

FROM: P L GREGSON CB, DEPUTY SECRETARY

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Mr Mike Reidy
Private Secretary to the Secretary of
State
Department of Energy
Thames House South
Millbank

P.01424

5 November 1984

Covering SECRET: CMO (Until 31 December 1984)

Dear Mike

REPORT OF THE MINISTERIAL GROUP ON PUBLIC EXPENDITURE (MISC 106):
GAS AND ELECTRICITY INDUSTRIES

I attach drafts of the section in the main MISC 106 report which deals with the gas and electricity industries and the relevant Annex (Annex H), which reflect the understanding reached between the Prime Minister and the Secretary of State for Energy this morning.

As your Secretary of State knows, the Lord President's paper to the Cabinet reporting the recommendations of MISC 106 has to be finalised this evening for circulation to the Cabinet first thing tomorrow morning. I must therefore ask for any suggested amendments to the draft to reach me by 4.00 pm this afternoon.

*Yr
P.L.G.*

P L GREGSON

bcc Mr Broadbent
(PS/Chief Secretary)
Mr Paul Gray (Tsy)
Mr Steve Robson (Tsy)
Mr Buckley
Mr Dart

Covering SECRET: CMO (Until 31 December 1984)

Gas and Electricity industries

14. The industries submitted bids for additions to their EFLs totalling:

Gas	+159	+237	+389
Electricity	+ 24	+298	+570

A significant part of these bids was to finance higher payments of corporation tax.

15. The Secretary of State for Energy has held discussions with the Chairmen of the industries and considers that the bids could be reduced, by a combination of efficiency and other savings and price increases, to the following extent (after allowing for extra corporation tax):

Gas	-115	-212	-272
Electricity	-130	-408	-472

These reductions are likely to involve increases of 4½ per cent in electricity prices and 6 per cent in gas prices in 1985-86. The industries have not been explicit about price increases in later years; but the Secretary of State for Energy thinks it possible that there will be increases in electricity prices of 4½ per cent in both 1986-87 and 1987-88 and increases in gas prices of 7 per cent and 8 per cent.

16. The reductions in paragraph 15 would mean the following changes in the combined baseline for the two industries:

-62	-85	+215
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Recognising the difficult overall public expenditure situation, particularly in the third year, the Secretary of State for Energy has undertaken to go back to the industries and seek their agreement to additional savings amounting to £215 million net in 1987/88 (probably amounting to around £250 million gross) so as to bring the industries back to their combined baseline in that year. The Secretary of State believes that this proposal for additional savings will be strongly resisted by the industries but will use every effort to persuade them to accept it. MISC 106 recommend that these proposals (ie those in paragraph 15 as revised in this paragraph) should be accepted.

ANNEX HBRITISH GAS CORPORATION (BGC) AND ELECTRICITY SUPPLY INDUSTRY (ESI)EXTERNAL FINANCING

	<u>1985-86</u>	<u>1986-87</u>	<u>1987-88</u>
Survey baseline			
- BGC	- 396	- 495	- 507
- ESI	-1022	-1337	-1370
	<hr/>	<hr/>	<hr/>
Total	-1418	-1832	-1877

2. The industries submitted the following bids for additions to their external financing limits.

BGC	+ 159	+ 237	+ 389
ESI	+ 24	+ 298	+ 570
	<hr/>	<hr/>	<hr/>
Total	+ 183	+ 535	+ 959

A significant part of these bids was to finance higher payments of corporation tax.

3. The Secretary of State for Energy has held discussions with the Chairmen of the industries and considers that the bids could be reduced, by a combination of efficiency and other savings and price increases, to the following extent.

Gas	- 115	- 212	- 272
Electricity	- 130	- 408	- 472

These reductions are likely to involve increases of 4½ per cent in electricity prices and 6 per cent in gas prices in 1985-86. The industries have not been explicit about price increases in later years; but the Secretary of State for Energy thinks it possible that there will be increases in electricity prices of 4½ per cent in both 1986-87 and 1987-88 and increases in gas prices of 7 per cent and 8 per cent.

4. Other main sources of these reductions are as follows.

(i) Full use of electricity links with France, saving £45 million by 1987-88.

(ii) An assumption that the Sizewell project will be delayed by six months, saving

20	70	50
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[(iii) Miscellaneous cost savings in the ESI of]

[(iv) Miscellaneous cost savings in the BGC of]

5. The reductions in paragraph 3 would mean the following changes in the combined baseline for the two industries:

	£ million		
	<u>1985-86</u>	<u>1986-87</u>	<u>1987-88</u>
	- 62	- 85	+ 215

Recognising the difficult overall public expenditure situation, particularly in the final year, the Secretary of State for Energy has undertaken to go back to the industries and seek their agreement to additional savings amounting to £215 million net in 1987-88 (probably amounting to around £250 million gross) so as to bring the industries back to their combined baseline in that year. The Secretary of State believes that this proposal for additional savings will be strongly resisted by the industries but will use every effort to persuade them to accept it.