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Prime Minister
To glance

RECORD OF A MEETING BETWEEN MINISTERS AND THE NATIONALISED INDUSTRIES CHAIRMEN'S GROUP : HELD IN THE CHANCELLOR OF THE EXCHEQUER'S ROOM AT H.M. TREASURY AT 4.00 P.M. ON TUESDAY, 20TH FEBRUARY 1980

Present:

Chancellor of the Exchequer
Secretary of State for Industry
Secretary of State for Employment
Secretary of State for Energy
Chief Secretary to the Treasury
Minister of Transport
Mr. W.S. Ryrie
Mr. N. Monck
Mr. M.A. Hall
Sir Francis Tombs
Sir William Barlow
Sir Humphrey Browne
Sir Derek Ezra
Sir Anthony Griffin
Sir Peter Parker
Lord Donnet
Mr. J. Driscoll
Mr. P. Wilkins

...... The agenda for the meeting is attached.

2. Welcoming the Chairmen, the Chancellor said the purpose of the meeting was to go over the more important ground in the Chairmen's document "Framework of Financial Discipline" forwarded to the Chancellor with Sir William Barlow's letter of 18th October 1979. This was an important analysis of intractable problems, on which he and the Chairman of the NICG had since been in correspondence.

3. Sir Francis Tombs thanked Ministers for this opportunity to discuss the nationalised industries' financial arrangements. The Chairmen wished to concentrate on three main issues:-

(a) The Chairmen thought that it was not in the interests of the public, the Government or the nationalised industries for their borrowing to be included in the Public Sector Borrowing Requirement. This essentially presentational point was an important element of the Chairmen's case.

(b) The role and consistency of the nationalised industries' financial targets and external financing limits.

(c) Sources of finance for the nationalised industries

Inclusion of nationalised industry borrowing in the PSBR

4. The Chancellor observed that this was more than a presentational point, and lay at the heart of the relationship between the industries and the Government. There was no escaping the fact that the Government was the nationalised industries' banker of last resort. This made the issue of public concern.

5. Sir William Barlow said that the Chairmen well understood the Government's commitment to control the PSBR. They recognised too that there was an important issue of substance. But the presentational aspects were important to the Chairmen, who would like the Government to consider what could be done to meet their concern. In the first place, the inclusion of their borrowing in the PSBR meant that the nationalised industries were being restrained from profitable investment. Other countries had found ways of distinguishing between the Government's own needs and those of Government-owned industries. The Chairmen believed that the present arrangement was against the national interest, and would like to work jointly with the Treasury to see whether progress could not be made towards identifying nationalised industry borrowing as a separate category. Sir Francis Tombs noted that even within the category of nationalised industry borrowing, there was an important distinction to be drawn between borrowing for revenue and borrowing for investment.

6. The Chancellor said that Ministers well understood the Chairmen's strength of feeling on this. He was content for joint work to proceed on looking at ways of meeting the Chairmen's difficulties on this point. But he had to remind the Chairmen that the cash restraint on their industries' borrowing, whether for revenue or investment purposes, was inescapable.

7. Sir Derek Ezra said that the Chairmen were increasingly sensitive to the suggestion that investment by nationalised industries was somehow a wrong application of funds. Many of the nationalised industries were growth sectors of the economy. Their investment projects were pursued only after careful scrutiny; and yet there was an implied stigma attached to their investment activities. This stemmed in large part from indiscriminate inclusion in the PSBR aggregate. The Chancellor reminded the Chairmen that it was for this reason that he now referred in public to the "enterprise" rather than the "private" sector.

8. The Chief Secretary said that the Government might well be prepared to move in a purely presentational way towards separately identified figures for nationalised industry borrowing. But such borrowing was incontrovertibly an "integral part of the borrowing requirement". It would be a mistake to expect a change of front by the Government on the substantive issue. Sir Francis Tombs confirmed that it was the presentational aspects with which the Chairmen were concerned. Within the total of nationalised industry borrowing, separately identified, they would like a further sub-division between revenue expenditure and loan capital. The Secretary of State for Industry commented that whatever the categorisation, it would be the market's perceptions which counted. Sir Francis Tombs accepted that a different classification would have little bearing on the Government's capacity to market public debt; but it might imply a different market reaction from that which would have met an undivided PSBR; and it might help the industries in their efforts to gain access to the capital markets (see paras 18-23 below). The Secretary of State for Industry said that the proposals for involving private equity capital which the Government had already put to the Chairmen gave them a degree of scope. They were more than just cosmetic. Sir Francis Tombs accepted that these arrangements would be useful, but said they did not tackle the problem at its root. Sir William Barlow thought the new arrangements would be of relatively little help to the Post Office.

