At present the Corporation are obtaining the maximum take from all their other suppliers. In the meantime, they have made it clear that consumers should not waste gas.

4. Elf Norge are making every effort to resolve the dispute with their workforce but they are unable to forecast how long this might take. We are in touch with the Norwegian Government through our Embassy and have been assured by the Norwegian Ministry of Petroleum and Energy that they are fully seized of our concerns and that they will inter alia be trying to persuade the trade unions to let the UK side of the field continue in operation. However, the prospects for this are not good. The Norwegians have indicated that the strike could continue for at least another ten days.

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6. They can hold the position for a day or two. If necessary, they could deal with a slight demand/supply imbalance by drawing on a limited amount of stored LNG, by exhorting customers to economise and by requesting some of their large industrial consumers on non-interruptible contracts to cease or reduce their gas consumption. But clearly they could not rely for very long on voluntary co-operation. We would then need to invoke the emergency powers in the Energy Act 1976 in order to over-ride their contractual obligations and to direct supplies where they are most needed.

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CONFIDENTIAL

statutory or contractual obligations in relation to gas. The directions to industrial users to stop using gas would therefore be given statutory force. It would not be my intention, unless the industrial action proved very protracted, to make orders restricting the use of gas in commercial or domestic premises.

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9. I am of course keeping in close touch with events with British Gas, the Norwegians and the producers. The purpose of this minute is to advise you of the situation now facing British Gas and to warn colleagues that I may have to seek their urgent agreement, at very little notice, to my seeking an Order in Council invoking the emergency powers in the Energy Act.

10. I am copying this to the members of the Cabinet, the Attorney General and Sir Robert Armstrong.

B. D. W—

pp. SECRETARY OF STATE FOR ENERGY

28 October 1981
(Approved by the Secretary of State and signed in his absence).

PRIME MINISTER

You may have seen news reports of a strike in Norway's Frigg field, which is affecting supplies of gas to BGC.

The Corporation is already interrupting supplies to customers who have interruptible contracts. If the action persists, they may have to consider curtailing supplies to some other customers. This would arise in a matter of days rather than weeks. However, we understand that the Norwegian unions involved have now acknowledged that their strike action is illegal,so the Department of Energy are optimistic about a return to something like normal working. There is also an overtime ban in progress at present, which further complicates the position.

MAP

27 October 1981

BF with X when it arrives
MH 21/10

Mr PATTISON

GAS SAFETY

Thank you for your minute of yesterday. We shall be glad to advise if we can when you receive the analysis.

CP

C PRIESTLEY
20 October 1981

21 OCT 1981

CONFIDENTIAL

VLS

BF 4 weeks please

10 DOWNING STREET

From the Private Secretary

19 October 1981

The Prime Minister has seen your Secretary of State's minute of 6 October, about future arrangements on gas safety. She has also seen the Chancellor of the Duchy of Lancaster's comments in her minute of 14 October.

Given the Government's decision not to seek legislation on these matters in the forthcoming Session, there seems to be no immediate need for a final decision on where to locate the necessary regulatory machinery. The Prime Minister is, however, disturbed to learn that over 100 staff are thought to be necessary. She would like to see a breakdown of requirements, together with a note of how these have been calculated.

I am sending copies of this letter to Jim Buckley (Chancellor of the Duchy of Lancaster's Office), Peter McCarthy (Mrs. Oppenheim's Office, Department of Trade), Richard Dykes (Department of Employment) and Jill Rutter (H.M. Treasury).

M. A. PATTISON

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

CONFIDENTIAL

Nat Ind

cc Mr. Gow

Copied to Parliament Legislation

PRIME MINISTER

Gas Legislation

Mr. Lawson's Answer (given at 3.30) on the gas industry monopolies caused considerable excitement in the House. Peter Viggers used his supplementary to press for further details of the amount of money involved and the timescale. David Owen rose next, attacking Mr. Lawson's announcements as pure Party political dogma. He wanted to know whether the decision on maintaining a Government minority shareholding in BNOC meant that the Government was ready to negotiate all the participation agreements, and whether the entire Continental Shelf issue would be reopened. On gas appliances, he called for the Government to admit that it had made a wrong decision, and not simply to react to industrial blackmail.

