

CONFIDENTIAL



10 DOWNING STREET

From the Private Secretary

14 September 1983

Dear Michael,

ENERGY PRICES

The Prime Minister took a meeting on energy prices yesterday evening. The Chancellor of the Exchequer, your Secretary of State, the Secretary of State for Scotland, Mr. Lamont (Minister of State, Department of Trade and Industry), Sir Robert Armstrong and Mr. Gregson were present.

It was argued that the high profits in the gas industry, and the fact that gas prices were considerably higher than the average costs of the industry had produced a public perception that gas prices were too high, and would generate severe political difficulty over future price increases. It would not be sufficient to appeal to a principle of economic pricing, reflecting long-run marginal costs in the industry, given that application of the same principle in the electricity and coal industry would point to price reductions, which would be unacceptable on PSBR and other grounds. Against this it was argued that these principles of economic pricing ought to be followed throughout the energy industries: this, indeed, had been the justification for the recent standstill in electricity prices. It would be unfortunate, in view of the higher cost of new gas supplies, to maintain a price structure which encouraged consumers to switch to electricity, thus compounding the industry's over-capacity difficulties. The high profits of the gas industry were a direct consequence of the low-price contracts they had secured in the past. This windfall gain ought to benefit the whole economy, not just gas-users.

In further discussion it was argued that, to bring gas prices to their international level it would be necessary to increase them in real terms by between 6% and 7% a year over the next three years. The importance of bringing prices to the international market level could be seen in the substantial, and growing, proportion of imported gas. Every 1% subsidy on the gas price cost £50 million. In the present public expenditure climate it was essential not to impose any additional burden from this source.

/ Summing up

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Summing up the discussion, the Prime Minister said that the price increase at the beginning of January 1984 should be such as to maintain gas prices in real terms at the level achieved by the three successive 10% real price increases. As to future years, no decision should be taken immediately. Your Secretary of State would provide further figures, illustrating our position relative to other countries as regards industrial gas prices (both for gas as a fuel and as a feedstock), and showing the relationship between domestic and industrial prices in the United Kingdom. There might be a case for making the timing of future price increases towards the international price reflect the changing proportion of old and new supply contracts within the totality of British Gas's cost structure. There would, however, be great political difficulty in a future series of real price increases, given that the three successive 10% increases in the last Parliament had been presented as a necessary step, now completed, to put gas prices on a proper economic footing. Your Secretary of State and the Chancellor of the Exchequer should consider the precise figure for the January 1984 price increase; and further consideration would be given to the longer term price issues when the further information she had requested was available.

I am sending copies of this letter to John Kerr (HM Treasury), Muir Russell (Scottish Office), John Alty (Mr. Lamont's Office, Department of Trade and Industry), Peter Gregson and Richard Hatfield (Cabinet Office).

*Yours sincerely,*

*Michael Scholar*

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Michael Reidy, Esq.,  
Department of Energy.



Not End  
Gas + Elect Prices  
with WR



CC NO  
(2)

Prime Minister

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Mus 16/9

PRIME MINISTER

ENERGY PRICES

I have seen your office's record of our discussion on 13 September and, whilst broadly it strikes me as an accurate and helpful record, there is one point I should like to add for the sake of completeness. I was grateful to the Chancellor of the Exchequer for agreeing to my proposal that, having settled gas prices, we should go on to establish what would be involved in the full application of economic pricing to the electricity and coal industries. This is a point of some importance on which the record should be explicit.

I am copying this minute to the Chancellor of the Exchequer, the Secretary of State for Scotland, the Minister of State at the Department of Trade and Industry and Sir Robert Armstrong.

16 September 1983

PP SECRETARY OF STATE FOR ENERGY

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

Wrat. Ind:  
E Gas + EUC  
Pt 8



DEPARTMENT OF ENERGY

ENERGY FILES

I have seen your office's record of our discussion on  
12 September and, while probably it arrives as an accurate  
and helpful record, there is one point I should like to add  
for the sake of completeness. I was grateful to the Commission  
of the Exchange for referring to my proposal that, having  
settled gas prices, we should go on to establish what would be  
involved in the full application of economic pricing to the  
electricity and coal industries. In a number of ways  
importance on which the record should be explicit.

I am copying this letter to the Commission of the Exchange,  
the Secretary of State, the Director of the Office of Energy  
the Department of Trade and Industry and Sir Robert Armstrong.

SECRETARY OF STATE FOR ENERGY

10 September 1973

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

SECRET



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✓ NO / ④  
Prime Minister

Ms 22/9

(Clear by PM)

Treasury Chambers, Parliament Street, SW1P 3AG  
01-233 3000

21 September 1983

Michael Reidy Esq  
Private Secretary to the Secretary of State  
for Energy  
Department of Energy  
Thames House South  
Millbank  
LONDON SW1P 4QJ

Dear Michael,

ENERGY PRICES

A 8 with M.C.S.?

The Chancellor has seen your Secretary of State's minute to the Prime Minister of 16 September, amplifying Michael Scholar's record of the Prime Minister's meeting on 13 September. However, the Chancellor found Mr Walker's minute slightly ambiguous.

If by settling gas prices, your Secretary of State means first establishing what economic pricing implies for gas and then implementing the result, the Chancellor is happy to accept his proposition that economic pricing should be applied to the other fuels. However, if by settling gas prices, Mr Walker means holding real prices constant, while Ministers continue to debate the future path of gas prices, then the Chancellor cannot accept Mr Walker's conclusion. He notes first that the benefits in terms of resource allocation would be negated if two fuels were correctly priced but the third was not, since it would not be possible to achieve the correct level of demand and supply for the first two fuels. Second, the Chancellor points out that the Government cannot ignore the public expenditure consequences of conceding full economic prices for electricity and coal, where this principle points to lower prices, but of failing to act where economic pricing points to higher prices for gas.

I am copying this letter to Michael Scholar at No. 10.

Yours sincerely,  
Margaret O'Mara

MISS M O'MARA  
Private Secretary

NAT. IND GAS + ELEC PRICES Pt 8