9. It was agreed that officials concerned with financial arrangements for the nationalised industries should consider the scope for identifying nationalised industry borrowing separately from the PSBR, and within that category differentiating between borrowing for revenue and for investment purposes. Mr. Ryrie would keep in touch with the Chairmen through Mr. Driscoll as the work progressed.

External financing limits

10. Sir Francis Tombs said that EFLs were of necessity derivative from the nationalised industries' financial targets. The Chairmen found EFLs valuable in imposing commercial disciplines on their industries. But to manage their affairs so as to meet their EFLs there were three important underpinning elements - the financial targets; a stable investment programme; and an orderly pricing policy. Problems and distortions were now arising because the Government had elevated EFLs to an objective in their own right. The Chairmen found the concept of EFLs confusing. Were they intended to be like a bank overdraft ceiling? If so it was necessary for the nationalised industries to live well within them, and make suitable dispositions. Or were they mid-point estimates, aimed at, but not necessarily observed to the letter? The Government appeared to switch inconsistently from one to the other? The EFLs had considerable value as a short-term management tool. But they were positively unhelpful as a short term regulator. Admiral Griffin observed that the present regime of EFLs created peculiar and severe problems for manufacturing and exporting nationalised industries.

11. The Chancellor accepted that EFLs were clearly related to the financial elements Sir Francis had listed. But at the end of the day the Government had to keep the aggregate of EFLs within prescribed limits. The Post Office billing dispute had for instance greatly worsened the PSBR for the current year. More was involved than the Government's

role as banker of last resort to particular industries. What would be the position if the Post Office's overrun had been the pattern for the other industries as well?

12. Sir Derek Ezra said that nationalised industries tended to perceive the danger of overrunning their EFLs towards the end of the financial year. This was in great part because major industrial disputes tended to occur in the winter. Taking the National Coal Board as an example, they had suffered badly a year ago as a result of the transport dispute. They had improved their financial position during the first part of the current year, but now their finances were threatened by the steel dispute, as the end of the financial year approached. There was no time to circumvent the impact of such extraneous events on a rigid EFL. The Chancellor agreed with Sir Francis Tombs that the swings and roundabouts principle frequently applied. But it could not be relied upon, and the Government must concern itself with the aggregate of EFLs, within the PSBR.

13. Sir William Barlow said that the EFL was a residual total which was highly sensitive to changing external economic circumstances. When such developments necessitated a change in policy to avoid an excess over an industry's EFL, decisions were taken which were harmful both to the business and to its customers. In the Post Office profitable investment in the telcommunications business had been cut back and the reduction of manning slowed down. Compared with the overall budgets of the industries, the figures by which EFLs were exceeded were small, and well within the normal operating margin of error for a commercial enterprise of comparable size. Rigid control through EFLs would inevitably inhibit nationalised industries' ability to meet their financial targets eg by restricting investment. Sir Francis Tombs noted the absurdity of delaying payment of debts to the next financial year and thus incurring an interest charge. In this sense the nationalised industries were already borrowing from alternative sources in order to meet their external financing limits. In response

to a question from the Secretary of State for Employment, the Chairmen emphasised the looseness of the link between financial targets and EFLs. Additionally EFLs covered financial years but the financial targets of some industries cover calendar years. Sir William Barlow said the discipline of the EFL amounted to getting the figures right at midnight on 31st March. There were indeed occasions with some EFLs that the limit was breached in the course of the year on condition that the end-year figure fell within it. Sir Humphrey Browne urged Ministers not to form the impression that the Chairmen opposed the concept of EFLs. They thoroughly welcomed the present emphasis on cash rather than relying only on return on capital. In his view, the main key to the issues under discussion at this meeting was that the nationalised industries should have access to alternative sources of capital. Sir Peter Parker said he found the EFL very useful in his dealings with trade unions. But it should not become the dominant strand in the nationalised industries' financial framework.

14. The Chancellor said the Government did not dissent from the Chairmen's assessment of the crucial importance of the nationalised industries' financial targets. But when faced with a shortage of cash, even private industry had to curtail its investment plans. Sir William Barlow thought that in practice a large private sector company would never find itself unable to borrow sums of the order of £200 million for sound investment purposes. Sir Peter Parker noted that private sector companies faced with cash flow problems would resort to leasing. This route was barred to the nationalised industries. He hoped the leasing aspect could be studied.

