Prime Minister
put in back-up
This item was put off from the last meeting of Cabinet - except that the coal cash limit has been agreed bilaterally.
TL 31/10

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PRIME MINISTER

Nationalised Industries' Cash Limits
(C(79) 48 - and letters of 24th October from Mr. Howell and Mr. Fowler)
(with Item 5)

BACKGROUND

At its last discussion of cash limits, E Committee endorsed the general approach to the nationalised industries. The main components were:

(i) to make allowances for the differing circumstances of each industry;

(ii) to note that their cash limits (which apply to external finance only) are the residuals of very much larger figures, and correspondingly volatile;

(iii) to agree, nevertheless, to use cash limits to put pressure on pay;

(iv) to start from the assumption that increases in wage costs (not necessarily increases for individuals) should be somewhat less than the predicted increase in the RPI - how much less, to be settled case by case.

At the same meeting, E decided on the general line on the Rate Support Grant cash limit; this is now the subject of a separate paper for this Cabinet.

2. This paper is also relevant to the Public Expenditure White Paper for 1980-81, which is also on the Agenda. Any decisions taken by Cabinet which involve increasing the cash limits beyond the numbers proposed by the Treasury represent volume increases which have to be reflected in the White Paper. The point is made in the brief on that White Paper.

3. The main urgency is to get decisions on the cash limit for the NCB. The negotiating meeting is, as you know, on 30th October. But the Chancellor hopes to get decisions on all the cash limits listed here (save for gas and electricity, which will have to be picked up next week at E) and to announce the whole lot on 20th November, the day of the RSG 'statutory meeting', probably by way of a Press notice or arranged Parliamentary Question. As the Chancellor points out (paragraph 13) broad consistency between the treatment of the two is important.

4. One final complication arises from the letter from the Nationalised Industries' Chairmen's Group, at Annex C. This raises a wide range of issues, beyond the scope of the present meeting. You will no doubt want them discussed, when Sir Keith Joseph reports on nationalised industry policy in general (probably now in December). Meanwhile, the immediate response to the chairmen is proposed in paragraphs 6 and 7.

5. But the immediate problem for Cabinet is to agree specific figures for the cash limits listed in Annex A. Our information is that only four of these are likely to be contested: coal, rail, bus and airways. Detailed notes on these four are below. It should be possible to get agreement on the other cash limits "on the nod".

HANDLING

6. You might invite the Chancellor to introduce his paper, and then seek general comments from the Secretary of State for Industry (as de factor chairman of the unofficial group of Ministers on nationalised industry policy); the Secretary of State for Employment (because of the implications for pay negotiations); the Secretary of State for Trade (consumers) and any others who wish to join in. But you will want to keep this part of the discussion short and avoid special pleading on particular cases. The key issues which are likely to come up are:-

(i) the vulnerability of nationalised industry performance to extraneous factors: for example, the difference between a standard and a bad winter can mean £55 million to the electricity industry alone;

(ii) the inflexibility of their response. Because of constraints on redundancy agreements, closures, price increases, market response, and above all improved productivity, the industries cannot react very quickly to any deterioration in their performance which threatens their cash limit;

(iii) special nature of their cash limit. Not all of your colleagues may fully appreciate that the nationalised industry 'cash limits' apply to their external financial needs only: and that holding to these limits involves giving the industries freedom to adjust other factors including prices if they are to stay within them. The suggested change in nomenclature to "external financing limit" may help here though, in the last resort the cash limit may have to give;

(iv) Pay. The starting point was, as E agreed, increases in wage costs somewhat less than the movement of the RPI. In fact, the Treasury have moved quite away off this target, and not just to reflect the different considerations applying to each industry. In most cases (though the Chancellor's paper does not say this) the figures have been uprated from the volume totals agreed in the summer by a standard figure of 17 per cent. This is, of course, not consistent with the 14.6 per cent starting point for the RSG proposals. It is even more generous, in one or two cases, than the industries themselves had assumed (but the industries were operating on much earlier information). You may want to probe a bit on the reasons for choosing these figures: but we know that the Chancellor has himself rounded them down from those discussed with Departments earlier. Whatever is decided, however, you will want to ensure that no figure as high as 17 per cent gains currency outside the Cabinet room especially if the RSG is based on a lower percentage. This bears on the proposal in paragraph 7 of the Chancellor's paper that the industries might be told the assumption underlying the limits.

(v) other costs. The 17 per cent covers other costs as well as pay. This makes it harder still to disentangle this specific pay assumption.

