NOTE OF A MEETING HELD AT NO.11, DOWNING STREET AT 4.30 PM ON MONDAY, 30TH MARCH, 1981

Present:

Chancellor of the Exchequer (in the chair)
Chief Secretary
Financial Secretary
Mr. Ryrie
Mr. Burgner
Mr. Monck
Mr. Ridley
Mr. Cropper

Mr. A. Walters) No.10
Mr. D. Wolfson) Downing St.
Mr. A. Duguid)
Mr. D. Young (Dept. of Industry)

NATIONALISED INDUSTRIES INVESTMENT

The meeting was held to consider the case for, and the ways of financing, additional investment in the nationalised industries; there was an immediate issue of particular importance where British Telecom (BT) had sought an increase of £200 million in available external finance.

2. The Chancellor asked the Policy Unit representatives and Mr. Young whether they accepted the analysis in the memorandum prepared by Mr. Cropper. They made the following points in response:-

(i) Substantial real resources were currently lying idle in the British economy; drawing these back into employment need not be inflationary, and would strengthen the UK's economic infrastructure.

(ii) There was a good deal of scope for additional investment by the nationalised industries, which would yield substantial real returns.

(iii) The available returns would be appreciably larger than those accruing in respect of marginal investments in the private sector. Thus even if the additional nationalised industry investment "crowded out" an equivalent amount of private sector investment, there would still be a net benefit to the economy. (The Policy Unit did not accept that there would be 100 per cent "crowding out".)

(iv) Techniques were available to finance the investment without adding to the PSBR. Possibilities were raising money through the sale and lease back of property, or through leasing the new equipment in question. The further point was made that an "operating" lease could yield a substantial efficiency benefit, in that the performance of the asset remained the responsibility of the private sector supplier rather than the nationalised industry using it. (This technique was particularly appropriate in the case of equipment used by the transport industries).

(v) Substantial funds were available for financing additional nationalised industries investment; GEC, for example, were likely to increase investment overseas if BT did not maintain the momentum of their purchases of telecommunications equipment.

3. The Chancellor and other Treasury representatives replied as follows:-

(i) Investment by nationalised industries was not subject to market tests in the same way as private sector investment; in a number of cases adequate returns could be secured by exploiting a monopoly position without any progress being made towards greater efficiency, and in all cases the Government in effect guaranteed the industries' borrowing from whatever source. Thus it was not possible to make exact comparisons between the returns on alternative investments in the public and private sectors.

(ii) If there were to be any question of drawing private sector finance into certain nationalised industry investments, this should be associated with arrangements whereby the returns to the private investors depended on the performance of the investments and the investors shared in their management. The Treasury were exploring various aspects of this partial privatisation approach in those industries where total privatisation was not feasible.

(iii) It was possible that financing nationalised industry investments other than through NLF lending could contribute to greater efficiency, and - for a given investment programme - might have a somewhat smaller direct expansionary impact on £M3. On the other hand, additional investment, however financed - and whichever side of an arbitrarily defined PSBR it fell - would represent an additional demand for credit in the economy which, given the Government's monetary target, could only be financed either at the cost of an increase in interest rates or a reduction in other public expenditure or an increase in taxes. There was a sense in which the Policy Unit's advocacy of a higher level of investment in the nationalised industries implied a net increase in demand in the economy and a relaxation of the monetary target.

(iv) The Government had deliberately decided to give priority to activity in the private sector, and had therefore reduced interest rates even at the cost of higher taxation. It was inevitable that the private sector would not be able instantly to take up the room in the economy created by the additional taxation -

but this was a temporary cost of adjustment which could not be avoided if the private sector were to be revitalised as the Government wished.

(v) Much nationalised industry investment was not particularly profitable, and the Treasury would be working to try to achieve a better ordering of priorities within the total programme. Control of each industry's external financing was the only weapon available to the Government with which to apply pressure for greater efficiency. If additional investment were to be agreed in BT, it was strongly desirable that this should be financed, at least in part, through cost reductions. The Post Office had been substantially shielded from pressure for cost reductions, and the need now for additional external finance mainly arose because of BT's failure to meet their financial target. (It was noted that a 5 per cent reduction in BT's pay bill would produce most of the £200 million for which BT had originally asked - but BT might now raise their bid to £300 million.)

4. The Chancellor, summing up the discussion, said that he appreciated the strength of the case for additional investment in the nationalised industries, and in particular in BT, and that he recognised the need for an early decision on the latter. But he did not see diversification of the sources of finance, not associated with other action to subject parts of nationalised industry operations to market disciplines, as removing the need for controls over nationalised industries' investment and external financing; these controls were needed both as a means of applying pressure on the industries to become more efficient, and in order to contain the aggregate burden of the public sector on the rest of the economy, given the monetary target. If investment reductions by BT were to be avoided, the appropriate course in present circumstances

appeared to be an increase in the external financing limit, which would be a charge on the contingency reserve; the amount of the increase should, however, be less than the total financing required, with the remainder to be secured through efficiency savings. The extra financing should be conditional on BT's explicit acceptance of the need to achieve these savings. Following the meeting the Chancellor asked that the Policy Unit should let him have a note of any further points they wished to make by 2.30 p.m. on 1 April.

JW

A.J. WIGGINS

31 March 1981

Circulation:

Those present
Mr. Middleton
Mrs. Case
Mr. Norton