



SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ

01 211 6402

The Rt Hon John Major MP
Chief Secretary
HM Treasury
Parliament Street
LONDON
SW1P 3AG

Wbpm
AUGUST
4 July 1987

Dear John,
UKAEA: EXTERNAL FINANCING REQUIREMENTS

As promised in my letter of 2 July about my Department's bids in the 1987 PES, I am now writing about the United Kingdom Atomic Energy Authority's External Financing Requirements.

In their Corporate Plan (about which I will be writing separately) the Authority have proposed external financing limits of £7 million above the 1988/89 EFL baseline of -£6.60 million. Their proposals for 1989/90 and 1990/91 remain on baseline at -£6.40 million and -£6.60 million respectively.

I have considered these proposals carefully, but have concluded that the Authority should be asked to stick to baseline, subject to three technical adjustments which I discuss further below. I believe the Authority can make savings by further improving its efficiency, particularly in its control of working capital.

The three adjustments arise from the creation of the trading fund arrangements, and are nothing to do with the way the Authority runs its business. The most significant of them has already been agreed with your officials. The other two arise from factors which caused incorrect estimates of the baseline when it was set.

The first technical adjustment would reduce the EFL bid for the PES years, but increase my Department's programme expenditure bids for nuclear R&D by corresponding amounts. Officials propose to bring forward by one day the timing of payments made by the Department to the Authority for programme letter work. This would make for improved and simpler administration and have no net impact on public expenditure; your officials support it. Details are at Annex A. The impact on the EFLs would be (£ million):

1988/89	1989/90	1990/91
-15.49	-0.43	-0.35



The second adjustment arises because the Authority will be paying to the Consolidated Fund just over £1 million in distribution payments which were not allowed for (because the distribution policy had not been sorted out) when the baseline was set. I propose that the EFL be increased by £1 million in 1988/89; in addition to leaving the Authority neither better nor worse off, this adjustment would maintain PSBR neutrality.

The third adjustment arises from the fact that, as your officials know, the value and depreciation lifetime of the Authority's assets have only recently been finalised. The final depreciation profile differs significantly from that used in estimating the EFL baseline. About 95% of the Authority's work is charged according to the CBI/Treasury cost-plus formula, which includes an element for depreciation; feeding the new depreciation profile into this formula will produce about £1 million less income for the Authority than was calculated when the baseline was set. I propose that the EFL be adjusted by £1 million accordingly.

In total, then, I propose the following for the Authority's EFLs (£ million):

	1988/89	1989/90	1990/91
Baseline	-6.60	-6.40	-6.60
New bid	-20.09	-6.83	-6.95

These EFL proposals are consistent with the nuclear elements of the PES figures set out in my letter of 2 July. I made it clear that I was taking a hard look at these figures, but we have to recognise that reductions in this area would not bring immediate savings in public expenditure. This is because the Authority's short-term funding requirements would increase since its main customer, the Department, would be providing lower income than budgeted. It would be almost impossible for the Authority to find new business elsewhere immediately to compensate fully, and shedding labour would involve further short-term costs.

I am copying this letter to the Prime Minister, Willie Whitelaw and Sir Robert Armstrong.

Yours *Earl*
Earl

CECIL PARKINSON

ANNEX A

PROGRAMME LETTER EXPENDITURE

With the introduction of Trading Fund arrangements on 1 April 1986, the Department as customers of the AEA moved from payment in advance to the more commercial practice of paying the AEA monthly in arrears. One effect of this is that on 1 April of any financial year we make the last payment in respect of the programme letter for the preceding year. PES figures therefore comprise 11/12 of the relevant year's programme cost plus 1/12 of the previous year's. We are thus dealing with the AEA on one set of figures (on an accruals basis), and the Treasury on another (on a cash basis). This leads to confusion and increases the risk of possible errors. The problem can quite simply be solved by making payments on the last day of the month (ie a day earlier) with effect from the next financial year; although this would mean that we would be making 13 payments in the first year - one payment from this year and 12 from next. It would necessitate an increase in the PES bids as follows:

		£m	
	1988/89	1989/90	1990/91
Existing PES bid	13.69	16.00	16.19
Additional PES bid	15.49	0.43	0.35
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	29.18	16.43	16.54