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SCOTTISH OFFICE

WHITEHALL, LONDON SW1A 2AU

NBPM

AT 15/12

SECRET

The Rt Hon Peter Rees QC MP
Chief Secretary to the Treasury
HM Treasury
Parliament Street
LONDON SW1

14 December 1983

Dear Peter,

SCOTTISH ELECTRICITY BOARDS: EXTERNAL FINANCING LIMITS AND PRICES

I have seen the paper which Peter Walker has circulated for tomorrow's Cabinet about electricity prices.

The EFLs which I agreed with you for the Scottish Electricity Boards in October involved substantial reductions in my proposals, particularly in the case of the SSEB. As I made clear to you at the time my agreement was on the understanding that financial restrictions would not delay progress of SSEB's major capital investment at Torness and that I could not contemplate a situation where the EFL led to a substantial price increase in Scotland when there was a freeze in England and Wales.

It is now clear that the present level of EFLs will lead to price increases of at least 5% in Scotland: in a recent informal discussion the Chairman of SSEB mentioned the possibility of 7% and some of the Board's internal estimates point to figures even higher than that. I think it is essential that we should be able to restrict these increases to something less than the rate of inflation, a point to which the Prime Minister clearly attaches importance, as indicated in her Private Secretary's letter of 8 December. To allow sizeable increase which would be attributed to the construction of Torness, which represents such a major financial burden on SSEB, would attract severe criticism of our nuclear programme. I would also remind you that the long-run marginal cost in Scotland is substantially below that in England and Wales so that the principles of economic pricing mean that an increase in Scotland which would very largely close the gap with England and Wales (and would probably make industrial prices higher) would be particularly unjustifiable.

I cannot yet quantify the precise implications for the EFL's of keeping increases in Scotland below the rate of inflation, because the Scottish Boards still have to complete their estimates for 1984-85, but I hope it will be possible to agree the policy objective at this stage.

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

Yours ever,

George.

CONFIDENTIAL

cc NO.

File

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but Mr Turnbull to see o/v
DWB 29/12

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon George Younger TD MP
Secretary of State for Scotland
Scottish Office
Dover House
Whitehall
LONDON
SW1A 2AU

23 December 1983

Dear Secretary of State,

Thank you for your letter of 14 December about the external financing limits of the Scottish Electricity Board.

I suspect that the problem you envisaged has eased somewhat with our agreement in Cabinet last week that electricity prices in England and Wales should increase by some 2 per cent overall next year.

We have always been sympathetic to your desire to avoid external financing reductions affecting Torness. I was, however, surprised to hear that both Scottish Boards are now seeking higher levels of capital expenditure than those before us at our bilateral. The figures are:

Capital expenditure proposals compared to baseline for IFR 83

£m cash

	1984-85	1985-86	1986-87
SSEB IFR (April)	+ 83	+ 69	- 23
IFR Report (July)	+ 55	+ 45	- 23
IFR Bilateral (September)	+ 62	+ 50	- 23
Post-IFR Return (November)	+ 95	+ 68	- 22
NSHEB			
IFR Report (July) and Bilateral (September)	+ 2	+ 1	+ 7
Post-IFR Return (November)	+ 4	+ 9	+ 21

CONFIDENTIAL

For SSEB, some £7m of the increase for 1984-85 and some £5m for 1985-86 arises from your planning decision on the Torness transmission lines (though you did say the Board would have to absorb these). The rest of the increase for SSEB has been attributed to change in the timing of Torness expenditure. Since, as I commented in my letter of 27 September, this Board declined to provide up-dated figures for our IFR discussion in September, it is reasonable that they live with the consequences. Have they cut back any other capital programmes? Given the history of underspending on Torness, we should be surprised if there was any residual problem that could not be solved by the scheme for rolling-over NI investment to which I referred in my letter of 14 October. No explanation has been offered for the NSHEB increases.

