MR. TURNBULL

ELECTRICITY PRICES

The central question for Cabinet tomorrow is whether the industry can deliver the agreed EFL of £740 millions in 1984-85 without a price increase. All other arguments are secondary.

Even if this is possible, there is still a strong case for accepting the savings and insisting on a price rise. Cabinet on 10 November concluded that "any additional savings which the industries were able to offer would be welcome but that Cabinet was not ready at this stage to regard them as a substitute for desirable price increases".

Efficiency Savings

We have no indication of the source of the additional £210 million of savings. The Electricity Council have merely stated that they will do their best to achieve the EFL and that they have always delivered in the past.

This is not good enough. MISC 99 had understood that there was no further scope for efficiency savings. Although there is undoubtedly more fat in the industry, we must have a clearer indication of whether further savings are appropriate and realistic.

The option of raising prices later in the year if the savings are not being achieved is unattractive. It will be both difficult and politically damaging, particularly if, as well might be the case, the necessary rise is higher than 3%.

Presentation

A 3% rise will still be below the rate of inflation. It can be presented as the direct consequence of Government pressure on the industry to improve efficiency and reduce costs.

Economic Pricing

Any settlement below the rate of inflation will be consistent with a move towards economic pricing.

/There is no

There is no difference of opinion among Treasury, Energy and the Policy Unit about the direction in which prices should move but only about the magnitude.

Our view that prices probably need to fall further than the levels given by a 3% increase is based on the figures produced when the current financial target was set. The Treasury have never been convinced about the validity of these figures. They consider that a 3% rise would be in the middle of a range of uncertainty about the proper level of economic prices.

A 3% rise, therefore, would not be inconsistent with economic pricing principles.

Financial Framework

A 3% price rise is not inconsistent with the financial framework and Government's desired relationship with the industry. Our pressure upon the industry has already produced significant efficiency savings which were not apparent when the financial target was set. As a result the target will be exceeded, irrespective of any decisions on pricing.

At the time the target was set, we anticipated that prices would rise by 1½% less than the rate of inflation in 1984/85. There is no reason, therefore, why we should not maintain the original pricing path and raise the EFL.

Industrial Consumers

We do not accept that the consequence of current decisions on pricing should be to disadvantage industrial consumers. Fuel adjustment clauses and tariffs are both part of the price which the consumer pays. It must be possible to ensure that all consumers receive equal benefit from falling real prices.

Next Steps

Whatever is agreed for 1984/85, the implications of introducing economic pricing principles from 1985/86 onwards should be established well ahead of the next IFR. There are difficult issues here which must be resolved before the next financial target is set.

Conclusions

The case for a price freeze rests upon the ability of the Electricity Council to deliver the EFL through efficiency savings.

We have no evidence and no confidence that this is possible.

We should insist on the 3% price rise.

We should ensure that all consumers receive equal benefit from falling real prices.

The full implications of economic pricing should be established well ahead of the next IFR.

DLP.

DAVID PASCALL
14 December 1983

PRIME MINISTER

ELECTRICITY PRICES

You discussed this with the Chancellor. You both felt that the Electricity Council's word on achieving the EFL was an insufficient basis for a commitment to freeze prices as far ahead as April 1985.

You agreed to suggest a 2% rise on domestic prices and no increase in industrial prices, other than operation of the fuel adjustment clause.

I disagree with the Policy Unit advice. In my view, you are right to think that, without the co-operation of the Departmental Minister, you would incur great political damage in trying to impose a 3% rise. If the Minister concerned had been more enthusiastic, it might be different, but then the problem might not have arisen in the first place.

AT

14 December 1983