



Prime Minister

2

Mus 30/3

PRIME MINISTER

LONG TERM PUBLIC EXPENDITURE

I am replying to your minute of 4 February about the possibilities for a substantial reduction in public expenditure in the longer-term.

GENERAL VIEW

Public expenditure across the energy sector is expected to total around £930 million in 1983-84. Without the external financing requirement of the National Coal Board there would probably be a slight surplus. Key figures are attached: both they and figures below are in 1980-81 cost terms.

I see three areas which could produce major changes in public expenditure in the energy sector in the period up to 1990-91:-

- i) a major reduction in the deficit and in the external financing requirement of the NCB;
- ii) a large growth in payments by the nationalised gas and electricity industries to the Exchequer, through increasingly negative external financing requirements;
- iii) the payment to the Exchequer of substantial proceeds from the privatisation of substantial parts of the gas and electricity industries, possibly involving a programme of part-sales, or the sale of tranches of equity in these undertakings over a period.



This might be accompanied by progressive diversion of the industries to private capital for their investment requirements.

The path will of course be uncertain and by no means necessarily smooth. A recovery in the real oil price could make a considerable difference to how it looked. I do not at present see major changes coming from outside the areas listed above.

Operating in the other direction there may be demands for expenditures to meet rising environmental standards. We have seen the large amounts at stake in connection with 'acid rain', nuclear safety and the disposal of coal-mining spoil. Such costs will normally fall on the consumer but one cannot exclude that they may sometimes affect External Financing Limits (EFLs) or the Exchequer. These costs are difficult to control and I think it would be a mistake not to recognise the possibility of new demands.

MAIN AREAS OF EXPENDITURE

I attach a note which summarises the main elements of the energy expenditure programmes. Our policies are already designed to produce a substantial decline in the longer-term although a hard core of expenditure on nuclear and other research and development and on the coal industry is likely to remain.

You are familiar with the steps we are taking to reduce the NCB deficit by closure of uneconomic pits. The other major factors here are the evolution of the national demand for coal; what happens to world prices of coal and competing forms of energy, especially oil; and productivity in the coal industry.



On negative EFL's in electricity and gas, the key factors are the scale of investment needed and prices to consumers. Raising prices beyond what marginal costs justify would mean taxing gas and electricity. Industry would certainly resist that and of course there would be a further constraint on the extent to which we could add to consumer costs if we were obliged to charge VAT on energy. Gas prices are likely to rise in real terms without any increased contribution to the Exchequer because of the need to pay higher prices for imported gas, or for new and probably more marginal discoveries on the UK Continental Shelf.

Privatisation of the main structures of the electricity and gas industries could yield very large sums in this period. I would also hope to see smaller but still important disposals eg BNFL, opencast coal. As privatisation proceeded however, the scope for revenue from these industries (in the form of negative EFL's, a contribution to reducing the NCB deficit, or BNFL dividends to the Exchequer) would also be reduced. It might be necessary to consider too whether the significance of the PSBR was changing somewhat, either because the proceeds were so large in some years that transfer of assets obviously played an exceptional part in the Exchequer accounts; or because financing of the investments of these "regulated utilities" was now outside rather than inside the PSBR, but still represented a major demand on savings within our monetary targets.

CONCLUSION

It does not seem to me possible to quantify in any meaningful way the net effects by 1990/91 of changes in these main areas. We shall clearly strive very hard to eliminate the present NCB deficit of £500m a year. The Report by Officials (LTPE(82)5) which we considered last September indicated that the EFL's of the nationalised energy industries, together with

SECRET



Departmental expenditure, could decline from £960m in 1983/4 to between £450m and £680m, according to economic circumstances. Negative EFL's for electricity and gas could reduce this further, but some of the environmental possibilities could operate the other way. Privatisation would have different effects in different years until completed, when it would remove the possibility of negative EFL's.

Perhaps the best guess we can make is that in favourable circumstances we might reduce energy public expenditure by 1990/91 by £ $\frac{1}{2}$ billion to £ $\frac{3}{4}$ billion in 1980/81 cost terms.

I have consulted the Chief Secretary about this note as you asked and am sending a copy to him.

Secretary of State for Energy.

