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CONFIDENTIAL

PRIME MINISTER

Nationalised Industries Financing
(E(80) 121)

BACKGROUND

The purpose of the meeting will be to take provisional decisions on the total financing requirements of the nationalised industries in the Public Expenditure Survey period, and in particular on their External Financing Limits for 1981-82 which will be announced in November. It will however be for Cabinet to take the final decisions on these figures in the context of their discussions, beginning on 30th October, of the public expenditure programme as a whole.

2. It was agreed in the summer that an additional £470 million (1980 Survey prices) should be allocated in each year to the nationalised industry programme to cover the general deterioration in their prospects, and in particular the problems of the loss making industries. These sums have to be covered by offsetting savings on other public expenditure programmes.

3. In E(80) 121 the Chief Secretary reports that he has not had detailed discussions on 1982-83 and 1983-84. These will take place when 1981-82 is settled but, in the meantime, his firm assumption is that there will be no further increases for the nationalised industries beyond the £470 million allocated to them in each year.

4. His paper focuses therefore on 1981-82. The figures are summarised in Annex A which shows that the original bids made by the industries were £1,270 million in excess of a baseline inclusive of the £470 million already transferred to them. This increase is mainly attributed to the effect on their markets of the recession.

5. Following discussions with the sponsoring Departments and the industries the Treasury concluded that the increase of £1,270 million could be reduced to £500 million, (a reduction equivalent to £1 billion in cash). The savings would be found by a combination of low assumptions for pay, further cuts on capital investment and in some cases higher and earlier tariff increases. They have not all been accepted by Departments.

6. The Chief Secretary now proposes that this additional bid of £500 million should be further reduced by at least £200 million. He proposes, in his paragraph 10, that this should be achieved either:-

(i) by an across the board cut in each industry's financing requirement equivalent to 4 per cent of their investment programme; or

(ii) by selective cuts on electricity, telecommunications and rail as shown in paragraph 10(ii).

To offset the full £500 million would need cuts equivalent to 10 per cent of capital investment.

7. As the Chief Secretary explains in his paragraph 6, the industries are responsible for their own inflation assumptions, although they discuss them with Departments. Their GDP assumptions from 1979 to 1981 may still be optimistic. If this is so, and their turnover is less than they are expecting, it could more than offset any assumptions they are making which might turn out to be pessimistic - e.g. on interest rates.

8. The Committee will want to look in particular at the approach to pay assumptions discussed in paragraphs 7 and 8. With the one exception of the British Airport Authority, Departments have 'talked down' the industries to assuming 11 per cent or less for settlements in the wage round ending 31st July 1981, with a majority at 10 per cent or less (in some cases the increase in earnings will be slightly more). The Chief Secretary advises against imposing lower assumptions on the industries, since this would be tantamount to imposing a pay norm. The important point here is that in choosing not to intervene the Government would not be blessing the particular assumptions made. But the industries need to be encouraged to settle at lower levels; the tighter the EFLs the stronger should be the pressure on them to do so.

9. The risk in looking for further savings, and from setting very tight EFLs, is that the industries will end up cutting further into productive capital investment - with, among other things, effects on private sector employment - and going for higher and earlier tariff increases. This is a point which the Committee will need to bear particularly in mind in looking through the options and prospects for each industry.

HANDLING

10. After the Chief Secretary has introduced his paper you might remind the Committee that, to the extent that cuts are not made, the burden of finding off-setting savings will fall on other public expenditure programmes. These are already under acute pressure, partly because of the £470 million a year already switched to the nationalised industries. Further savings will also have to be made if room is to be found for provision for special employment measures and further industrial support which the Committee discussed last week. There is a strong case for reducing the excess to at least the £500 million proposed by the Treasury and indeed for looking for substantially more than this - at least the £200 million proposed by the Chief Secretary.

11. You might then take the industries in groups, with each sponsoring Minister commenting on those for which he is responsible, and explaining the scope for cuts and any particular points which he thinks should be highlighted on tariff increases and pay assumptions. At Annex B to E(80) 121 there are useful notes on each industry with the key figures and assumptions highlighted. At the end of the discussion the Committee will wish to form a judgment on whether savings should be found by across the board cuts or by a selective approach.

Secretary of State for Energy (and Scotland - Mr. Younger will be represented by Mr. Fletcher)

12. Subject to any further across the board cuts, it has already been agreed that the EFL for coal should be £882 million. This makes no specific provision for pay, but Mr. Howell thinks that it will be a tight limit.

