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PRIME MINISTER

PRIVATISATION AND THE ENERGY INDUSTRIES

I think it may be useful if I let you know how my thinking is developing on privatisation and the major energy industries. I recently had a valuable discussion about this with the Financial Secretary. I hope to put papers to E(A) Committee early in February about the gas and electricity industries. A good deal of work is going on in the Department of Energy to identify and evaluate the options which will be set out in those papers, including some difficult work on the vexed question of regulation if monopoly elements have to be transferred to the private sector. But I am anxious to arrive as soon as possible at a strategic plan for action in the energy field in the lifetime of this Parliament because I fear that a really major privatisation may be a very close-run affair indeed if we miss the 1984/85 Session for the necessary legislation. With this in mind I have made a provisional bid for a place for a major Bill in that Session. But time is already short for planning and preparing such a Bill: that is why I would like to let you and Nigel Lawson know some of my thinking in advance of papers for E(A).

My impression at present is that the next major privatisation to follow British Telecom and British Airways in this Parliament could well be British Gas. The Financial Secretary and I agreed that there was no question of privatising the NCB in this Parliament, on either the deep mined or even the opencast side; though there might be some scope with its subsidiaries. The main field is therefore gas and electricity.

Electricity presents us with a number of major problems. The generating side of the industry is usually regarded as much less of a natural monopoly than the distribution side, but the generating side runs us into the question whether at this stage it would be acceptable to sell off nuclear power stations. The sheer scale of the industry (£32 billion of investment, or more than three times the size of British Gas), also raises acutely the question of dividing up the industry. But then one faces first, the problem of large

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regional imbalances in the location and capacity of power stations; and secondly, the question whether one could sell in this Parliament untried organisations created by breaking up the CEGB. In any event we would face very large write-offs because of over-capacity in the industry.

The relationship between the coal and electricity industries is another complication. Would we, could we continue to make a privatised electricity generating industry a captive market for British coal? We would certainly not be promoting competition if we did. But if we did not, we risk adding to the present over-capacity in the coal industry, giving Scargill the rallying issue he so desperately wants and inviting electricity workers and miners to make common cause against us.

If one concludes from this that it might be a mistake to try to put electricity privatisation ahead of gas privatisation, that should not exclude looking at steps towards greater competition in the electricity industry, or examining some partial privatisation in this Parliament or full privatisation in the next. But it looks very ambitious indeed to try to make electricity the main privatisation thrust in energy in this Parliament.

There are problems enough in privatising the gas industry, but they would be much simpler than those in electricity. There is nothing analogous to the nuclear problem and no problem of over-capacity. The gas industry is much smaller. It already draws the bulk of its natural gas supplies from the private sector. If we can make an early effort there is a real prospect of completing privatisation in this Parliament, provided the market is not totally pre-empted or spoiled by British Telecom and British Airways.

But even with gas the timing is quite tight. Even assuming a 5 year Parliament, it would probably be necessary to complete any major sale of shares by mid-1987. One possibility might be to sell shares on a partly-paid basis, as for British Telecom, with calls spaced over 1986/87. Certainly it would be better to avoid a situation in which we had sold only 51% of the shares or less, whether in the whole or a large part of the industry, by the

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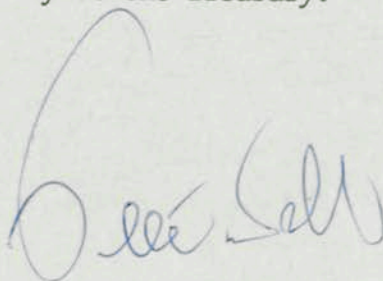
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time of an election; or in which most of the money on partly-paid shares was outstanding at such a time. It would also be much better if the industry had been able to run in private hands for at least a year before the next election. All this argues strongly for legislation in the 1984/85 Session with a view to beginning sale in, say, the early part of 1986. That would mean facing a substantial demand on legislative time in the 1984/85 Session. But a delay of a year would, on the best assumptions, leave us dangerously little time for sale before we reached the election "shadow".

If this timetable is right, it may limit our scope for radical restructuring of the gas industry. Nevertheless, my paper to E(A) will look at all the options, including the scope for genuine elements of competition. It already seems clear however that under any conceivable form of privatisation a regulatory system will be necessary because large elements of monopoly, at least for the domestic and small commercial and industrial consumer, will remain. My aim would be to get as much simplicity in it as would be consistent with effectiveness.

I do not of course seek any immediate decisions on this. My own thinking is in any event still at a formative stage and in particular I need to do more work on what would be involved in gas privatisation in 1984/85. I know too that the Financial Secretary will be putting an overview of privatisation candidates to E(A). But I hope that this note may help in forming a policy perspective for this Parliament, and explaining my provisional bid for the 1984/85 legislative programme.

I am copying this to the Chancellor of the Exchequer and the Financial Secretary to the Treasury.



SECRETARY OF STATE FOR ENERGY

20 December 1983

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21 December 1983

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MR TURNBULL

Prime Minister ①

Agree I write welcoming Mr Walker's report but asking for competition to be fully taken account of.

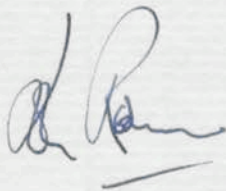
PRIVATISATION AND THE ENERGY INDUSTRIES

Yes no AT 21/12

Peter Walker's letter is to be welcomed in that:

1. He promises a paper to E(A) looking at all the options in the case of the gas industry as requested under the remit given to him.
2. He is proposing dealing with gas first which makes sense, as the problems are less intractable than coal and electricity.
3. He wishes to make a bid for 1984/5 session for legislation: this implies a welcome urgency in tackling these problems.
4. The E(A) Paper apparently will include serious options for introducing competition in the electricity and gas industries and will review scope for selling some assets in electricity.

In replying, the Prime Minister should stress these favourable points to confirm that they will be included in the E(A) Paper. At the same time, she could argue that it is vital that as much competition as possible be introduced when legislation is framed for gas privatisation, to avoid the sale of a monopoly and the need for unduly complex regulation.



JOHN REDWOOD

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10 DOWNING STREET

From the Private Secretary

22 December 1983

PRIVATISATION AND THE ENERGY INDUSTRIES

The Prime Minister has seen your Secretary of State's minute of 20 December and was grateful for the progress he has made in defining the programme for privatisation in the energy industries. She accepts that privatisation of electricity will take longer to complete and that it makes sense to start with gas. Nevertheless, it would be desirable to start planning for changes in the electricity industry, given the time they will take to implement.

On gas, the Prime Minister has noted the provisional bid for legislation in 1984/85 and the reasons for it. While it is obviously difficult to introduce competition into the gas industry, the Prime Minister hopes that every effort will be made to do so in order to reduce the reliance that has to be placed on regulation. She looks forward to receiving the paper in E(A) in due course.

I am copying this letter to John Kerr (H.M. Treasury), and Andrew Hudson (Financial Secretary's Office).

ANDREW TURNBULL

Michael Reidy, Esq.,
Department of Energy.

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