

  
 SECRETARY OF STATE FOR ENERGY  
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SECRET

The Rt Hon Lord Whitelaw CH MC  
 Lord President  
 Privy Council Office  
 Whitehall  
 LONDON  
 SW1A 2AT

/ November 1984

*Dear Willie*

IFR 1984

As you know, I made it clear at yesterday's discussion of MISC 106 that I hope to persuade the gas and electricity industries to reduce their EFL bids by finding further savings between them totalling £1.9 billion pre-tax. I understand that you would find it helpful to know the corresponding after-tax figure.

I have to say that I will have great difficulty persuading the industries to find the last £300m of the £1.9 billion I was asked to do. Neither industry has yet agreed what is wanted and the issues involved are very thorny. On electricity for instance the industry have made it clear that they will only agree the figures if their proposed financial target and performance aim are agreed.

Against this background it is naturally difficult to give post-tax figures with any confidence. The amount of tax payable will depend on how the savings are found. The whole difficulty with the treatment of this tax as public expenditure in the EFLs is that it adds to uncertainty and unpredictability. But on the understanding that the figures are subject to revision in the light of the final outcome, my Department's own best estimate at present is that reductions of £1.9 billion pre-tax would amount to £1.6 billion post-tax. On the same illustrative basis, the assumed breakdown between industries, before and after tax, would be as follows:

	1985-85	1986-87	1987-88	Total
<u>Gas</u>				
Before tax	115	255	345	715
Tax	<u>nil</u>	<u>43</u>	<u>73</u>	<u>116</u>
After tax	115	212	272	599
<u>Electricity</u>				
Before tax	130	450	605	1185
Tax	<u>nil</u>	<u>42</u>	<u>133</u>	<u>175</u>
After tax	130	408	472	1010



SECRET

I confirm that I believe that I can, with great pressure and difficulty, deliver the £1.9 billion. I confirm also that it is, in my opinion, totally impossible to deliver any more.

A large, stylized handwritten signature in black ink. The signature is highly cursive and appears to be the name 'Peter Walker'.

PETER WALKER



PUBLIC EXPENDITURE SURVEY 1984: GAS AND ELECTRICITY EFLs

## STARTING POSITION

	£ million		
	1985/86	1986/87	1987/88
Survey baseline (negative External Financing Limits)			
BGC	-396	-495	-507
ESI	-1022	-1337	-1370
D/Energy's proposed changes to baseline			
BGC	+159	+237	+389
ESI	+24	+298	+570
Treasury's proposed changes to baseline			
BGC ) ESI ) combined	-400	-600	-1000

## DISCUSSION IN MISC 106

2. As the table above shows the Treasury started by asking for total reductions on the industries' combined EFL bids of £3.7 billion over the three years. The Secretary of State for Energy made much of the industries' sense of grievance about extra Corporation Tax which they would be paying, amounting to about £1.4 billion for the two industries over the three years. He said that, if this could be taken into account, the industries would be willing to cooperate in making savings. He was pressed to quantify what he thought it would be reasonable to aim at from the industries. The figure which emerged in discussion was £2.2 billion, ie (approximately) the Treasury's original bid for overall savings of £3.7 billion less the industries' extra Corporation Tax bill of £1.4 billion.



3. When the Secretary of State for Energy reported back to MISC 106 on 31 October he said that, on the basis of discussions with his industries, he hoped to be able to produce savings of £1.9 billion <sup>compared</sup> ~~combined~~ with his aim of £2.2 billion. It emerged however from his letter of 1 November that the effective reduction in the industries' EFL bids would be only £1.6 billion because of a further offset for Corporation Tax.

4. The Secretary of State for Energy has said very little about how the savings are to be achieved. He has indicated that the bulk will come from cost savings. On electricity prices he thought that the increase would be 4.5 per cent in 1985/86 and possibly of a similar order in the two later years. On gas prices he thought that the increase would be 6 per cent in 1985/86, and possibly 7 per cent in 1986/87 and 8 per cent in 1987/88.

5. Mr Walker also said that the electricity industry would make the necessary savings only if the Government agreed to the industry's proposals for its financial target over the next three years. The present financial target (pre-interest current cost on net assets) is 1.4 per cent for the two years to March 1985. The electricity industry's proposals are:

per cent		
1985/86	1986/87	1987/88
2.3	2.9	3.1

The Treasury had been looking for a higher target as follows:

2.8	3.6	4.5.
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Cabinet Office

2 November 1984



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