Prime Minister

Mr Howell has offered to see you on Sunday – I assume he could come to Chequers – to discuss this. On the whole, I think it would be better for him to develop his recommendations further and then* you could discuss with him and the Chancellor before going to E. if already.

31/12

cc Mr Hoskyns

Perhaps I can see Mr Howell as soon as he returns. What concerns me most is that there is no spur to efficiency on this price basis nor

Seen to Energy 2/1

PRIME MINISTER

ENERGY PRICES

1 At your meeting with Geoffrey Howe, Keith Joseph and myself on 22 December, you asked for a note on what the Government could do now, immediately, to help industry on energy prices in this very deep recession. This minute sets out the possibilities on which I have been working. As I told you I would propose to put my recommendations to 'E' Committee very soon after I return from my trip to the Gulf in early January. However, if you think it would be helpful, I would be very willing to call on you on 3 January - the day before my departure - for an informal discussion on this note, in which I could perhaps explain more fully the background to these possibilities and the wider implications for our overall economic policy and its presentation.

2 There can be no doubt that it is vital to achieve much greater efficiency in all the nationalised industries. In the energy industries, substantial progress has already been and continues to be made. The gas and electricity industries have achieved a faster growth in labour productivity and a slower growth in employment costs per unit of output than in the rest of the economy over the last decade. In coal the pressures of the financial strategy have recently led to a big acceleration in the rate of colliery closures which had fallen to a negligible level under the previous Government. 3½ million tonnes will be closed this year. But much remains to be done in all the industries and there can and will be no letting up in the pressures on these industries to cut their costs.

3 Private industry will reap the benefits of this work in due course. However, as you said, the pressure on industry from the world recession is immediate and demands immediate relief. And greater efficiency and lower costs in the nationalised energy industries will not affect the price of oil or gas prices to industry which, in a situation of excess demand for gas, are set by market forces. Indeed, as BGC cuts its costs its profits are further enlarged.

* In other words, he should circulate a paper to E, which you would discuss with him and the Chancellor before the meeting.

4. Our general policy which I am sure we must stick to is to require the nationalised energy industries to base their pricing policy on sound economic principles and to refrain from the detailed intervention by the Government which has done so much damage under previous administrations. This means letting them charge so as to reflect the cost of supply on a continuing basis: but it also means that the industries should behave sensibly and flexibly in response to both short and long term market factors. It also gives consumers a clear picture on the cost of their fuel consumption, enabling them to make rational decisions about fuel use, investment in fuel appliances and in energy conservation. Artificial under-pricing or general price control would both promote wasteful use and reduce incentives to develop new sources of energy. I have therefore been looking for possibilities which are consistent with our long term objectives. Some (Nos (i), (iii) and (iv)) could bring a minor but immediate easing of prices charged to some users. Others (ii and v) are more radical and expensive. They would involve a substantial gross cost to the PSBR - partly offset by PSBR savings through the jobs they would help to preserve. Number (vi) - the duty on heavy fuel oil - is really a question of energy tax policy rather than energy pricing policy. However, I offer some views below.

But there is no spur to efficiency

5. The possibilities are:-

ON GAS

(i) I have asked the BGC to consider two changes of pricing practice:-

(a) Their present policy is to provide interruptible gas at a discount to industrial consumers who would otherwise use heavy fuel oil. The discount on interruptible gas would however be of greater value to consumers who would otherwise use the more expensive gas oil. I have asked BGC to consider whether it is practicable to create a category of "priority interruptible" supply for such customers. This might save them 3p/therm and it would remove one of the discrepancies between pricing practice in the UK and some Continental countries.

German
Dut.. Neth.

(b) I have also asked whether the structure of firm gas renewal prices adequately reflects the discounts for bulk which would be available in an unconstrained competitive market. Bulk discounts might save large users a few p/therm.

Both these possibilities would have some immediate PSBR implications on which I am awaiting the advice of the BGC, although the ultimate net PSBR effects could well be smaller.

(ii) a more far-reaching step would be a reduction of, say, 3p/therm on the price of gas to all industrial consumers of firm gas. This would involve direct and overt intervention and be inconsistent with our pricing principles; it would create an additional demand for gas which could not be met; and it would cost the PSBR (gross) some £80 million in a full year.

No.

On Electricity

(iii) I asked the CEGB in July to undertake a comprehensive review of the Bulk Supply Tariff under which they supply electricity to the Area Boards. Some marginal benefits should be available to customers with special agreements in the Spring. The full review will be completed next year.

(iv) I have also asked the electricity boards to show as much flexibility as possible in the application of the existing tariffs. This too is now producing some small benefits for industry: as one example, a joint investigation by an Area Board and a large industrial consumer (steel) into process and other improvements will realise savings of 2% on an electricity bill of £10 million per annum.

(v) Because of the statutory position under the Electricity Acts tariff cuts would have to be across the board. A cut of the order of 5% would cost the PSBR (gross) about £250 million

X

a year; would be inconsistent with our general pricing policy; and would not be a cost effective way of helping industry. It would be hard to tailor any concession to help large users without changing the legislation against undue discrimination. This would be seen as a very hostile move against smaller industries, which we want to encourage not hurt more.

On Oil

(vi) I am examining the question of the £8 per tonne duty on Heavy Fuel Oil - the matter which Keith Joseph has also raised with me. I believe there could be a case on energy policy grounds for, say, halving this duty. This would bring it much closer to the level in other Community countries and help ensure that our fuel oil prices, which are currently below most of those elsewhere in Europe anyway, stay in a good competitive position. However, the direct and indirect cost to the PSBR would be about £200m (gross) in a full year, of which £100m would, under the Frigg contract, be payment overseas to Norway and to the French companies operating the Frigg field. We are looking urgently at possible ways of getting round this disadvantage.

Only just.

[illegible]

6 I have not mentioned coal in the list of measures. There is now acute pressure on coal price increases. Although the industry is facing some severe short term problems it is making good progress towards an economic and efficient? long term future.

7 Finally, a general point. If we want to bring short term immediate help to certain industries in this very deep recession, as I understand we do, then to attempt this by general intervention to reduce energy prices is bound to be highly inefficient, very costly and the most damaging form of help when it comes to our long term interests. Finding more efficient ways of helping those industries and firms which face immediate difficulties but have good long term prospects goes beyond my Departmental responsibilities. But collectively we should be looking for them urgently.

8 I am copying this to Geoffrey Howe, Keith Joseph and Sir Robert Armstrong.

pp Secretary of State for Energy
31 December 1980

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