(2) MS

PRIME MINISTER

This is ridiculous. We are paying £1½ billion to subsidise coal and not getting it back on electricity prices. Reduce the EFL to coal and make them pick it up on the electricity contract. MT

The Electricity Council have put forward two propositions:-

(i) they can achieve 1984-85 EFL of -£740 million with a price freeze.

(ii) they now believe that the price rise required in 1985-86 is only 3 per cent, rather than the 6 per cent envisaged which MISC 99 considered.

They now propose continuing the freeze, but with an undertaking to raise prices if it looks as though the EFL will be overshot. Peter Walker endorses this.

The Chancellor is considering how to respond. He will discuss this at his bilateral on Wednesday. Even if he feels disposed to accept, he does not think he can do so without agreement of Cabinet colleagues, particularly Lord Whitelaw. The minutes of the 10 November meeting stated:

> "any additional savings which the industries were able to offer through increased efficiency would be welcome but that Cabinet was not ready at this stage to regard them as a substitute for desirable price increases".

While this does not rule out an arrangement of the kind suggested, it implies that it needs to be blessed by colleagues.

What is the difference between the average cost of a ton of coal produced and the price paid per ton by CEGB. AT

28 November, 1983.

(B)

MR TURNBULL

Electricity Prices

The Electricity Council are now proposing to find additional savings of £210 million in 1984/85. These would meet the EFL of £740 million without the need for a general price increase. Peter Walker is prepared to accept subject to certain conditions. The Chancellor has requested a precise breakdown of those savings before the matter is brought back to Cabinet.

It is highly disturbing and a comment upon the efficiency of the industry that the threat of a price increase has now revealed significant additional savings which were not available to MISC 99. Indeed since we produced our proposals for electricity and gas price rises, the two industries have found further efficiency savings of over £700 million.

Furthermore, Cabinet concluded on 10 November that "any additional savings which the industries were able to offer through increased efficiency would be welcome but that Cabinet was not ready at this stage to regard them as a substitute for desirable price increases". There is therefore a strong argument for taking the further efficiency savings and insisting on the proposed price increases.

On the other hand, the current proposals could have the merit of achieving both the required public expenditure objectives and of bringing prices more quickly into line with economic principles. Although the full implications of economic pricing have yet to be established, we consider that prices do need to fall further than the real price decrease which would result from a 3 per cent increase in 1984/85.

A price freeze would also be popular and could be presented as the direct consequence of Government pressure on the industry to improve efficiency and reduce costs.

We do need, however, to be clear whether the implications of holding tariffs on average would benefit domestic more than industrial users, as the Electricity Council seems to be saying.

/Conclusions

Conclusions

Our conclusions are

- on balance the proposals to meet the industry's EFL by further savings could be acceptable providing that they are realistic and do not conflict with other objectives such as the need to extend power station endurance.

- the Electricity Council must undertake to increase prices if the EFL appears unlikely to be achieved.

- whatever is agreed for 1984/85, the implications of introducing economic pricing principles from 1985/86 onwards should be established ahead of the next IFR. As with gas, this will enable the next financial target to be based on clearly agreed pricing principles.

AT

29 November 1983 pp DAVID PASCALL

 PERSONAL AND CONFIDENTIAL

ec NO

F

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

29 November 1983

The Rt. Hon. Peter Walker MBE MP
Secretary of State for Energy

Dear Peter

ELECTRICITY PRICES

Thank you for your letter of 24 November.

My approach throughout these discussions has been based on the Government's commitment to economic pricing. The Council have undertaken to use their best endeavours to live within the EFL and you say that they can already see their way to obtaining the bulk of the £210 million savings. As your people know, I think we need to see a precise breakdown of what they have in mind, and it would be helpful to have this before you take the matter back to Cabinet. It would be important, for example, to avoid action which would reduce power station endurance, or put additional pressure on later years, or cause increased problems for the NCB's EFL. As I understand it, the latest monitoring figures for the ESI suggest that the industry is planning on a level of stocks in 1984-85 below the estimate of outturn for 1983-84.

I am also a little unclear about the increase in charges the Council now envisage in 1984-85. Philip Jones' letter suggests that they expect an average increase of 0.9 per cent, which would be entirely loaded onto industrial and large commercial consumers. The overall increase for them would presumably thus be nearly 2 per cent, with the increases for industrial consumers in the Midlands coming out nearer to 4 per cent. You will no doubt wish to consider whether it might not be preferable to load the increase more onto the domestic consumer instead.

Philip Jones also refers to the prospective EFL savings in 1983-84 of some £170 million. He goes on to mention the possibilities of a rebate, of using the saving to help the position in 1984-85, and of seeking "some recognition" of this "contribution to the relief of the 1983-84 PSBR." I hope you will make clear to him that the saving is in fact needed to offset the excess on the NCB's EFL, and that his suggestions are therefore non-starters.

