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PRIME MINISTER 25 January 1988

ELECTRICITY PRIVATISATION

In the final analysis this government will be judged on whether electricity privatisation secures lasting benefits for electricity consumers. What are the potential sources of these benefits:

1. Liberalisation of coal supplies (50% of final cost to consumers) - not at issue since all the options now on the table envisage the abolition of British Coal's protected position.

2. Sharing with consumers the savings from managing electricity demand (through price incentives) to reduce the need for expensive new generating capacity - achieved by privatising the 12 Area Boards separately and introducing fundamental changes to switch the orientation of the industry from "supplier (CEGB) - dominated" to "market-led". Again, not at issue for the options on the table.

3. Competition for new generating capacity, given that the industry will have to renew all its generating assets over the next 20-30 years.

The crucial point at issue is whether fragmenting the CEGB into CEGCO (70%) and GENCO (30%) is significantly inferior, in terms of competition, to Nigel Lawson's preferred solution of 50/25/25 or perhaps 60/20/20. Two comments:

- the really stimulating and vigorous competition will come not from the daughters of the fragmented CEGB but the new entrants to the generating market - the

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oil companies, British Gas, construction consortia etc.

- there is widespread fear that CEGCO will overawe prospective new entrants with its capacity to price wholesale electricity in a predatory way. However the regulator will have to hold the ring in this area of competition because in the final analysis he will need to approve the pass-through of the cost of incremental new supplies to end consumers.

4. Insurance for electricity supply security through the preservation of a healthy nuclear industry and the projected nuclear programme.

True, we talk of this as being justified on strategic rather than economic grounds. However, Cecil Parkinson is right to remind us that even today, with coal prices severely depressed for exceptional reasons, the cost implications of the nuclear programme for consumers is marginal. There is no telling whether in five or ten years' time oil prices and coal prices will be reflecting the finite nature of the world's fossil fuel resources and the nuclear programme will again look both strategically and economically sound.

We conclude that the nuclear programme must be maintained and if necessary underwritten by the government. We share Cecil Parkinson's concern that going beyond option C would seriously jeopardise our ability to implement the nuclear programme, particularly having regard to the need for planning consents.

It seems reasonable that electricity consumers, rather than the taxpayer, should bear the cost of insurance for supply security - just as oil consumers effectively pay for the country's strategic oil stocks. By reflecting

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this insurance element in the price of electricity we reduce distortion in the competition between alternative energy sources such as electricity, gas, oil - and we remind consumers that energy conservation may be a sound investment.

Conclusion

Given the diversity of competition which we are intent on introducing to the generating sector and the dynamics of an industry set to renew its assets, I support Cecil Parkinson's view that the incremental benefits which might be achieved from going beyond option C are not such as to justify the further delays and the greater risks. It is not just this government which is at risk; consumers are at risk from industrial action and from under-investment during this difficult period of transition.

JW.

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