Merlyn Rees argued that this Answer had been no way to put to the House fundamental changes in Government policy (after quick consultation with Michael Cocks, he later moved for an SO9 Debate, but was turned down). The Government, he said, had shown itself to be anti public enterprise. He wanted details of the necessary legislation, and of the limitations on the Secretary of State's powers under it. Whatever else had been said in the announcement, the death of the sale of gas showrooms had been declared. He asked whether the measures on the gas supply monopoly would really increase gas availability. Mr. Lawson said that the details would be given in The Queen's Speech, and there would be the usual opportunity to debate them then. He had merely taken the first opportunity after the Summer Recess to acquaint the House with the Government's latest thinking.

There were two other contributions from each side before the Speaker drew matters to a close, emphasising that this was a Question not a Statement. Peter Hardy claimed that the announcement was a sweeping betrayal of the national interest, which required a Debate immediately, not some incidental discussion in the Debate on the Address. Tim Eggar, on the other hand, described the proposed measures as bold and imaginative.

/Mr. Lawson

Mr. Lawson held his end up well. And the gas showrooms decision was successfully set in a wider context of Government intentions. But I understand that Mr. Lawson is still unhappy about not having been allowed to offer a Statement, and he feels that the Opposition's reaction may give added force to his view. In practice, there was going to be some kind of a row however the announcement was handled, and the Government may come quite well out of this package.

MR

19 October 1981

FILE

VLG

Nat Ind

10 DOWNING STREET

From the Private Secretary

MR. PRIESTLEY
CABINET OFFICE

I enclose copies of recent minutes about the arrangements for gas safety which will need to be introduced when the British Gas Corporation ceases appliance retailing.

As indicated in my letter of today's date, the Prime Minister is not impressed with the assumption that over 100 new staff will be needed, whether at the Department of Energy or in a new quango. She has therefore asked for the breakdown requested in my minute. She has it in mind that this might usefully be submitted to management consultants for analysis, but she would be grateful for advice from your office when the breakdown is received.

BF

M. A. PATTISON

19 October 1981

PRIME MINISTER

Mr Lawson has not spoken to me about this – MT

STATEMENTS IN THE SPILLOVER

but I don't like the tone of his statement at all. It will have to be modified for his sake. MT

At present, it looks as if there will be at least five Government statements in the next two weeks.

The most difficult may be one on gas appliances. In view of the leak today about the Government's decision not to introduce safety legislation next Session, it is now urgent to set the record straight. Mr Lawson may have spoken to you about this at Blackpool, or may telephone you about it over the weekend. He is top for Questions on Monday, and Peter Viggers has a Question at No 7 which could be the vehicle for a statement like the one Mr Lawson originally proposed to make at the Conference. Alternatively, he could make such a statement by answering Mr Viggers' Question at the end of Question Time. But at present, Ministers seem to favour an entirely separate statement on the subject. As this will be primarily about legislative intentions, it seems to me tricky to volunteer such a statement, and then make one which will have to be hedged with qualifications about not pre-empting the Queen's Speech. If you are, however, content that Mr Lawson should make a special statement in the House on the subject, I suggest that it should be on Wednesday or Thursday next week. Tuesday is likely to be a noisy and difficult day. It will not be a good moment for the Government to declare that it has set back the timetable for action which was announced earlier in the year. Do you agree? [First draft attached]

The second tentative bid for next week is Mr Walker, who may need to report on Tuesday about the Agricultural Council, if there is something to say. We need not be too concerned about any disruption in the House for one of these routine statements.

/ The following

The following week, there may be three statements. You will need to report on Cancun on Monday 26 October. You have one other statement in mind, and may by now have decided with Clive whether to go for Tuesday 27 or Thursday 29 October. The Home Secretary hopes to make a statement on the Scarman Inquiry in so far as it relates to Brixton. That can probably come on the Wednesday.