I am very worried about the position of the NCB, which is, I understand, deteriorating. As you know, the public expenditure position this year is very difficult. I must look to you to find whatever savings are necessary from the nationalised industries for which you are responsible to cover the NCB overshoot and the additional expenditure on RMPS. We must aim to settle this quickly, as the NCB must have a clear target to which to work; and I should be grateful if you could make some early proposals on this.

I am copying this letter to the Prime Minister and Sir Robert Armstrong.

Yours ever
Nigel

NIGEL LAWSON

cc NO

I would welcome a policy unit note when Ch/Ex replies.

AT 24/11

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01-211 6402

The Rt Hon Nigel Lawson MP
The Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1

24 November 1983

Following the Cabinet discussion on 10 November I put very firmly to the Chairman of the Electricity Council the Government's view that the Council should make a 3% price increase, contributing £210m to the EFL of the industry in 1984/85. I also told him that the Government was setting the EFL for the Electricity Council for 1984/85 at £740m, including £210m from this price increase.

Philip Jones undertook to convey to the Electricity Council the Government's view, and I know that he put the view firmly to them on 17 November. As a result of that I have now received the attached letter from him. On receipt of this letter I asked my officials to discuss with the Electricity Council what was meant by using their best endeavours to achieve the EFL of £740m set by the Government as from the Government's point of view it was essential that that figure was obtained. The Council can already see their way to obtaining the bulk of the £210m that will be required. They also pointed out that as an industry whenever they have promised to use their best endeavours to obtain a target they have always delivered.

I think, however, it is important that we carefully monitor the performance of the industry in the early part of next year in order to make quite certain that the EFL figure will be reached. I think we should also seek an undertaking from Philip Jones that if it became clear as the year proceeded the EFL would not be achieved, then a price increase would take place in order to secure the figures placed upon them by the Government.

I am copying this letter to the Prime Minister and Sir Robert Armstrong.

Peter,

PETER WALKER

SECRET AND PERSONAL

PS/PUS PS/MOS PS/PUSS PS/PUSS Mr Manley Mr Morphet Mr E. Price Mr Wilson Mr Brown Mr Fullerton Mr Thynne.

6/12/83

RICITY COUNCIL

30 MILLBANK
LONDON, SW1P 4RD
TELEPHONE: 01-834 2333

(A)

21st November 1983.

The Rt. Hon. Peter Walker, MBE, MP,
Secretary of State for Energy,
Thames House South,
Millbank,
LONDON SW1P 4QJ.

SECRETARY OF STATE FOR ENERGY'S OFFICE RECEIVED 22 NOV 1983

Dear Secretary of State,

When I saw you on 14th November you explained that the Government wished the Electricity Supply Industry to increase its tariffs by 3% in 1984/85 with the prospect of a further 3% increase in 1985/86. You urged very strongly that the Industry should accede to this request. I duly reported your request to the Electricity Council at its meeting on 17th November, making quite clear the importance the Government attached to it.

The Industry fully understands that the need to contain public expenditure is central to the Government's policies and is more than ready to play its part in contributing to this objective. The Industry is meeting the performance targets set for it and has already offered very large EFL repayments to assist the recent review of public expenditure; over £2.8 billion over the three years 1984/85 to 1986/87. It is therefore very concerned that it should be asked to increase its tariffs in addition, when it cannot defend the proposed increase either by reference to the needs of the Industry or by reference to the financial target agreed with the then Secretary of State as recently as March of this year.

The Industry's target of 1.4% return for the two years 1983/84 - 1984/85 on net assets on a CCA basis, and the associated individual targets for the twelve Area Boards and the CEGB, were set in March following several months of discussion. The Industry at that time suggested a target for a longer period and with a higher rate of return. The then Secretary of State however did not feel able to agree to this and our financial target was determined accordingly.

We have recently reviewed our progress towards meeting our EFL for 1983/84, and our financial target for the two years 1983/84 and 1984/85. Our EFL for this year requires us to make a repayment to the Government of £418M. Because of the favourable effect on our finances of a lower rate of inflation than we had assumed, lower fuel prices and our own efforts to control costs, we now expect to over-achieve that EFL by some £170M.

We had hoped that this excess could be rolled forward to help the position in 1984/85. We understand that the Treasury rules will not permit this. We would, nevertheless, hope that this is something that could be considered further. If it cannot, we would still hope that some recognition could be made of the further contribution we will be making to the relief of the PSBR in 1983/84.

