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CABINET  
MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

ENERGY PRICING

Note by Secretary of State for Energy

1 The papers on coal strategy (E(79)50), gas (E(79)51) and electricity pricing (E(79)52) I have submitted for discussion on 17 October cover a major part of our energy future and have wider implications for the general structure of costs in this country and the standard of living. It may help colleagues to have this brief note on the strategic thinking behind all three papers.

2 Though we have in this country avoided the worst excesses of artificially low-priced energy, as seen in the USA, we are still a long way from a price structure which reflects the present high cost of world energy and its future prospects. Except possibly in the short term world oil prices are likely to rise by at least the OECD rate of inflation, and probably more - very substantially more in the longer term.

3 Coal is vital to our future energy needs. We must do everything possible to keep down the cost of UK coal. This can best be done through a strategy, such as I have recommended in my paper, of investing in efficient capacity and cutting losses elsewhere.

4 Despite the rapid rise in the world price of energy since 1973, the price of domestic gas reflects old low-priced contracts for gas from the North Sea. The benefits of this national resource, unlike those of our North Sea oil resource, are in large part being distributed to those households (some 70% of the total) who happen to use gas.

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We are depleting the resource faster than is desirable and encouraging excessive consumption.

5 Substantially higher prices for electricity are needed if the industry is to earn an adequate return and provide for its future capital investment. At present the industry's accounts, if calculated according to current costs, would show a loss after interest.

6 For both short-term and long-term energy policy reasons we must correct the current under-pricing of both gas and electricity. Only by doing so can we enable market forces to play their part in solving our energy problems. It is also important for public expenditure reasons that the current under-pricing should be corrected as quickly as possible.

7 Gas is under-priced to a far greater degree than electricity. Gas prices need to move up rapidly, enabling electricity prices to rise to an economic level without damaging the industry's growth prospects and the structure into which our expanding nuclear programme must be fitted.

8 The increases I am proposing both for gas and electricity are substantial - for gas 10% per annum in real terms for the next 3 years for electricity a correction of under pricing (after allowing for any real increases in the industry's primary fuel costs) of  $2\frac{1}{2}\%$  next year and 1% per annum thereafter.

9 What these increases mean in money terms will depend on future rates of inflation and on movements in primary fuel costs. Illustrative figures are given in my papers.

10 Clearly the industries must not be given an easy ride on cutting costs within their own control. But pressure on this front should continue to be applied through annual cash limits, with a resultant contribution to the reduction of public expenditure, not by delaying the correction of under-pricing; and by strengthening the Board's management.

D.A.R.H.

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