MAP

16 October 1981

Mufaxed to Blackpool

MR. WHITMORE

MAP 16/x.

Gas applicances

Mr. Lawson may try to speak to the Prime Minister about gas appliances after her speech this afternoon, following the Daily Express report this morning which has been picked up by radio.

I have told Energy that Mr. Lawson may not find it easy to corner the Prime Minister this afternoon, and that it may be easier for him to speak to her on the telephone later in the weekend. But it may be helpful for you to have the background in case there is some discussion at Blackpool.

In the middle of last week, Cecil Parkinson assured Nigel Lawson that energy pricing would be one of the balloted subjects for debate at Blackpool. Lawson then minuted the Prime Minister suggesting that he could best deal with the Government's disappointing record on energy prices by broadening his speech to cover legislative intentions. He proposed to outline Cabinet decisions on oil and gas legislation, and at the same time mention that the Government would not expect to deal next session with all the legislative issues involved in disposing of BGC's gas showrooms, as the other measures would take priority. This Lawson argued would be the best way of deferring the threat of a gas strike over the showrooms whilst presenting the decision as something other than a straight climb down in the face of union pressure.

Mr. Lawson deliberately chose not to copy his minute to Mr. Biffen or Mrs. Oppenheim, as he preferred to negotiate directly with Mrs. Oppenheim.

The Prime Minister endorsed Mr. Lawson's strategy, and Mrs. Oppenheim reluctantly concurred. But all this fell apart when energy failed to become a balloted subject for debate.

/ Energy

Energy therefore spent this week thinking about how else to make this package announcement. They had in mind a Parliamentary statement during the resumed session. I had some doubts about this. Whilst a Party Conference speech would be a legitimate platform for indicating legislative intentions, it is much more difficult to find a justifiable reason for making a statement in the resumed session primarily about legislative intentions, when these cannot be formally revealed in advance of The Queen's speech one week later.

But the Government's plans have now been leaked to the Daily Express. There is no point in speculating about the source, but Energy are now anxious to set the record straight. Mr. Lawson is top for Questions next Monday, and there may well be a case for his dealing with these issues during Question time. There is at least one suitable Question down to him high on the Order Paper. He may well press the idea of a statement, not simply an Answer to a Question. If he approaches the Prime Minister, she may want to ensure that Mr. Pym is consulted about the implications of a statement before she agrees. Another option would be to go for the "Question after Questions" technique on Monday, on the grounds that Mr. Lawson's Answer to the existing Question needs to be a little too lengthy to fit into the normal Question time practice.

MAP

16 October 1981

01-211-6402

John Rhodes Esq
Private Secretary to the Secretary
of State for Trade
Department of Trade
1 Victoria Street
London SW1

16 October 1981

Dear John

POSSIBLE GAS STATEMENT

As you know, my Secretary of State wishes, subject to the views of his colleagues, to make a statement on gas as early as possible next week, preferably on Monday.

We agreed, in view of the limited amount of time available, that I would let you have a copy of the draft statement at the same time as it was submitted to my Secretary of State. A copy is now enclosed.

I should stress that my Secretary of State may well make substantial changes to the draft over the weekend. If he does, I will circulate a revised draft on Monday.

I am copying this letter and enclosure to Mike Pattison (No.10), Jill Rutter (Treasury), Richard Dykes (Employment), and Nick Huxtable (Privy Council Office).

Yours ever

David Lumley

DAVID LUMLEY
Private Secretary

DRAFT

With permission, Mr. Speaker, I will make a statement.

