



file

4

✓ NO

10 DOWNING STREET

From the Private Secretary

8 December 1983

Dear Michael

Electricity Prices

The Prime Minister is concerned at the time it is taking to settle electricity prices following the recommendation made by MISC 99 to the Cabinet on 10 November. This uncertainty is regrettable since it is spoiling what should otherwise be a favourable story for the Government, as whatever is settled will still be considerably below the rate of inflation.

She would be grateful if your Secretary of State could circulate a note to colleagues in time for a discussion at next week's Cabinet.

This will need to answer three points. First where are the savings that the electricity industry now think are possible coming from? Colleagues will need assurance that they are not being achieved for example by running down stocks or pushing financing costs into later years. Secondly assurance is needed that the prices proposed are consistent with the principles of economic pricing. Thirdly assurance is needed that the balance between domestic and industrial prices is sensible.

I am copying this letter to Janet Lewis-Jones (Lord President's Office), John Kerr (HM Treasury), Alex Galloway (Chancellor of the Duchy of Lancaster's Office), Callum McCarthy (Department of Trade and Industry), John Graham (Scottish Office), David Heyhoe (Lord Privy Seal's Office) and John Gieve (Chief Secretary's Office), and to Richard Hatfield (Cabinet Office).

Yours sincerely
Andrew Turnbull

Andrew Turnbull

Michael Reidy, Esq.,
Department of Energy.

LM

SECRET

ELECTRICITY PRICES

10

Uncertainty about electricity prices has gone on too long. It is spoiling what should be a favourable story for the Government since whatever is settled will still be considerably below the rate of inflation.

Suggest that Secretary of State for Energy circulates a paper to colleagues in time for discussion at next week's Cabinet.

Will need to answer three points:

- (i) Where are savings that Electricity Industry now think are possible coming from? Need assurance that not being achieved e.g. by running down stocks or pushing financing costs into later years.
- (ii) Need assurance that the pricing path proposed is consistent with economic pricing.
- (iii) Need assurance that the balance between domestic and industrial prices is sensible.

AT

8 December 1983



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

9 December 1983

Michael Reidy Esq
Private Secretary to the Secretary of State
for Energy
Department of Energy
Thames House South
Millbank
LONDON SW1P 4QJ

Dear Michael,

ELECTRICITY PRICES

The Chancellor has asked me to say that he was grateful for your Secretary of State's letter of 8 December, but is concerned at the position it describes, and looks forward to seeing the paper for Cabinet which was requested in Andrew Turnbull's letter, also of 8 December, to you.

Copies of this letter go to Andrew Turnbull, and to Richard Hatfield.

Yours ever

J O Kerr

J O KERR

29 DEC 1983

0 11 12 1
8 9 2
7 6 5 4 3

(D)

CC No.

Prime Minister

This crossed with my letter commissioning a note for Cabinet colleagues, to be taken next week. This is a small advance but no more. White X gives some reassurance, I don't think Y will cut much ice. Agree await paper for Cabinet?

01 211 6402

PERSONAL AND CONFIDENTIAL

Rt Hon Nigel Lawson Esq MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
London SW1

AT 9/12

8 December 1983

Yes
MT

Dear Chancellor
ELECTRICITY PRICES

Thank you for your letter of 29 November.

I fully understand your concern that the electricity industry should in fact achieve the EFL set them for 1984/85 and that the NCB should not add more than is necessary to your public expenditure difficulties, though it is fair to say that the electricity and gas industries between them contributed over £400m to savings in 1984/85 in the recent Investment and Financing Review.

But I think we have to be careful not to treat these industries in much the same way as we would treat cash limited Government Departments. As you know, these are commercial undertakings and their EFLs, like the PSBR itself, are cash flow differences between very large flows of expenditures and receipts. In the case of the electricity industry, we are talking of an aggregate of the separate budgets of 13 statutory Boards. These are figures of a very different type and quality from many programmes of Government Departments, especially when one tries to look two or three years ahead.

I think this bears on the question of the precise identification of savings. I do not think we can look at this mainly or wholly in terms of specific cuts. What the industry has to do, and has said it will seek to do, is to manage its affairs so as to produce the £740m payment to the Exchequer in 1984/85.

The Chairman of the Electricity Council is confident that with a special effort, the industry will achieve this. If the Council finds that it cannot see its way to achieving the EFL without a price increase, it will impose a small increase during 1984/85. I think that the balance of this should be a matter for the Council to decide.

only after the 1979-80 EFL was raised.

The Council have a good record in this respect. They have achieved their EFL in each of the past 5 years. They are on course for achieving their cost saving performance aim for the two years 1983/84 and 1984/85. Their latest view of their EFL overshoot in 1983/84 has risen from £170m to £184m, though the winter months, with their uncertainty for the industry's cash flow, lie mainly ahead. They propose to review the management of working capital, a point to which the Treasury has recently attached importance. Beyond this, they will now be looking at any and every area where some extraordinary savings can be made. As I have said, I shall be monitoring progress closely.

X There is no question of meeting the EFL by running down power station coal stocks. The figures to which you refer assumed a modest rundown of the CEGB's continental stock pile, which I know you would like to see, but which must in the end depend on our coal import policy. There is no impact here on endurance.

M You also asked in your letter about the course of electricity prices to industry. The Council tell me that in 1983/4 industry will in fact fare better than domestic consumers as a result of the combined operation of the industrial tariff and the fuel price adjustment clauses. The operation of the fuel price adjustment clause in 1984/85 is expected to do no more than restore the balance between the two classes of consumer.

The Council is also well aware that, within an average price standstill, some Area Boards will need a small price increase anyway. I understand that they will be considering ways in which this might be alleviated and I shall certainly keep in touch with their thinking. But we are talking here of management at Area Board level and we have to bear in mind that it would be contrary to our general approach to efficiency to urge that the consequences of differences of financial performance between Areas be obscured by equalisation.

As regards the position of the NCB, my officials are in touch with yours about setting a revised EFL for 1983/84 which will impose a better financial discipline for the remainder of 1983/84. I think, however, that it would be quite wrong to require the electricity industry to achieve a higher EFL more than half way through a financial year simply in order to offset bad performance in another industry where anyway a large part of the trouble is attributable to a decision to carry over £130m of excess from the 1982/83 NCB EFL into 1983/84 in order to assist a PSBR outturn in 1982/83. I come back to the point that we are not here talking about two Departmental services within a single cash limit.

In fact, as I have said, the latest view of the electricity EFL overshoot in 1983/84 is £184m and, provided all goes well in the rest of the year, the 1983/84 PSBR will get the benefit of that. And the Chairman tells me that he has succeeded in convincing his Council that a rebate in 1983/84 would not be the right course; and that it would be better to minimise any tariff increase in 1984/85. So I have every hope that your point about 1983/84 will be largely met in substance, but without taking steps which would undermine the proper management and financial responsibility of the industries.

I think you may agree that there is here a satisfactory way forward on outstanding questions which could be reported as appropriate to colleagues.

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

Yours sincerely

Michael Reidy

for

PETER WALKER
Approved by the Secretary of State and
signed in his absence.

Nat. Ind: Gas + Elect
Pt. 2



19 DEC 1983