30 March 1983

A handwritten signature in dark ink, appearing to be 'JL', is written to the right of the typed name.

SECRET



S E C R E T

Enclosure

MAIN ELEMENTS OF ENERGY EXPENDITURE PROGRAMMES

A table summarising the main elements of energy expenditure programmes projected for 1983/84 and 1990/91 is attached. The figures for 1990/91 are drawn from LTPE(82)5, the report considered by Ministers last September.

GAS

2 The projection in LTPE(82)5 of a financing requirement for the British Gas Corporation (BGC) ranging from zero to negative still appears the best judgement to make, on the assumption that the Corporation remains in substantially its present form. Privatisation of BGC's main stream operations would remove both costs and revenues from the public sector, leaving at most only a 'rump' which should be largely self-financing.

ELECTRICITY

3 The expectation last September was that the electricity supply industry in England and Wales would have a zero financing requirement by 1990-91. The assumption that there would be a real increase in capital investment has now been reversed and the financing requirement should range between zero and substantially negative.

4 The effect of privatisation will depend on its scale and character. Full privatisation would provide a major once-for-all benefit to the Exchequer although surpluses would thereafter be lost.

COAL

5 The most significant contribution to a reduction in the present level of public expenditure within my responsibilities will flow from success in staunching the losses of the coal industry. Last September's report envisaged the NCB's external financing limit declining from about £900m in 1983/84 to £200m - £400m in 1990/91.

6 The outlook for sales of coal has worsened in recent months and achievement of the figures for 1990/91 looks a still more ambitious target. Certainly it would not be realistic to expect a better outcome by the end of the decade.

7 Privatisation of the profitable parts of the NCB, for instance opencast, is a matter of considerable sensitivity. If achieved it will increase the Board's external financing requirement but benefit the Exchequer substantially through the proceeds.

8 The Redundant Mineworkers' Pension Scheme is not seen as an area for major savings. The planned reduction in the NCB's deficit will inevitably mean substantial redundancies in the industry and a consequent increase in public expenditure on the Scheme.



RESEARCH AND DEVELOPMENT

9 Nuclear research and development is projected to cost £135 million in 1990/91. This assumes the reduced fast reactor programme based on international collaboration which we have agreed plus further savings in other programmes including increased Generating Board contributions to thermal reactor R & D. To make a significant further reduction would entail policy decisions to eliminate or severely curtail specific programmes. Sir Peter Hirsch has been asked to take a fresh look at the way in which the UK Atomic Energy Authority formulates and manage their programme. If the beneficiaries of the Authority's research, mainly the Generating Boards and the electricity consumer, were persuaded to meet the bills for a much higher proportion of its work, the Department's expenditure on nuclear R & D might fall well below £135 million; but this may not prove realistic.

10. The figure of £40m for non-nuclear research and development in 1990/91 allows for some real increase over the present level of expenditure but contains no provision for large-scale demonstration of renewable energy sources, combined heat and power schemes or high technology projects for exploitation of North Sea resources. To plan for a reduction in real terms in this area would require decisions which would be difficult to defend, for instance, to the Select Committee on Energy.

LONG TERM PUBLIC EXPENDITURE ON ENERGY
 (£m 1980-81 cost terms : figures rounded)

	<u>1983-84</u>	<u>1990-91</u> projection (as in 1982 exercise)
NCB external finance	952	200-400
BGC external finance	- 24	zero/negative (Scenario A) substantially negative (Scenario B)
Electricity (England & Wales) external finance	-319	0 (Note 1)
Nuclear R & D	167	135
Non-nuclear R & D	31	40
Redundant mineworkers payment scheme	74	50- 80
Offshore supplies interest relief grants	17	0
Departmental administration, energy conservation etc	31	25 (Note 2)
	<u>929</u>	<u>450-680 (or less - Note 3)</u>

NOTE 1 : Now considered to range from zero to substantially negative.

NOTE 2 : Now needs to be increased by £10m to cover repayment services.

NOTE 3 : Bottom end of range would be lower if BGC and Electricity external finance is negative

NOTE 4 : Nuclear R & D could be well below £135 million if a large proportion of the AEA's R & D were paid for by consumers, mainly the Generating Boards.