We do not believe that nationalised industries should undertake activities which can be performed equally as well by the private sector. Equally, we are determined to improve the efficiency of those parts of the industry which remain in the public sector. We believe this can best be ensured by introducing competition wherever possible into their activities. We have already announced our plans to introduce private capital into the upstream activities of the British National Oil Corporation. Action now needs to be taken in respect of the activities of the British Gas Corporation. On 13th October I issued a direction, under Section 7 of the Gas Act 1972, to the British Gas Corporation instructing them to dispose of their interests in the Wytch Farm onshore oil field. I now intend to seek powers to enable me to privatise the Corporation's offshore activities. The powers I shall be seeking will also enable me to require the Corporation to dispose of its showrooms. There is no justification for the British Gas Corporation's dominance of the appliance retailing business which the recent Monopolies and Mergers Commission report has clearly shown has been against the public interest. We shall end British Gas Corporation's dominance in this field and introduce competition as soon as practicable. But in taking action in this area we will ensure that safety standards are fully maintained. This will require complex legislation and it may not be possible to find time for this in the coming session of Parliament. This is because I intend, in addition to the powers to introduce private capital in the BNOC's upstream operations and to dispose of BGC's assets, also to seek powers to end BGC's privileges in respect of purchase and distribution of gas to certain customers, in particular industry. These privileges have acted as a disincentive to the exploration and development of gas supplies with the result that industry has gone short. The measures I intend will introduce for the first time effective competition in the gas market and end BGC's monopoly power.

We were elected to roll back frontiers of nationalisation. The proposals I have outlined today will form the most ambitious programme for privatisation put before Parliament. They will introduce much needed and long overdue competition. As such they will be good for British industry, good for the successful development of our oil and gas industries and, above all, good for the nation.

16 OCT 1981

OCO

√ MAP

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With the Compliments of

the Minister of State
for Consumer Affairs Office

CS 178

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DEPARTMENT OF TRADE
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From the
Minister of State
for Consumer Affairs's Office
The Rt Hon Sally Oppenheim MP

Julian West Esq
Private Secretary to the
Secretary of State for Energy
Thames House South

1C October 1981

Dear Julian,

MMC Report on Gas Appliances

You will have seen today's press reports about the decision to delay action on the MMC's report on gas appliances.

My Minister has commented that she feels that a statement should be made as soon as possible to put the Government's position on record. The statement should stress that the planned disposal of gas showrooms has been postponed, not dropped, and that the reason for the delay is the Government's concern for safety, not fear of confrontation. The Secretary of State agrees with this course of action.

Mrs Oppenheim is in America but, in her absence, any statement can be cleared through John Rhodes in the Secretary of State's office.

I am copying this to the private secretaries to members of the Cabinet.

Yours ever,

Peter.

PETER McCARTHY
Private Secretary

CONFIDENTIAL

16 OCT 1981

1

PRIME MINISTER

Gas Appliances

I attach minutes from Mr. Lawson and Lady Young about the details of the safety arrangements which will need to be introduced when the BGC cease appliance retailing (you saw Mr. Lawson's minute last weekend in the context of this session's legislation but you may not then have taken note of the detailed proposals which are no longer relevant to the next session).

You will see that he and Lady Young are agreed that the regulatory machine should be a new statutory quango. Lady Young argues that this proposal meets the two main tests for quango proposals. The second of these is whether it could be done as well by the Department itself. She believes that the quango proposal passes this test because the Department would have to employ more staff, even though the Department would be more publicly accountable than any quango. It seems to me that either approach will create similar numbers of new public employees. Are you convinced that Civil Service manpower policy is so overriding as to justify creating a completely new quango? In practice, the legislative delay means that no final decision on this point need to be taken in a hurry. The manpower position may change, and BGC's own attitude may change. Should we ask that the question be left open for the time being?

MAP

15 October 1981

100 staff? Please ask for a breakdown and we will then submit it to management consultants for analysis. But perhaps Derek Rayner's dept. could look at it first. MT.

Top copy:
Parliament, Pt 8
Legislation

FROM THE LEADER OF THE HOUSE

HOUSE OF LORDS

14 October 1981

Dear Francis,

I have seen your letter to Nigel Lawson of 9 October and also the earlier correspondence on the parliamentary handling of next session's legislation on gas and BNOC.

Despite the advantages of merging the legislation into a composite Bill, I entirely agree with you that if such a Bill is not ready until January, the chances of achieving Royal Assent by July are slim. Our experience this session clearly suggests that unless the Lords can receive a major Bill by the Whitsun recess, its final stages will have to be completed in a spillover period.

