



National Economic Development Council

ELECTRICITY PRICING

NEDC(82)61

Memorandum by the Secretary of State for Energy

1. The Government has now completed the review of electricity pricing policy to which I referred at the Council meeting in March. The results were reflected in my announcement of 12 November; I have agreed with the electricity supply industry that there should be no increase in the average level of electricity prices next year. I shall be announcing as soon as possible a new financial target and performance aim, agreed with the Industry, to follow the present target. This will also take full account of the conclusions we have reached in our studies of economic pricing over the past year, as well as encouraging cost-conscious management in the industry.
2. In carrying out those studies (summarised in NEDC(82)61 circulated on 3 December), my Department has been greatly helped by the thoughtful papers received, and the detailed discussions held with industrial consumers and their representatives. It has also benefited from the valuable assistance of the independent consultants, Coopers and Lybrand.
3. The studies reaffirm the importance which the Government continues to attach to the correct pricing of energy. For primary fuels, the world market price gives an indication of true value. For electricity, in which there is little or no international trade, the economic price must depend on the marginal cost of generation in the UK, as successive Governments have accepted.
4. The Electricity Council's review of the CEGB's Bulk Supply Tariff, which I made available early this year, was also based on this approach. In our further studies, however, I have paid particular attention to the way in which these economic pricing principles are applied in practice. Both Government and the electricity supply industry have looked especially at the effect of the continuing recession on demand forecasts. The fact that demand is now expected to grow at a slower rate than was previously forecast means that the present over capacity in the industry is likely to last for longer.

5. A normal commercial response to stagnant demand and excess capacity would be for the supplying industry to reduce prices. Economic principles point in the same direction; the cost to the supply industry of meeting an increment to demand (its marginal cost) will be lower over the next few years since demand can be met from the capacity already on the system and expected to come on stream. The present BST already reflects this situation to some extent; I have however now agreed with the Industry that against this background there should be no increase in the average level of prices next year.
6. This does not mean the present tariff structure will be frozen - my Department's review showed that some changes would be necessary, and the Industry are currently working out the details. What it does mean is that although there will be variations in the level of final prices paid by different consumers, on average and taking the country as a whole, prices will not increase in 1983/84.
7. The Government also examined the BST very carefully in the light of views expressed to us that existing tariff structures are biassed against large or continuous load electricity users. Our studies do not bear out these criticisms. The broad principles that electricity should be priced more highly at peak times, and that all consumers taking electricity at those times should contribute equally to the costs of meeting peak demand, are both economically sound and equitable.
8. It is however important that the supply industry and its major customers should continue to examine possibilities for load management or other mutually advantageous arrangements. It is also essential that the supply industry should do all possible to contain and reduce the costs of electricity generation. Significant improvements in operating efficiency have in fact been achieved over the past year - another factor underlying next year's price standstill. For the future, the level of fuel, and particularly coal, costs will be especially important

in determining the course of electricity prices. It is vital that the NCB should contain costs and continue to increase efficiency. Increased competition will also help and a Bill to encourage the private generation of electricity is currently before Parliament. This will make it easier for industry to pursue cost-saving electricity projects itself, for example through combined heat and power schemes.

9. I recognise the difficulties some large consumers of electricity continue to face, even though the new load management arrangements announced in this year's Budget have brought welcome relief to a number of hard-pressed companies. Next year's price standstill should help to narrow international disparities, subject to exchange rate movements. However genuine international cost differences, such as those due to France's high proportion of nuclear and hydro-electric generating capacity, cannot be wished out of existence. To fix UK prices according to electricity costs in other countries, or to attempt to match price subsidies overseas with subsidies at home, could only be done by passing costs on to the taxpayer, other sectors of industry, or energy consumers generally.
10. Over the long term, UK electricity costs will come down if we are able to reduce our dependence on relatively high cost fossil fuel and if new power stations, in particular nuclear power stations, can be successfully built to time and cost. I am confident that, with the support of all sides of industry, progress can be made on both counts. Meanwhile, there can be no doubt that our action on electricity prices next year will be of benefit to commerce and industry, as to all users of electricity.

6 December 1982

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National Economic Development Council



NEDC(82)61 (Cover Note)

NOTE BY THE SECRETARY TO THE COUNCIL

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The attached paper by the Secretary of State for Energy is a cover note for the memorandum by officials of the Department of Energy already circulated as NEDC(82)61.

P V Dixon

7 December 1982

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