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PUBLIC EXPENDITURE SURVEY 1986: DEPARTMENT OF ENERGY
Note of a Meeting held in the Chief Secretary's Room,
H M Treasury, at 9.30am on Friday, 19 September

Present:

H M Treasury

Chief Secretary
 Mr F E R Butler
 Mr Monck
 Mr Moore
 Mr Turnbull
 Mrs Diggle
 Dr Bird
 Miss Rutter

Department of Energy

Secretary of State for Energy
 Mr Gregson
 Mr Buckley
 Mr Wilcock
 Mr Bretherton
 Mr Thynne
 Mr Pash
 Mr Dart

I: Departmental ProgrammeRunning Costs

It was agreed that the Department's running cost targets for the Survey period should be set at the level agreed provisionally by officials.

Departmental Expenditure

2 The Secretary of State for Energy said that in order to keep within his baseline he had had to trim back a number of bids made within his Department. Any further squeeze would result in decisions which would be wrong in themselves and politically unpopular. It was not possible, against the background of the imminent Sizewell Report and Chernobyl to cut back expenditure on either nuclear waste disposal or renewable energy R & D. He was offering savings on the Coal Firing Scheme. The energy efficiency budget would be lower in later years than in 1986-87. And the Offshore Supplies Office had an important role to play at present since oil companies were cutting back their investment programme.

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3 The Secretary of State was prepared to offer savings of:

1987-88	1988-89	(£ million) 1989-90
-9	-11	-13

on his Departmental baseline (exclusive of what might be agreed on the AEA). In 1989-90 the figure offered was in addition to the £10 million reduction previously agreed for the CFS. The savings would reduce the baseline to:

		(£ million)
310	319	315

AEA

4 The Secretary of State supported the idea of transferring part of the responsibility for financing fast reactor research to the CEGB. Lord Marshall was already in favour. It remained to persuade the Electricity Council. It might be necessary to phase in a transfer of up to £25 million a year, or it might be possible to settle on a step change in financing arrangements. The Chief Secretary asked for a report back within ten days. Mr Walker said he would report back as soon as possible.

5 Turning to the AEA's EFL, the Secretary of State was prepared to drop the bid for a new neutron source subject to examining it again next year after discussions between the AEA and officials. The Chief Secretary accepted this. In addition, the Secretary of State could offer savings of £3 million, £1.5 million and £2.4 million in the 3 PES years. These would not merely defer expenditure. The Chief Secretary

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hop for further savings of £3 million in 1987-88 in order to make room for the £2½ million a year venture capital fund the AEA wanted.

6 It was agreed that when the Secretary of State reported to the Chief Secretary on his discussions with Lord Marshall, decisions would be taken on the AEA and departmental expenditure at the same time.

II: British Coal

7 The Secretary of State thought it important to show confidence in Sir Robert Haslam's management of the coal industry. It would take a little time to put together his new plans. Substantial progress had already been made, with 31 pits shut since the strike, together with colliery amalgamations, and at least 3 further closures in the pipeline. Haslam intended to link pay to productivity and had ambitious plans for more closures; he was reviewing BC's capital investment programme and this might lead to reduced bids.

8 It was agreed that Department of Energy officials would prepare a paper on Sir Robert Haslam's latest plans within the next 2 weeks. This would be the basis for further discussion between the Secretary of State and the Chief Secretary.

9 Discussing the general strategy for the coal industry, the Secretary of State made it clear that the new profit objectives demanded further closures. The industry was no longer production led but market driven. There was a possibility that more redundancies this year, and increased costs, could improve prospects in the later IFR years. Ministers agreed to defer further discussion of miners' redundancy costs until more information was available.

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III: Electricity

10 The Secretary of State explained that the Sizewell report was due on 17 October and that he was eager to make a rapid decision once it was available. The Chief Secretary pointed out that the timetable implicit in the ESI's bid was unrealistic in assuming S2 consent in autumn 1986. The Secretary of State agreed.

11 It was decided to adopt a working assumption of S2 consent at the end of calendar 1987, on the understanding (similar to the agreement in the 1985 IFR) that the agreed EFL's would need to be adjusted if this timetable assumption proved incorrect. Officials would agree the figures separately.

12 As for other items/ⁱⁿthe ESI's capital bid, the Chief Secretary suggested that it was too soon to provide for a new coal station; and that further savings on capital might also be found. The Secretary of State was prepared to look at the case for deferring a decision on the coal station until the 1987 IFR. The scope for further capital savings was limited by the need for additional resources for the AGRs, and there was also pressure from suppliers to maintain investment on the transmission and distribution network. It was agreed that officials should discuss what capital savings could be identified.

13 The Chief Secretary suggested that it should also be possible to have a contributions holiday for the employer's input to the ESI pension fund once the triennial actuarial valuation was available in respect of end March 1987; credit should be taken now for the expected savings. The Secretary of State agreed that officials should examine this option, but stressed any savings scored on this account would have to be subject to a best endeavours understanding.

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14 Turning to profits, the Secretary of State said that the Electricity Council rejected the case for a tariff increase next year and intended small real price decreases in 1988-89 and 1989-90. This revised tariff path would not add to the ESI's bid because there would be offsetting savings.

15 The Secretary of State felt unable to press the Electricity Council to raise prices higher than their intentions. He had no powers to do so. In 1987-88 higher prices would mean exceeding the financial target and putting electricity at a competitive disadvantage against gas. The industry's imminent debt freedom meant that higher price increases than commercially necessary would be open to challenge in the courts. It was already earning a better return than any other energy utility in the world. Price decreases would be indicated if the same pricing formula as gas were to be adopted. £1.3 billion a year should be adequate return for the Treasury.

16 The Chief Secretary pointed out that the electricity industry's own proposals for a bonus scheme envisaged reward for exceeding the financial target. He envisaged that the ESI should progressively move toward the target of a 5 per cent real return on capital which applied to nationalised industries generally. It was very important that a prudent public expenditure path should be presented in the autumn statement, not least because of its impact on public perceptions of the economic background to gas privatisation. The ESI could and should make a contribution to improving that overall picture.

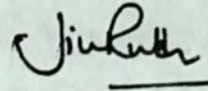
Conclusions

17 Summing up, the Chief Secretary said that he would hope to settle the Departmental programme in correspondence once the Secretary of State had established the position on the

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AEA's EFL. Further action on coal would have to await the paper by Department of Energy on Sir Robert Haslam's proposals. Officials would also consider the capital programme and a possible contributions holiday on pensions. He noted the Secretary of State's position on electricity tariff increases. He did not think that this was a question which could be settled bilaterally.



JILL RUTTER

Private Secretary

Distribution

Those present
Principal Private Secretary
PS/Sir Peter Middleton
Mr Robson
Mr Hoare

H M Treasury
24 September 1986

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