I said in that letter that I could understand your difficulty over large differences in price increases North and South of the border but I remain to be convinced that any difficulties are not largely of the Board's own making. Have they, for example, assumed cost savings on a comparable scale to the ESI? You also mentioned long-run marginal costs in Scotland. As you know, the Treasury has long argued that if trading between Scotland and England and Wales was optimised the marginal costs of the two systems should come into line apart from small differences in transmission costs. Increasing exports of Scottish Electricity, in the ways you discussed with John Moore on Tuesday should therefore have two consequences:

(a) the net proceeds should help directly the cash position of the Scottish Boards

(b) prices should come closer in line.

Clearly you are under pressure from the Chairman of the two Boards. But I am sure you would understand the difficult repercussions of allowing any increases in external financing limits announced only a month ago. We need to send to print early in the New Year, the figures for capital expenditure to be included in the Public Expenditure White Paper. In the circumstances, my inclination is to leave them as agreed at our bilateral.

I am copying this letter to the recipients of yours.

yours sincerely

[signature]

for PETER REES
(approved by the Chief Secretary & signed in his absence).

Nat. Ind: Gas & Electricity Policy Pt 8.

CENO

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

Prime Minister (2)
Secretary of State for Scotland very close to settling, though he could reopen if an electricity price freeze is agreed in England and Wales. As a member of MISC 99, he ought not to be in dispute.
AT 25/10

CONFIDENTIAL

The Rt Hon Peter Rees QC MP
Chief Secretary to the Treasury
HM Treasury
Parliament Street
LONDON
SW1P 3AG

7 October 1983

Dear Peter

EXTERNAL FINANCING LIMITS: SCOTTISH NATIONALISED INDUSTRIES

At our meeting on 29 September you requested a number of cuts in the external financing requirements of the Scottish Electricity Boards. My officials have since been in contact with the Chairmen of the Boards about your proposals.

These cuts will undoubtedly cause difficulties for the Boards since their budgets are already tight. The Chairmen are particularly concerned about the effect on the financial target and performance aims which we have only recently negotiated and there is a danger that imposed cuts will bring the system into disrepute.

Nevertheless I am prepared to accept your proposals for reductions for NSHEB in the three years 1984/85-1986/87. In light of these reductions the Board will clearly have to reconsider its planned refurbishment programme and its run of river schemes.

In the case of SSEB, I can accept the reductions in 1984/85 and 1985/86. Officials have agreed that the baseline figure for 1986/87 should be £160m but that further discussions will be necessary in the context of next year's IFR. We also agreed that these decisions should not be allowed to cause the Torness project to be delayed, and it may be that I shall need to seek an additional bid if there is a danger of this happening.

The final point I should like to make in connection with the Electricity Boards concerns the possibility of a freeze on electricity prices in 1984/85. Cecil Parkinson's letter of 22 September to Peter Walker refers to the fact that in England and Wales there might be no worsening of the public expenditure position. This is not the case in Scotland: my officials estimate that the external financing requirements would be increased in each of the three years by about £30m-£40m for SSEB and by £10m-£15m for NSHEB. There would be great public criticism if electricity prices were increased only in Scotland. We have argued consistently for a number of years that electricity prices are higher in Scotland than in justified by economic principles. In these circumstances, I would need to seek a relaxation of the EFLs in order to allow the Scottish Boards also to freeze their tariffs.

As for STG, I have some revised proposals for the EFL. The figures are:

	1984/85	1985/86	1986/87
		£m	
29 September			
My bid	17.8	15.8	17.5
Treasury target	14.3	12.3	15.5
Further reduction sought by Treasury	3.5	3.5	2.0
Present bid	15.8	14.3	15.5
Further reduction now offered on earlier bid	2.0	1.5	2.0

My current bid for STG, comes very close to your target, and indeed achieves it in 1986/87. I cannot, however, meet you in full for each year. Our officials have discussed the reasons for this, namely that my bid at the bilateral already took account of future efficiency gains and that allowance for the Group's repaying debt ahead of schedule was not appropriate.

But after further consideration of the Group's investment proposals I now offer the following:-

	1984/85	1985/86	1986/87
		£m	
29 September bid	21.7	19.9	19.7
Present bid	20.2	19.4	19.2
Reduction	1.5	0.5	0.5

I trust these reconsidered STG bids can now be agreed between us.

Yours ever,

George

Nat Ind: Gen Elect: Pt 8

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