7.43

SECRET AND PERSONAL

Prime Minister ① 25

Chancellor has made his proposal on electricity prices. Agree / arrange a meeting?

AT 16/7

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

16 July 1984

Andrew Turnbull Esq
10 Downing Street
LONDON SW1

1700 Monday

Dear Andrew

PUBLIC EXPENDITURE

I attach a note which the Chancellor would like to discuss with the Prime Minister and other colleagues.

In view of the sensitive subject matter the Chancellor thinks it important that no copies should be taken of the note, that the note should not be allowed out of private offices, and that officials should only be allowed to see it on a strict need to know basis.

I am sending copies to Callum McCarthy (DTI), Michael Reidy (Energy) and John Graham (Scottish Office).

Yours ever
David

D L C PERETZ
Principal Private Secretary

cc Sir Robert Armstrong
N Gregson

SECRET AND PERSONAL

PUBLIC EXPENDITURE AND ELECTRICITY PRICES

Memorandum by the Chancellor of the Exchequer

As colleagues are aware, the public expenditure outlook for the current year, 1984-85, is distinctly worrying. There is upward pressure in a number of areas, but two stand out: local authority expenditure, both current and capital, and the cost of the miners' strike.

2. The public expenditure Reserve began the year at £2¾ billion. Although under £½ billion - mainly on Health Service Review Body pay awards, launch aid, and the redundant miners' payments scheme - has so far been charged formally to the Reserve, local authority current expenditure is likely to take up a further £1.8 billion, and an additional £425 million will be required for the EC settlement. Beyond that there are many other bids, some of which will be irresistible - including £290 million for end-year flexibility. On top of all this is the huge prospective overspend on local authority capital - now put in the range £¼-1¼ billion.

3. We have discussed separately the prospective overspend on local authority capital expenditure and have agreed that urgent action has to be taken to reduce it.

4. Meanwhile, the miners' strike has cost the public sector about £300 million to date and these costs are mounting at a rate of some £30 million a week. The CEGB's bill for additional oil to the end of June was some £450 million. At the same time they used less coal and, taking this into account, their net extra costs to the same date were some £250 million, a figure that is rising at some £20 million a week. The CEGB's savings are, however,

no help to the PSBR, since savings from using less coal are offset in PSBR terms by a corresponding reduction in NCB sales. Moreover, as and when coal stocks are rebuilt after the strike, the CEGB will find that their present savings on coal purchases are reversed and eliminated.

5. As noted above, these extra costs cannot be met from the public expenditure Reserve. We have, of course, so far deferred considering whether an increase in electricity prices to recover at least part of these costs is needed. But the reasons for such deferment are no longer valid, and further delay now will severely limit the extent to which costs can be recovered in 1984-85. The need to consult the Consumer Councils means that, in any event, it takes about 6 weeks to bring electricity price increases into effect.

7. In these circumstances I believe that the time has now come to look for an early increase in electricity prices. There are various ways in which this could be done, but in my view the best approach would be for the electricity industry to bring forward the price increase normally due in April 1985. No decisions have yet, of course, been taken on the size of that increase, or on the ESI financial target for 1985-1986 and for future years.

8. As the costs of electricity generation are now some 10 per cent higher than expected, this in itself would justify a 10 per cent price rise. But I would not press for so large a figure: it may be right for the industry temporarily to bear part of the cost itself, even though that increases our difficulties with public expenditure.

9. An increase of 6 per cent from the beginning of September for all consumers would produce roughly £250 million in 1984-85. It would add a little under 0.2 percentage points to the RPI, but this would be simply bringing forward a rise that would

in any case have followed an electricity price increase in 1985. On the ESI's present figures for 1985-86, it would represent a return of something over 2 per cent - similar to that expected for the period of its current financial target, before the miners' strike.

10. The Secretary of State for Energy will clearly wish to ensure that the increase is announced by the electricity industry itself and presented as essential to offset the additional cost the industry is incurring to ensure uninterrupted electricity supply to its customers.

11. The financial markets are, of course, well aware of the burden on the public finances that oilburn is imposing, and evidence that this will not be met by increased Government borrowing will have a beneficial effect on confidence.

N.L.

16 July 1984