Qa 05217 CONFIDENTIAL

To: MR LANKESTER

From: J R IBBS

ENERGY PRICES

Background

1. I understand that the Prime Minister is to discuss Energy Prices with some of her colleagues on Monday. You may find the following notes helpful in that they highlight in simple terms some of the main points at issue.

2. At this week's NEDC discussion on industrial energy costs the CBI made it clear that they were not advocating a general relaxation from the principles of economic pricing of energy; their case was the more limited one that British Industry should not be disadvantaged on energy costs vis-a-vis its competitors in Europe. The papers prepared for the NEDC showed that in general while UK prices were not out of line, there were three particular areas of concern -

electricity prices to the large consumer; Rem. b.s.t. v large users smaller consumers

firm gas prices in certain instances; and

fuel oil prices during the first nine months of 1980 including the level of duty.

It was agreed at the NEDC meeting to set up a small task force with representatives from all sides to investigate claims and counterclaims and report back definitively on their substance for the March NEDC meeting

3. The Secretary of State for Energy has already implemented some measures aimed at alleviating these areas - on electricity he has asked the area boards to be more flexible within the limits already open to them, and the Bulk supply tariff is also

being reviewed by the CEGB; on gas he asked BGC to reduce the price for new contracts; market forces have made the fuel oil disparity disappear at least for the moment. Overall, energy costs are reported to be only 4 or 5% of Industry's total costs. In so far as special assistance is provided it is important that it should be concentrated where it will make a difference, i.e. on users for whom energy is a substantial proportion of total costs (some may be quite small companies and so not be regarded as large consumers).

Disparities already clearly established.

4. On the evidence produced so far the price of electricity to large consumers and the level of fuel oil duty do seem to result in British industry being disadvantaged. In the period before the NEDC report in March the CPRS suggest that the Department of Energy might, as well as ensuring that the review of the Bulk supply tariff is completed as soon as possible, clarify whether the price to large consumers of electricity could be substantially decreased without contravening the statutory requirement that the electricity supply industry shall not discriminate; prices on the continent are more tilted in favour of the large consumer - is this discrimination or just a proper way in which the market should work? On the question of fuel oil duty, doubtless the Chancellor is giving consideration to the level of this in his deliberations for the Budget.

The domestic/industrial price balance.

5. Perhaps the most striking difference in comparing UK energy prices in general with the continent is the substantial under-pricing of the domestic vis-a-vis the industrial market, particularly in respect of gas. However, the CPRS would support the Secretary of State for Energy in his judgement expressed in his minute of 7 January to the Secretary of State for Wales, that the current policy of an annual 10% real increase in domestic prices to redress this imbalance probably runs pretty close

to the limits of public acceptability. It is of course, important to ensure, so far as the balance is concerned, that the effect of this is not being offset by similar price increases to industrial users.

The U.S. energy price advantage.

6. Pricing parity with European competitors in the industrial sector would, still leave a substantial unfavourable differential for industry when compared to the USA. Whilst Europe cannot hope to match the USA's huge cost advantages that come from cheap coal resources, the slow rate of de-regulation particularly of gas prices, contributes greatly to the substantial under-pricing of products that is causing damage, for example to our textile and chemical industries. The CPRS believes that Mr Reagan's administration should be exhorted to give high priority to much more rapid deregulation of gas prices.

Energy Conservation.

7. The present cash flow pressures on the manufacturing sector mean that what funds are available are directed by industry to primary strategic investment rather that to energy conservation measures which even with a good return often appear to companies to be of secondary importance. Ministers might like to consider whether further incentives (financial or otherwise) to industry for conservation could be justified.

8. I am sending a copy of this Minute to Sir Robert Armstrong.

VRJ.

9 January 1981