Our present assessment is that in addition to exceeding this year's EFL we will exceed the financial target set last March for two years, even if we hold the current tariffs on average for a further year. Against this background Board Chairmen considered that they would come under considerable pressure from their Boards, which, as you know, include influential external non-executive Members, and from the Consultative Councils to agree to a rebate for this year and a price reduction in 1984/85. The Council agreed at the October meeting that it would try to hold off pressure for a rebate in 1983/84 by announcing its intention because of improved results to hold the average level of tariffs unchanged for another year. This seemed to the Council a defensible position, notwithstanding that it would mean over-achievement of the EFL and of the financial target.

I should explain that holding tariffs on average in 1984/85 does not mean that no consumer would suffer price increases. The fuel price adjustment clause which applies to industrial and larger commercial consumers would continue to operate, and would increase charges for them by nearly 2%, or the equivalent of 0.9% across the Industry. In addition to this, some Area Boards would need to raise tariffs within the average, while others, mainly in the south, would be able to reduce them. In the Midlands, for example, this could mean an increase of 2% to industrial consumers in addition to the operation of the fuel price adjustment clause. If the Council had to impose a further increase on top of that, this would be bound to attract the sharpest criticism from industry which is still complaining that electricity prices are too high in comparison with those of their international competitors and is constantly pressing for reduction.

Any imposed increase, apart from the criticism it will draw from British industry, would also make much more difficult management's task of securing further improvements in this Industry's efficiency and our ability to negotiate a reasonable wage settlement with our unions next year. We have impressed upon our staff the need to control and reduce costs as a means of keeping electricity prices as low as possible in order to achieve our profit targets, and to increase our competitiveness. We are making good progress towards achieving the performance aims set us by the Government. The CEGB has negotiated with the NCB a favourable coal price agreement and this was only secured because it was seen as a means of stimulating electricity demand and hence coal sales. The tariff increase now proposed would more than absorb the benefit of the prices agreed with the NCB.

We had intended to approach the forthcoming wage round on the need to avoid any increase in costs which would threaten the prospects of holding electricity prices unchanged on average next year. Any proposed tariff increase is bound seriously to weaken the stance we take in pay negotiations. The electricity unions have, as you know, the power well short of strike action to cause considerable disruption to electricity supplies and to the merit-order running of power stations which would cost the Industry dear. The Council has asked me to stress to you the serious, demotivating effect on staff in general and on the pay situation in particular if the Industry is forced to increase tariffs beyond what is necessary to meet its needs.

We recognise that the Government had in mind the advantages of a smooth progression in electricity prices in urging a tariff increase of 3% in 1984/85 and a further 3% in 1985/86. You will however appreciate that it is simply not possible to predict with any certainty the level of tariff increases likely to be required for more than a year ahead. Many assumptions have to be built into such forecasts. In September we were expecting that a 6% increase would be needed in 1985/86. At the time this was a reasonable indication but no more than that. Our re-examination of the position now indicates that an increase of 3% in 1985/86 would be sufficient to enable us to meet the EFL requirement for that year. As far as we can see at present therefore the problem of a sharp increase in 1985/86, following no increase in 1984/85, seems unlikely to arise. Our preferred course would be that average prices in 1984/85 should be held level, with the possibility of a 3% increase in 1985/86, (plus about 0.9% for FPA).

The Chancellor announced in his statement in the House last Thursday afternoon that he had set an EFL for the Industry for 1984/85 of £740M. This is considerably higher than we had anticipated or would have wished. Although it is not an agreed EFL we will now give urgent consideration to the action the Industry needs to take to reach this EFL and we will do our best to achieve it. We would however ask that the Industry should be allowed, as is customary, to decide for itself what action is necessary to meet the Government's financial requirements.

The EFL and the financial target on which it is based should be consistent. We have heard suggestions that our present target of 1.4% return on net assets is too low. But our return was agreed with the Government, and is related to net assets on a CCA basis. Many British companies, as you know, are still on an historic cost accounting basis.

We are however at any time ready to discuss with you the pricing principles which should be followed for this Industry and to agree a financial target with you for the period beyond 1984/85. Such a target would, we hope, last for at least three years and would not be changed in mid stream. We do recognise at the same time the right of the Government to change such a target should there be a radical change of circumstances.

I have written at some length which reflects the deep concern which Council has asked me to express to you about the Government's request. We have always been as an Industry co-operative with the Government and I can assure you we wish to remain so. We do however hope that the points made in this letter will be carefully considered by you and your colleagues.

Yours sincerely

Phelps Jones

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10 DOWNING STREET

Prime Minister

I was surprised to hear the Lord President say that the Cabinet minutes gave Mr. Walker a let-out on energy prices. It seems to me that they are quite clear (copy below) and that Mr. Walker could not fail to secure the price increases without bringing the matter back to Cabinet.

CC (83) 33rd Concl Min 4 (LCM)

FERB

15.11.83