15. Sir Francis Tombs regretted that EFLs had come to be regarded as the same as cash limits. There was a crucial difference, in that EFLs were necessarily residuals, whereas cash limits were global budgets. Whilst not disputing this, the Chancellor noted that on the criterion the PSBR was the biggest EFL of all.

16. Sir Francis Tombs said that the Chairmen would like guidance on how the Government saw the role of EFLs. They would

like to set up some kind of joint work to define more clearly the role of EFLs and to consider improvements in their operation. The Chancellor agreed that Mr. Ryrie's official group could also look at this problem. They would examine whether there was any scope for flexibility in the application of EFLs. The idea of carry-over was currently being considered in respect of certain central government cash limits, and was worth examination in this context also. The Secretary of State for Energy commented that it was very valuable that there should be a clearer common understanding of EFLs, even if at the end of the day it was unpalatable to the Chairmen.

17. It was therefore agreed that Mr. Ryrie would be in contact with the Chairmen's Group in due course when officials had taken further their study of EFLs. Within the tight limits necessarily set by the Government's responsibility for controlling the aggregate of public sector borrowing, they would examine what scope there might be for flexibility in the application of EFLs, and seek, with the Chairmen, to arrive at a clearer mutual understanding of the role EFLs should play.

Access to capital markets

18. Sir Derek Ezra said that although there had been great advances in the functioning of financial markets, the Treasury had over the years refused to modify twenty-year old arrangements for borrowing by nationalised industries. The Chairmen would like the possibilities to be explored firstly of the circumstances in which it might be possible to widen the range of access by the nationalised industries to sources of finance other than the Government, and secondly for making the arrangements for borrowing from the NLF more flexible, particularly with regard to the time-scale. He also felt that the Government should provide more equity finance for nationalised industries. There was a degree of risk in their activities, and it was only fair that the owners should share it. It was unreasonable for the Government to expect a fixed return on risk capital.

19. The Chancellor said that whilst he saw the force of Sir Derek's analysis, the fact was that all borrowing by the nationalised industries was on the Government's credit in the last resort. The ultimate solution to the Chairmen's problem was full privatisation. Now the Government had offered a half-way house in the shape of "semi-privatisation".

20. Sir Peter Parker thought that apart from the essentially marginal projects which might benefit from the new arrangements suggested by the Government, there were major separable projects - e.g. electrification of the railways, and the Channel tunnel, which he thought could be financed in new and more imaginative ways. Sir William Barlow saw it as imperative to tap other sources. Limitation to one source within strict limits pushed the nationalised industries into raising their prices. Lord Donnet supported this view.

21. The Secretary of State for Industry again emphasised the value to the nationalised industries of the new possibilities for semi-privatisation proposed by the Government.

22. The Chancellor asked Mr. Ryrie whether he thought his official Group could throw any new light on this perennial problem. Mr. Ryrie said that if nationalised industries, e.g. the Post Office or the Electricity Council were to borrow in their own name, perhaps by issuing bonds, the effect would probably be wholly cosmetic. They would be tapping the same market as the Government, and the Government would have to take a close interest in the size, timing and marketing of nationalised industry debt because of its effect on monetary aggregates and the Government's own funding programme etc.

23. The Chancellor said that the Government had little control over the activities of the private sector, which had an impact on the exchange rate, the monetary aggregates, and other important indicators. The Government and the nationalised industries had a special relationship whether they like it or not, not least because of the Government's role as banker of last resort. But he was content for Mr. Ryrie's Group to examine whether it was possible to give the Chairmen more flexibility at the margin as they had suggested. Mr. Ryrie would be in touch with the NICG, and would report back to a further meeting between Ministers and the Chairmen in due course.

Envoi

24. The Chancellor said that at worst, it looked as thought there might be room for some purely cosmetic changes which would go some way to helping the Chairmen over the problems they had raised; at best, there might be some practical improvements. The work set in hand should help in thawing the present reluctant embrace between the Government and the nationalised industries.

25. Mr. Ryrie would discuss with Sir Francis Tombs arrangements for consulting the Chairmen on the studies set in hand, and would report back to a further meeting between the NICG and Ministers in two to three months' time.

MAH

(M.A. HALL)
21st February, 1980

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