As you know, I should regard it as very difficult to persuade the Lords to return more than one week earlier than the Commons next October. The House has now sat for five complete weeks without the Commons in just over a year and to impose a third consecutive burden on them next session would be unprecedented, at least in recent years. I hope you will agree that this is a point which must be borne in mind in any discussions about the shape of the legislation programme for 1981-82.

I am sending copies of this letter to the recipients of yours of 9 October.

Yours ever

Janet

BARONESS YOUNG

The Rt Hon Francis Pym MC, MP
Lord President of the Council

copied to
Parliament, Legislation
Pt 8.

CONFIDENTIAL

Chancellor of the Duchy of Lancaster

PRIME MINISTER

MMC REPORT ON GAS APPLIANCES

Nigel Lawson sent me a copy of his minute to you of 6 October about gas legislation in the coming session.

I agree with him that primary legislation looks unavoidable if we are to honour the assurances which, quite rightly, have been given about the maintenance of safety standards. I also agree that there are two main options for new regulatory machinery: either a new statutory quango or for the Department of Energy to take on the work itself. The choice between these options is important for our policies on quangos and on manpower.

There are two main tests for quango proposals: whether the function concerned is essential and whether it could be done as well by the Department itself (or by some other existing body). In this case, there seems no doubt of the need for regulation. There is also no doubt that a department is accountable to Ministers and to Parliament to an extent that no quango ever can be. That is a positive argument in favour of the Department of Energy taking on this function.

On the other hand, the Department could not do the job unless it recruited over 100 staff with the necessary skills and I cannot ignore the implications for civil service manpower. The Department of Energy is already hard pressed to meet its target. There seems no chance of it doing so if it takes on over 100 staff for this new work.

Reluctantly, I have come to the conclusion that the balance of the argument lies with the option of creating a new quango, with a right of appeal to the Secretary of State by a firm which is refused a licence.

I am copying this to the recipients of Nigel Lawson's minute.

Janet Young

BARONESS YOUNG
14 October 1981

CONFIDENTIAL

15 OCT 1981

PERSONAL

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

Prime Minister

Mrs Oppenheim's longer note below gives very reluctant acquiescence to Mr Lawson's strategy on gas issues. But I understand that, despite Mr Parkinson's prediction, energy will not be debated in Blackpool. So we need to find another chance to make these decisions public.

MAP 13/x

PRIME MINISTER

MT

Dear Prime Minister

I would have liked to have had the opportunity to discuss this with you personally but not surprisingly your diary was full on Monday morning and I was only able to stay in Blackpool overnight because of my impending departure to the USA. I apologise therefore for this long note when I know your own time is so heavily committed but you will understand my feelings in the matter.

It is a pity that such a rushed decision had to be taken when we are winning ground and now have the publicly declared support of the National Gas Consumer's Council for the policy, following my speech to them on 15th September.

Yours Ever

Sally

SALLY OPPENHEIM

PERSONAL

CONFIDENTIAL

PRIME MINISTER

I have seen a copy of your Private Secretary's letter of 12 October to Nigel Lawson's Private Secretary about the handling of the Government's decision on gas appliances at the Party Conference. Both John Biffen and I have discussed this matter with Nigel.

While we fully appreciate the need for delicate political handling of the matter and the necessity not to appear to be pushed into a precipitate climb-down we nevertheless feel that making such an announcement at the Party Conference raises some constitutional issues and will draw more attention to the climb-down - for that is what it is - than would have been drawn if a different and more appropriate, less conspicuous occasion could have been found soon enough to dispel any accusation of precipitate action. We both feel that the decision about, and the nature of, such an announcement should have been the result of Ministerial discussions and agreement. John Biffen and I have had between us several telephone discussions with Nigel at short notice, having first heard of this proposition on Friday and without having seen Nigel's minute of 8 October, which was not copied to us. Nigel still holds the view that this should be announced during his speech at the Conference and, in view of your letter, we most reluctantly defer to his wishes. I have, however, asked him to take particular care over the emphasis given to this matter in the general context of what he is saying in his speech and what he may say in subsequent interviews in order to minimise what I fear could be the immediate reaction of the press and others to what they will represent as a major climb-down if too much emphasis is given to the "delay" in Nigel's speech.

