

CONFIDENTIAL



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*Dear David*

*R 2617*

WORK ON ENERGY POLICIES

My Treasury colleagues and I recently discussed a number of issues in the energy field with major economic implications for our fiscal and monetary policies, and our external finance, with the object of seeing whether any further work needed to be commissioned. We came up with three proposals, on which I would welcome your views.

Supply in the Medium and Longer Term

Starting with the longer term, I suggest a review of our major plans on the supply side. These involve investment now to help meet demand in the rest of the century. The review would bring together nuclear development with the work you have already done on coal. (It would also cover the future of the National Nuclear Corporation and its operating arm in the Nuclear Power Company.)

Enormous costs are involved: two nuclear power stations or three years of coal investment are each roughly equivalent to the total cost to the UK of the Concorde programme; and just as vulnerable to miscalculation about the level of future demand. The aim would be for officials, led of course by the Department of Energy, to produce a basis for Ministerial decisions on the size and composition of our investment plans for coal and power stations, whether fossil-fueled or nuclear, and on other associated investment e.g. on nuclear fuel or technology for using coal.

The essence of the policy problem is uncertainty - increased by the possibility of lower economic growth in the world and the UK. Because of this and long lead times much energy investment amounts to taking out insurance policies. As well as defining policy options, officials should bring out both the premiums we are paying in the coal and nuclear fields and what we are getting for them, on various assumptions about the costs and availability of alternative fuels. Meanwhile I hope we can minimise firm decisions beyond 1980/81.

/I suggest

The Rt Hon David Howell MP



I suggest that officials from the Treasury, the CPRS and the Departments of Industry, Scotland and perhaps Environment would take part. I would hope the report could be ready early in the New Year.

#### Electricity and Gas Pricing in 1980-81 and Later Years

Proposals to move towards economic prices for electricity and domestic gas have been agreed in E(EA) and MISC(11) and credit has been taken for this in the public expenditure exercise. You have undertaken to provide a paper on energy pricing in the autumn. Work is also needed on the best way of presenting and channelling the extra revenue. This will be large but it will be presentationally helpful that the energy industries as a whole will need substantial external finance over at least the next two years, particularly if R & D is taken into account. The future position depends partly on whether the Gas Corporation has to meet the cost of a gas gathering pipeline in the years 1981-82 to 1984-85. But we do not need to prejudge that issue now; and I certainly do not think we should be led into unnecessary public expenditure as a by-product of economic pricing. The real increase in energy prices will of course be criticised but can be defended not only on energy policy grounds but because, given our monetary and fiscal objectives, it will enable other prices or taxes to be lower than they otherwise would be. There should therefore be no net effect on overall living standards and little or no effect on the general price level.

You and the Secretary of State for Scotland will no doubt wish to set medium-term financial targets for the electricity and gas corporations. But we also need to consider either charging the Gas Corporation a rental for its monopolistic access to North Sea gas fields or the alternative you have in mind. As I understand it this would mean allowing the producers of North Sea gas to renegotiate contracts so that the Gas Corporation pays higher prices but at the same time to raise more tax from the producers. I suspect that under this arrangement some of the economic rent which would otherwise come to the Exchequer would leak away to the oil companies. However both these possibilities ought to be examined. Because of the important tax aspects I suggest that this work should be led by the Treasury with representatives from the Departments of Energy, Scotland, CPRS and the Revenue. I hope a report could be ready by the autumn. (It could either be taken at the same time as the paper on energy pricing or combined with it: we could leave it to officials to do whatever is convenient.)

/Short-Term

Short-Term Matters

Finally, turning to the short term we must recognise the risk that an incident could create a serious oil shortage this winter. The seriousness of the potential damage to productive industry and the economy generally does not need stressing. In such circumstances we should, no doubt, feel obliged to use the Energy Act to implement such measures as those listed in Annex B to MISC 9(79)3, the recent report by officials on fuel supplies. I suggest that it would be useful if you could circulate to the Ministers most closely concerned a report on the state of readiness of our contingency plans - to call attention in particular to those options for which appreciable notice would be required before action could be taken and how far reasonable priority of supplies could be ensured for industry and agriculture. I should also like to suggest that the feasibility and economics of a rapid increase in supplies in a crisis should be considered during the current review of North Sea depletion policy.

Incidentally, at yesterday's Cabinet the possibility of increasing our share of the total "take" from the UK continental shelf was raised. We are as you know already studying the possibility of accelerating the receipt of PRT take in 1980-81. I would of course be willing to examine any other ideas which you or colleagues may have for maximising our UKCS revenues without adversely affecting the development of the UKCS.

I am sending copies of this minute to the Prime Minister, the Foreign Secretary and the Secretaries of State for Scotland, Industry and the Environment, and to Sir John Hunt and Sir Kenneth Berrill.

A handwritten signature in black ink, appearing to read "Geoffrey Howe", written in a cursive style.

GEOFFREY HOWE