Ref. P.0130

CONFIDENTIAL

PRIME MINISTER

NATIONALISED INDUSTRIES' CASH LIMITS - Revised brief
C(79) 48 and associated correspondence.

BACKGROUND

There was not time to discuss this paper at Cabinet on 25 October. Much of the brief you had then still stands but there have been a number of new moves. For convenience we have incorporated the fresh material in a single updated brief.

2. 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.

3. At the same meeting, E decided on the general line on the Rate Support Grant cash limit; this was, of course, later remitted to MISC 21 and agreed by Cabinet last week. The fairly tight line endorsed by Cabinet for local authority cash limits is broadly consistent with the proposals in the Chancellor's paper.

4. There was one urgent issue left over from last week's Cabinet - the cash limit for the NCB, which it was essential to settle before the negotiating meeting on 30 October. As you know, that has now been agreed, and Mr Howell's

minute to you of 29 October reports a settlement with the Chief Secretary on a figure of £834 million. This represents a concession by the Chief Secretary, which he insists should not be taken as a precedent for other industries. But the real question is whether the likely pay deal for the miners can be accommodated within this figure. You may want to use the opportunity of this meeting to seek a progress report from Mr Howell.

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5. The Chancellor hopes to get decisions on all the other cash limits at this meeting. Most of them are listed in the paper. Those for gas and electricity are set out in Mr Howell's letters of 30 October (electricity) and 31 October (gas) and in the Secretary of State for Scotland's minute of 31 October (Scottish electricity). These proposals follow the discussion on gas and electricity prices at Cabinet last week, and at E Committee on Tuesday. The Chancellor intends to announce the whole set of nationalised industry limits on 20 November, the day of the RSG 'Statutory Meeting', probably by way of a press notice or arranged PQ.

6. 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 and need cause no problems.

7. But the immediate task for Cabinet is to agree specific figures for the cash limits of the nationalised industries listed in Annex A, plus gas and electricity. Our information is that only three of these are likely to be contested - rail, bus and airways - though coal, gas and electricity merit special confirmation because they result from agreements not reported in the paper. Detailed notes on all six are in paragraph 9 below. It should be possible to get agreement on the other cash limits "on the nod".

HANDLING

8. You will probably want to divide the discussion into two parts: a general discussion and then detailed consideration of the individual industries. As a general lead in you might invite the Chancellor to introduce his paper, and then seek comments from the Secretary of State for Industry (as de facto 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 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 and market response, the industries cannot react very quickly to any deterioration in their performance.

(iii) the special nature of their cash limits. Not all of your colleagues may fully appreciate that the nationalised industry 'cash limits' apply to their external financial needs only and are the net result of much larger gross numbers. The suggested change in nomenclature to "external financing limit" may help here. The consequence, of course, is that holding to these limits involves giving the industries freedom to adjust other factors, especially prices, if they are to stay within them; and that, even then, the task they face can be a good deal more demanding and uncertain of achievement than say that of a Government Department with a cash limit essentially related to gross expenditure.

(iv) Pay and other costs. Although there are considerable variations between industries, the Treasury have in most cases uprated the volume totals agreed in the summer by a standard figure of 17 per cent to cover both pay and prices. This is, of course, considerably above the 13 per cent agreed for the calculations of RSG. Indeed, 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 as 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. Of course the fact that the 17 per cent - where this applies - covers other costs as well as pay makes it hard to disentangle any specific pay assumption. But considerable care will be needed if unfortunate public conclusions are to be avoided.

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

(a) Coal As suggested above, I think you will want to ask Mr Howell for a progress report on the result of the negotiating meeting on 31 October. Does the Coal Board seriously believe that it can get by with a cash limit of £834 million (the figure he has now agreed with the Chief Secretary? You might glance at his exchange of letters with the Chancellor (Howell 25 October and Howe 30 October). The cash limit provides for an increase of 13.4 per cent in wage costs over the period, and any excess above this will have to be picked up in coal prices. Is it too early to ask what this means? If so, you should ask Mr Howell to let you have a report as soon as the picture becomes clear.

Any future increase in ~~coal~~ coke prices hits BSC (which can't put up its prices)

(b) British Rail Mr Fowler wrote ~~has written~~ to the Chancellor on 24 Oct 1979 ~~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.

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20% → 40%!

(c) National Bus Company Mr Fowler's letter also deal 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 substantial 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.

(e) Electricity The Secretary of State for Energy (letter of 30 October to the Chancellor) proposes a cash limit of £187 million. The Chief Secretary is - I understand - prepared to accept this; indeed the Treasury thinks this limit is very tightly-drawn. (It leaves room only for about 12 per cent increase in wage costs, on top of increases already agreed.)

The Secretary of State for Scotland will be writing later today to propose limits of £73 million (South of Scotland Electricity Board) and £59 million (North of Scotland Hydro Board). These have already been agreed at official level with the Treasury.

All these limits are consistent with last week's decisions on electricity prices.

(f) Gas Agreement was reached this morning with the Gas Corporation on a limit of minus £400 million (ie, a repayment to the Exchequer). This is still subject to Ministerial approval, but I am told there will be an exchange of minutes between the Secretary of State for Energy and the Chief Secretary later today. This figure is £100 million better than the Corporation's original offer, and is regarded as very tight indeed.

CONCLUSIONS

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

(a) to note the cash limits agreed for the coal industry;

(b) to approve the cash limits for gas, electricity (England and Wales) and electricity (Scotland) set out in the Secretary of State for Energy's minutes of 30 and 31 October, and the Secretary of State for Scotland's minute of 31 October;

(c) to endorse the other cash limits listed in Annex A to C(79) 48 [with any changes agreed during discussion];

(d) to agree that the cash limits should be published by the Chancellor of the Exchequer on 20 November [by way of an arranged PQ];

(e) to agree the general approach to proposals of the nationalised industries' chairmen's group suggested by the Chancellor of the Exchequer in paragraphs 6 and 7 of his paper, and the procedure for dealing with the chairmen, individually and collectively, suggested in paragraph 12 of his paper.

P Le CHEMINANT

Cabinet Office
31 October 1979