Unfortunately, discussion on this has had to be brief. I am leaving for the United States later this week on a British tourism promotional visit and am not likely to be in the country to rebut any criticism when the speech is made. As a result, I hope it will be possible in the short time left to agree an acceptable form of words with Nigel who is anxious to be cooperative and also to gain his acceptance of the need not to over emphasise the matter.

I am copying this to members of the Cabinet, to Cecil Parkinson and to Sir Robert Armstrong.

Sally

SALLY OPPENHEIM

13/10

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PART 5 ends:-

8. 10. 81

PART 6 begins:-

13. 10. 81

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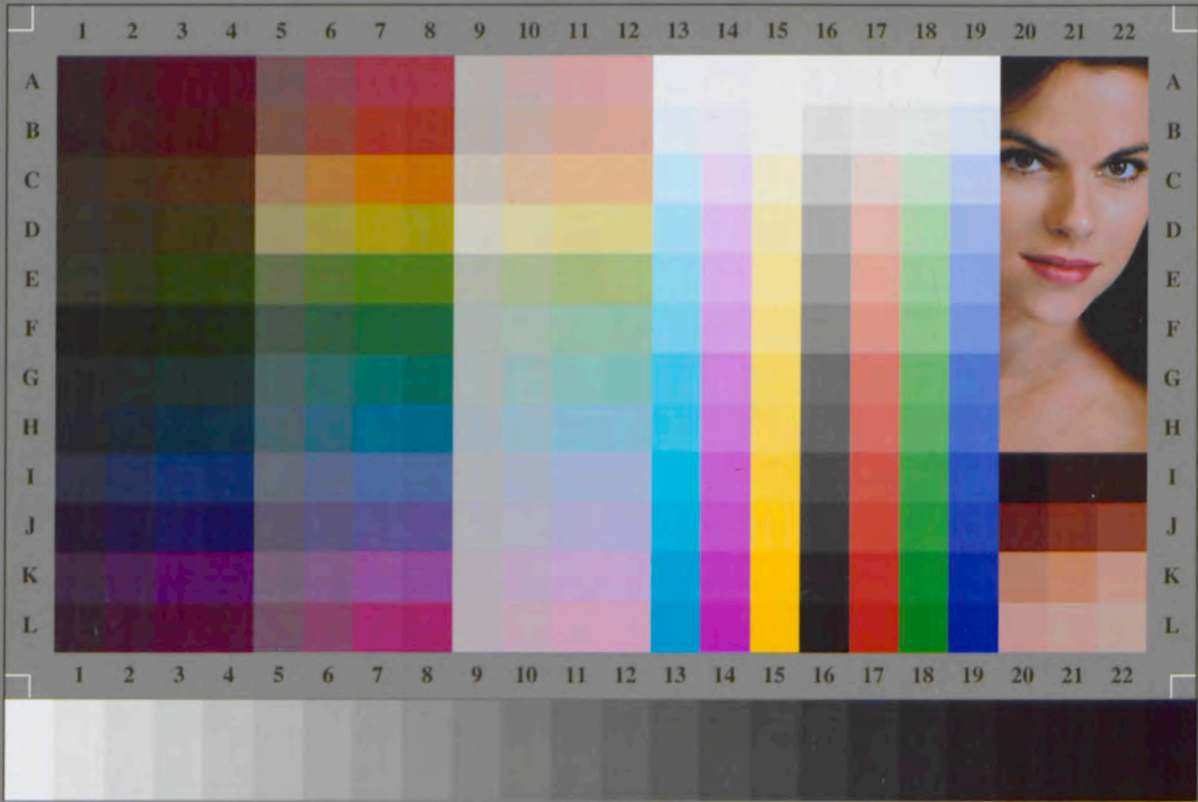

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