13. For electricity the pay assumption is a settlement of 10 per cent. In England and Wales it is assumed that to meet the financial target (a real rate of return of 1.8 per cent on average from 1980-81 to 1982-83) there will be a 16½ per cent tariff increase in April 1981 - not 18½ per cent as in the Annex - following the increases of 17 and 10 per cent in 1980-81. In Scotland the working assumption is 15 per cent from April 1981. Any concessions to help industrial consumers - as discussed in the paper on energy pricing, E(80) 120 - and any reduction in the financial target, as I understand the Electricity Council have now suggested, would considerably add to the difficulties of making the savings.

14. In particular the Secretary of State for Energy will wish to comment on the proposal in paragraph 10(ii) of the Chief Secretary's paper that, as a contribution to the further savings of £200 million, the electricity industry should cut a further £60 million off investment and raise another £60 million by sale of 2 million tonnes of coal stocks abroad.

15. The pay assumption for gas is 10 per cent. As their contribution to bringing the total bids down to an excess of £500 million it is assumed that domestic gas prices would have to be increased by 27 per cent in April 1981 or by a two stage increase in the year. The proposed £10 million concession to industrial users taking out new firm contracts - see E(80) 120 - would have to be offset.

16. The BNOC savings would have to be found by investment cuts. Their salary bill is too small to be relevant (any increases would be subsumed in their general provision for administrative expenditure which they assume will rise by 14 per cent).

Secretary of State for Industry

17. For telecommunications an 11 per cent pay settlement is assumed and a 10 per cent tariff increase in Autumn 1981. The Secretary of State for Industry will wish to comment on the possibility of a further £60 million investment cut - paragraph 10(ii) of the Chief Secretary's paper.

18. The assumption for Posts are a 10 per cent pay settlement and a 15 per cent tariff increase in October 1981.

19. Decisions on Steel will be deferred until the end of the year when the Chairman will be putting forward his proposals.

20. Shipbuilders will have been dealt with in discussion of E(80) 112, subject to any across the board cuts applying to BS. If, as now seems highly likely, British Aerospace is not privatised in 1980-81 provision will have to be made for it, and this will add to the overall difficulties.

Secretary of State for Trade

21. A 10 per cent pay award is assumed for British Airways.

22. The British Airports Authority are assuming a 12 per cent calendar year settlement for 1981 and 15 per cent for 1982. Against the background of the current legal battle with the airlines over landing fees, the Secretary of State for Trade is likely to argue against the Treasury's assumption that fees will be increased from April 1981 by inflation plus 5 per cent in order to achieve the Authority's financial target. This is an important issue in its own right, but the £5 million cash at stake is relatively small in the context of the present discussions.

Minister of Transport

23. The main question is over British Rail, where the proposed EFL is £888 million assuming a 10.7 per cent pay settlement and a 17 per cent price increase in November 1981. In view of the current pressures on the board, and of the well-publicised criticism of the effect on the network and services of cash restrictions, the Minister is likely to argue strongly against the proposal in paragraph 10(ii) that British Rail might contribute a further cut of £25 million.

24. I doubt whether the Committee needs to discuss in any detail the smaller transport industries which are all assuming pay settlements of 10 per cent or less.

CONCLUSIONS

25. Final decisions on the EFLs, and on the provision for the nationalised industries in 1982-83 and 1983-84, will be taken by Cabinet. In the light of the discussion of the individual industries you will however wish to record the Committee's provisional conclusions on:-

(i) whether it is agreed that savings sufficient to bring down the 1981-82 excess of £500 million should be assumed;

(ii) whether this excess should be further reduced by £200 million, as proposed by the Chief Secretary, or by some other sum;

(iii) how these further savings should be achieved - equality of misery with an X per cent cut across the board or by selective cuts from named industries;

(iv) whether it should be assumed that there will be no further additional provision in 1982-83 and 1983-84 beyond the £470 million in each year already agreed.

26. If it is agreed that selective cuts should be made, I suggest that the Chief Secretary should not be asked to identify these in further bilateral discussions. He has already had extensive discussions and managed to get only so far. What seems necessary now is a specific instruction from the Committee that sponsoring Ministers should go to particular industries to find named sums and that they should report the outcome within a week. Subject to discussion, the candidates would be those Ministers and industries in paragraph 10(ii) of the paper.

27. In the meantime, and in the light of discussion, the Chief Secretary would make provisional assumptions for additional provisions for the nationalised industries in 1981-82, but not in the two later years, in putting his report to Cabinet on the public expenditure programme as a whole.

RA

(Robert Armstrong)

21st October 1980