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AT 14/11

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Peter Walker MBE MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
London
SW1P 4QJ

14 November 1984

Dear Secretary of State,

**THREE YEAR FINANCIAL TARGET FOR
ELECTRICITY SUPPLY INDUSTRY**

Thank you for your letter of 13 November.

I am sorry you have difficulty with my proposal. I certainly did not intend it to involve a breach of faith. I cannot recall any mention of the electricity savings being conditional on a 2¼ per cent financial target. The record of the meetings of MISC 106, the MISC 106 report, the record of your meetings with the Prime Minister and the Cabinet conclusions certainly do not suggest this was the case. I do however recall that in the MISC 106 discussion - MISC 106 (84) 20th that the savings were consistent with the ESI's proposal for a new target, but that is a rather different matter. I cannot accept the view that targets should determine EFLs, rather than the other way round. As always, we have decided on EFLs and now need to work out targets consistent with these.

The line I proposed for the Chairman of the Electricity Council's appearance before the Select Committee was simply based on the formulation used in public on several occasions by Ministers - namely that decisions on recovering the cost of the strike will be taken when the strike is over. I find it hard to see how this could cause the problems you suggest. Problems are much more likely to arise if Mr Jones said anything else.

My concern here is that we do not foreclose options. Any Scargill surcharge could be levied in a range of ways. At one extreme there could be an explicit supplement for a defined period. At the other extreme it could be more unobtrusively incorporated in general price increases. I fear that setting a precise financial target now would largely foreclose the latter option.

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I agree that we should seek to finalise a performance aim. Officials should work to that end. I suggest we return to the financial target when their work is completed. In the meantime Mr Jones could say that decisions on the target and the aim will be announced in due course by Ministers.

I am copying this letter to the Prime Minister.

Yours sincerely
Paul Rees

PETER REES

*(Approved by the
Chief Secretary and
Signed in his absence)*

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File

Prime Minister

To be aware of
this now in case you are
brought into it tomorrow
morning.

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13.11

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

13 November 1984

See below

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Your letter of 13 November about the financial target for the electricity supply industry is totally unacceptable to me.

I made it clear throughout the IFR discussions that the savings I hoped to achieve from the electricity industry were conditional upon a three-year target. I cannot be a party to the breach of faith with the Chairman of the Electricity Council which your letter seeks to impose on me. The Chairman of the Council will, of course, rely on the understanding which has already been reached with him when he speaks to the Select Committee tomorrow, and under no circumstances will I seek to dissuade him.

On your points of detail, it is a nonsense to suggest that we could defer settling the three-year target until we know for certain whether the £215 million of additional savings in 1987/88 will in fact be achieved by reductions in Corporation Tax. It may well be a very long time before agreement is reached between the industry and the Inland Revenue on the industry's Corporation Tax liability for 1987/88. It is one of the unavoidable absurdities which arises from defining Corporation Tax payments as public expenditure that we cannot really foresee how the EFL will operate as a management instrument several years ahead. In this situation we must adhere to the basis I have proposed.

In your last two paragraphs you suggest that we defer setting a target until decisions have been taken on recovering the costs of the coal strike and inform the Energy Select Committee tomorrow that this is our intention. The whole basis of our IFR discussions, and of my discussions with both the NCB and the electricity industry, has been

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that effects of the strike would be put on one side for the purposes of this IFR. I could not in any event accept responsibility for setting off a new round of public discussion about a "Scargill surcharge" at this stage in the coal dispute and when the electricity unions have expressed to me their vehement opposition to it.

I am very happy to settle the performance aim for the industry as swiftly as possible. Some further definitional work is, I understand, necessary to achieve this; but it would be quite wrong to expect from this work efficiency savings going beyond those I have already achieved and which would therefore affect the 2.75 per cent target. There is therefore no ground here for holding up the financial target.

Delay in settling this target would not only put at risk the savings so painfully achieved with the industry. The whole course you are proposing invites the Select Committee and others to look for differences in Government and to exploit them as they did last year; and to renew their criticism of our whole process of managing the finances of these nationalised industries, including their strong view that targets should determine EFLs, not EFLs targets.

I am copying this letter to the Prime Minister.

PETER WALKER

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Andrew Turnbull



Already received
13/11 - went in
With the Compliments *box*

of the

Chief Secretary to the Treasury's

Private Secretary

This is letter Mr Walker
is referring to in his
letter of 13/11.

Treasury Chambers,
Parliament Street,
SW1P 3AG

*Liz
Gower 13/11*

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cc: Chancellor
 Sir P Middleton
 Mr Bailey
 Mr Monck
 Mr Burgner
 Mr Scholar
 Mr Gray
 Mr Webb
 Dr Bird
 Mr Robson

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Peter Walker MBE MP
 Secretary of State
 Department of Energy
 Thames House South
 Millbank
 London SW1P 4QJ

Mr Lord
 Mr Ridley

13 November 1984

**THREE YEAR FINANCIAL TARGET FOR THE ELECTRICITY
 SUPPLY INDUSTRY**

Thank you for your letter of 12 November.

I am afraid I cannot agree that you should confirm a three year target of 2½ per cent for the industry, or that the Chairman of the Council should mention this to the Energy Select Committee on November 14.

You say that such a target would be consistent with Cabinet's decisions. This will only be clear when we see a list detailing the savings produced by the industry. For example, the £215 million additional savings in 1987-88 which you offered at your meeting with the Prime Minister on 7 November were described as reductions in corporation tax or "savings from some other source for example increased efficiency". If these savings were to take the form of reduced operating costs, the rate of return in 1987-88 would rise from the 3.1 per cent you quote to something over 3½ per cent and the average return over the three years would rise to almost 3 per cent.

I also consider it necessary to set the industry's performance aim at the same time as its financial target. We are, I am sure, at one on the need to put maximum pressure on the industry to improve its efficiency. Again, we are in no position to take a decision on a performance aim until we know in detail the savings the industry is making.

Even when this information is available, I find it hard to see how we can set a financial target until we have taken decisions on recovering the costs of the coal strike. This would clearly affect electricity prices and the industry's rate of return. This points to delaying setting the target until the strike is over.

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As regards the appearance by the Chairman of the Council before the Energy Select Committee tomorrow, I suggest he says that no decisions have yet been taken as to recovering the costs of the coal strike, that the EFL for 1985-86 has been set on this basis and that the financial target will be set in the light of decisions on recovering the costs of the strike.

John W. W. Rees

PETER REES

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