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PRIME MINISTER

GAS PRICING POLICY

Prime Minister

This will come to E on 17 Oct.
These proposals would be
more palatable politically if
we gave some of the extra
revenue back to the poor -
especially pensioners. (If we
help non-pensioners, we of
course worsen the incentive
problem). Shall I ask Mr

Tankin to circulate a paper on
the possibilities?

E(EA) discussed this subject on 2 October, on the basis of a
paper by David Howell (E(EA)(79)47) which was presented in
his absence by Norman Lamont.

David Howell's paper argued that gas supplies to domestic
consumers are at present significantly under-priced. The degree
of under-pricing can be estimated variously from 25 per cent to
50 per cent, depending on the basis of calculation, but even
the Price Commission concluded that the domestic tariff was
30-35 per cent too low. The under-pricing is, of course,
increasing demand for gas as a domestic fuel. If nothing is
done, British Gas will need a quite disproportionate investment
programme to keep pace with the demand, and meanwhile the need
to supply domestic consumers is squeezing out industrial consumption.
The American experience shows all too clearly the dangers arising
from continued under-pricing of energy.

The Government does not, of course, set domestic gas prices,
but it does set the British Gas Corporation's financial targets.
At the meeting Norman Lamont recommended that we should set these
targets at levels which would require domestic gas prices to rise
by an average of 10 per cent a year in real terms over the next

/3 years.....

I thought we were going
to consider PRT on gas as
on oil? and



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3 years or so. This would more or less eliminate the underpricing, depending on the method of calculation used, by the end of the period. David Howell believes that increases of this size will enable supply and demand to be brought into balance and secure the public expenditure saving he has agreed bilaterally with the Chief Secretary, even after allowing for increased investment and discounting additional benefit from increased corporation tax.

The first increase would take effect from 1 April 1980, and the cash increase would be 10 per cent above the then going rate of inflation. *No*

E(EA) recognised that this was a major political issue, and did not attempt to reach final decisions. We have asked David Howell to prepare a further paper for consideration, if you agree, by Cabinet or E Committee in the week after the Party Conference. But you may like to know E(EA)'s initial reactions.

No one on the Sub-Committee questioned the case put forward by Norman Lamont, and one or two colleagues suggested that the increase might sensibly be faster than that proposed. But we were in no doubt that the increases would cause a major political row which would be all the greater because the gas industry is already so profitable.

We all agreed, therefore, that presentation would need very careful handling. It was suggested that the increases should

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be presented as one part of a coherent strategy on energy conservation and on the depletion of North Sea reserves. It was also suggested that in the announcement this autumn we should reveal our hand not only for next year but for the two years following, ie that we should announce a policy of continuing real price increases, with the reasons for it. This would have more effect than a single price increase on domestic consumers' decisions and should therefore help to reduce the pressure of domestic demand for gas over the next few years.

A 10 per cent rise in domestic gas prices increases the RPI by 0.16 per cent. We noted that the increases would have an effect on wage claims, but did not see this as a reason for shrinking away from them. We also noted that the price rise would bear relatively heavily on poorer households, who have of course enjoyed a greater relative benefit from the fall in real gas prices over the last few years. Norman Lamont argued that this problem should be dealt with through the Social Security system not through gas pricing, but as a Government we need to note that there will be pressures on us to divert some of the extra revenue towards relieving the worse-off rather than reducing the PSBR.

Finally, we did not reach any conclusions on the British Gas Corporation's profits, but there were suggestions that part of them should be creamed off by a special gas tax, to make it clear that the economic benefits of increased prices were being passed

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back to the community.

I am copying this minute to other members of E and E(EA), to Patrick Jenkin and to Sir John Hunt.

KJ

K J
5 October 1979

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F-5 OCT 1979

