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Ref. A01524

PRIME MINISTER

Electricity Industry in England and Wales: External
Financing Limit 1979-80

(E(80) 20)

BACKGROUND

Sir Kenneth Berrill warned you, in a minute dated 6th February, that the overspend on the electricity external financing limit would present Ministers with very serious problems. Accordingly, you asked that a paper should be prepared for E Committee. Mr. Howell sent you a long minute about this on 19th February, but the information was not complete, and further facts are still being sought from the Electricity Council about next year's position. But a decision on the limit for the current year is now urgent. If it is to be exceeded - as seems almost inevitable - the Chancellor considers (in his minute to you of 22nd February) that an announcement must be made very quickly. Otherwise, any announcement will look like retrospective validation of an overspend, and weaken the discipline which the limits are designed to impose. This means taking two bites at the subject: this week, for the current year, and next week (or a little later) for 1980-81.

2. The immediate problem is therefore whether to sanction an increase in the cash limit for 1979-80 of about £200 million. Since the total excess is about £325 million, the balance will be found by savings of £25-£30 million (not all of them real: some of them will be acceleration of payments by debtors) and by rolling forward £100 million of bills for fuel supplies into next year. The second makes the position next year even worse.

3. Two subsidiary questions then arise:

- (i) Should any disciplinary action be taken against the industry? It was precisely such a deterioration in the financial position of the steel industry which precipitated the decision to replace Sir Charles Villiers. The Chancellor's letter of 20th February and his minute to you of

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22nd February suggest an independent investigation by outside accountants of the electricity industry's internal financial control system; the Secretary of State (25th February) turns this down.

(ii) How does the Government defend increasing the limit for electricity, while at the same time standing firm on the limit for steel, despite the strike? There is a difference. Electricity relates to 1979-80 whereas the BSC argument is about 1980-81; the electricity increase relates largely to financing stocks rather than to pay; there are other examples of overruns in 1979-80, including the Post Office. But it will not be easy to defend the apparent difference of treatment in public unless of course BSC is also overrunning in 1979-80.

4. A later meeting will have to consider the very much more serious questions next year: should prices go up further in the autumn? Should there be cuts in the capital programme to compensate? Should the high level of stocks be allowed to run down again, to reduce the financing burden? Should the whole system of cash limits for nationalised industries be reconsidered? These are the issues which arise on Sir Kenneth Berrill's latest minute, dated 22nd February.

HANDLING

5. I suggest you start the discussion by defining the limited topics for discussion at this week's meeting: should the electricity financing limit for 1979-80 be increased by £200 million? Should there be any penalties against the industry? Should the announcement be made immediately, despite the steel strike?

6. You should then ask the Secretary of State for Energy to introduce his paper, and call for comments from the Chancellor of the Exchequer (or perhaps the Chief Secretary). The Secretary of State for Scotland should also be given a chance to speak, although the Scottish Electricity Boards, who have also faced similar cost increases, have apparently been able to live within their financing limits. The Secretary of State for Industry may want to comment on the implications for the steel industry. You might also ask Sir Kenneth Berrill to comment.

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7. Towards the end of the discussion, you might say that the Committee will have to consider very much wider questions in its next discussion. This will inevitably bring up the general question of the future of the cash limits for the nationalised industries. You have decided to set up a small Sub-Committee for this purpose (on which I submitted advice last week). But it will not be possible to redesign the cash limit system in a hurry: decisions on the electricity cash limit for 1980-81 will have to be taken very soon, because of the possible implications for prices later in the year.

CONCLUSIONS

8. At this stage, you might aim to record the conclusions on:
- (a) The proposed increase in the electricity external financing limit for 1979-80: by £200 million, or some other figure?
 - (b) Whether or not to impose some sanctions on the industry for their failure to report, and tackle, their problems in good time?
 - (c) When to announce the increase: now, or after the end of the steel strike?

REA

(Robert Armstrong)

25th February, 1980