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7. After this general discussion, you will want to turn to the detail of the disputed cases:-

(a) Coal. The Treasury bid is for a cash limit of £810 million, and the Energy bid is for £834 million. There is in fact a reasonable explanation for this difference, but I don't think you should delay Cabinet on it. (Mr. Howell's minute of 24th October sets out the argument: it concerns the method used for getting from survey prices to current prices). It is better to concentrate on the gap of £24 million, and the implications this has. It is common ground that there is little or no scope, in the short term, for dramatic improvements in productivity or for more rapid closures, in time to produce any effect during 1980-81. The E Committee decision on coal strategy generally was that the burden of adjustment should fall on prices. It is very difficult to be precise, and you should not rely too much on what follows. But very roughly, the £810 million proposed by the Treasury is consistent with 15 per cent increase in wages; it could be made consistent with a higher wage outcome if prices were allowed to rise higher. The £834 million proposed by Energy is said to be consistent with 17-17½ per cent increase on wages, on the assumption that the NCB can pass on its increased costs to the CEGB. This is allowed for in the CEGB calculations which underly the electricity price increases now proposed (increases in line with the RPI in April, and a further 5 per cent next autumn). Both calculations assume that coal remains competitive with oil. However, the latest unofficial information from the NCB is that the wage settlement may turn out to be about 20 per cent. This would add roughly £55 million to NCB's costs. To recover this involves a further coal price increase of 3 per cent, which in turn adds about 1½ per cent to electricity prices (provided that the agreement between the NCB and the CEGB to stabilise prices can be ignored). The Department of Energy reckon that the £24 million gap between their figure and the Treasury's would have to be recovered in prices - nearly another $1\frac{1}{2}$ per cent on prices, or $\frac{3}{4}$ per cent on electricity prices. These figures are inevitably pretty broad, as are the assumptions about the likely wage outcome. You also need to bear in mind the timetable. The next negotiating meeting with the miners is on Tuesday, 30th October. If Cabinet reaches a decision on Thursday, it can be communicated to the NCB that afternoon. But if Cabinet fails to agree, or if it agrees on a figure which the NCB does not accept, then there has to be time for further consultation. You will want to emphasise that, whatever happens, a firm cash limit must be agreed and in place, and accepted by the NCB, before 30th October. They cannot be allowed to negotiate, and maybe reach an agreement, without clear guidance on the available finance.

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(b) British Rail. Mr. Fowler has written to the Chancellor today about this. The Treasury bid is for a limit of £705 million, and his proposal is a bid of £750 million. The Treasury figure assumes a pay increase of about 12 per cent, plus a further 2 per cent which is a hangover from an earlier settlement. It also takes a very favourable view of all the commercial risks. The Department of Transport argue that railway pay has fallen behind (8-10 per cent below the peak of 1975 in real terms) and is bound to catch up somewhat; and that the going rate is emerging at something like 17 per cent; but they rest their argument much more on the economic assumptions than on pay. They see no scope for economies in the first year either from closures (because of the long statutory process of consultation), or productivity (because of the slow pace at which agreements are negotiated with the unions). They are convinced, therefore, that a £705 million cash limit would in practice be breached. I believe the Chief Secretary may be prepared to concede something here, though it is not clear how much.

(c) National Bus Company. Mr. Fowler's letter also deals with this. The main point here is that the cuts in local authority expenditure, and in Department of Transport expenditure on TSG and new Bus Grant, have already reduced the NBC cash flow; that consumer resistance to further fare increases makes them self-defeating; and that the scope for productivity changes, again in the short term, is pretty limited. The consequence of the cash limit proposed by the Treasury (£77 million, against a Transport bid of £85 million) might be a massive reduction in services. You will want to probe the realities here so that the political consequences can be weighed, not only in rural constituencies but generally.

(d) British Airways. There is a gap of £15 million between the Treasury bid of £205 million and the Department of Trade bid of £220 million. The difference arises because the standard inflation factor of 17 per cent is not enough to cope with increased fuel costs and the fare cuts imposed by the CAA. The difference represents one new aircraft. The Secretary of State will argue strongly that, given the impending privatisation of British Airways, it would be silly to make it change its programme in this way, thus damaging the prospects of a satisfactory sale. The £220 million limit proposed by Trade still puts a fairly realistic squeeze on pay and builds in a sizeable allowance for improvements in productivity.

CONCLUSIONS

8. Subject to the discussion, you might be able to reach the following conclusions:-

(a) To endorse the cash limits listed in Annex A to C(79) 48 [with any changes agreed during discussion].

(b) [If necessary] to invite the Secretary of State for Energy and the Chancellor of the Exchequer to agree between them on the cash limit for coal, and to communicate it to the NCB before the negotiating meeting on 30th October.

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(c) To note that the cash limit for gas and electricity will be settled either bilaterally between the Chief Secretary and the Secretary of State for Energy or, if necessary, at E Committee next Tuesday, 30th October in time for the results to be taken into account at Cabinet next week.

(d) To agree that the cash limits should be published by the Chancellor of the Exchequer on 20th November /by way of an arranged Parliamentary Question/.

(e) To agree the general approach to the Nationalised Industries' Chairmen's Group suggested by the Chancellor of the Exchequer in paragraphs 6 - 7 of his paper and the procedure suggested in paragraph 12 for a reply.

M.R.
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(John Hunt)

24th October 1979