Ref. A05352

PRIME MINISTER

Nationalised Industries: 1981 Investment and Financing Review
(E(81) 79 and 81)

BACKGROUND

The Chief Secretary's memorandum (E(81) 79) covers a detailed report by officials on the nationalised industries' investment and financing requirements and gives his recommendations on the steps necessary to deal with the additional bids which have emerged. The CPRS, in E(81) 81, give their suggestions on how to allocate the cuts and on the best tactics for ensuring that they are made.

2. The total additional bids over the provision in the Public Expenditure White Paper (Cmnd 8175) are:

£ billion cash

1982-83	1983-84	1984-85
2.5	3.2	3.0

The £2.5 billion for 1982-83 is part of the total of additional public expenditure bids of £6.5 billion which the Chancellor of the Exchequer has reported to the Cabinet. In practice the industries' additional bids could turn out to be higher on account of the optimistic economic assumptions made by some of them and when the fully-fledged proposals for the British Steel Corporation (BSC), the National Coal Board (NCB), British Rail (BR) and British Shipbuilders (BS) are available. Against this background the Chief Secretary is prepared to accept increases of £750 million in each year in the totals for the nationalised industries so that the net additional bids would then be:

£ billion cash

1982-83	1983-84	1984-85
1.75	2.45	2.25

3. The additional bids are made up partly of bids for additional investment but they are mainly on account of shortfall in internal resources due to a more pessimistic view of market prospects, and hence lower revenue forecasts, by most of the industries. The additional bids for each industry are tabulated in the

External Finance columns of Appendix A Table 1 immediately after the introductory text of the report by officials. Appendix B of their report sets out the details for each industry and shows for most of them (in line 9 of the tables) their assumptions for the increase in their pay bill which is generally related to their own general inflation assumptions.

4. The Chief Secretary points out that it is necessary for sponsoring Ministers to act now in seeking reductions in these additional bids in order to influence in good time the work which the industries will be doing preparatory to firm decisions in the autumn on their External Financing Limits for 1982-83. He puts forward three possible ways of securing the necessary cuts:-

I. To restrict each industry to 85 per cent of the investment level in Cmnd 8175 on the understanding that higher levels of investment would be approved to the extent that they were financed from additional internal resources (the effect for each industry is shown in Table (i) attached to his cover note).

II. To cut the current costs of each industry by 5 per cent in 1982-83 and by 7 and 5½ per cent in the two following years falling back on investment cuts only in the last resort (details in the Chief Secretary's Table (ii)).

III. To cut current costs of most of the industries by 6 per cent in 1982-83 and by 8 and 6 per cent in the two following years but to cut by less the costs of those industries subject to market competition (Table (iii)).

Each Minister would be free to alter the balance of overall savings between the industries for which he was responsible. If the Committee could not agree to either II or III, the Chief Secretary would want to fall back on I.

5. Option I would be the most certain in its effect but, as the CPRS point out in E(81) 81, it seems highly objectionable at a time when Ministers are trying to encourage a higher proportion of capital rather than current public expenditure and when they are looking for employment generating capital investment. Cuts based on reductions in current costs are more attractive in principle and, if possible, it would be better to operate selectively with some regard to priorities rather than

evenly across the board, that is to go for Option III rather than II. The CPRS agree with this and they propose that the aim for each industry should be to find its allocated cuts from a mix of working capital, current costs and fixed investment in that order so as to leave investment as near intact as possible. They go on to make the tactical suggestion that final investment approval (15 per cent in the case of 1982-83) should be withheld from each industry until it produces a detailed plan for delivering the required overall savings.

HANDLING

6. After the Chief Secretary and Mr. Ibbs have introduced their papers you might invite each of the sponsoring Ministers to comment on the proposals - the Secretaries of State for Energy, Trade, Transport and Scotland and the Minister of State, Department of Industry (Mr. Tebbit). The Secretary of State for Employment will probably want to comment on employment implications.

7. In discussion you will wish to give as firm a lead as possible towards a determined effort to find substantial savings; this is essential if there is to be any chance of getting the overall public expenditure overspend down to more manageable levels. At the same time you will wish to look for an outcome which is both practicable and acceptable and to that end you will in general want to steer the sponsoring Ministers to looking for reductions which:-

(i) Avoid capital investment cuts as far as possible (indeed some more employment generating investment would be welcome).

(ii) Avoid letting the monopoly industries buy themselves out of trouble by excessive price increases.

(iii) Take account of industrial realities in industries such as the NCB.

(iv) Focus, as the CPRS suggest, on current costs including wages.

While there is obviously no point in writing down the industries' wage assumptions to unrealistic levels, and the details are for discussion in September, it does seem that some current cost savings could be made from lower wage assumptions. (British Telecommunications are, for example, assuming increases in their pay bill of 14 per cent in 1982-83 and 13 and 11 per cent in the two following years.)

In the light of the discussion the Committee will no doubt form a view on whether it is realistic to meet these 4 criteria and to get the required cuts. In looking at the three options, and as each sponsor Minister gives his views, there will inevitably be some discussion of individual industries but I do not think that you need at this stage to get into details on each and every industry.

8. It may well be that the discussion will point to adopting the Chief Secretary's Option III (selective cuts on current costs) as glossed by the CPRS. Unless a convincing case were made to the contrary this seems the option worth trying on the industries. Obviously it will be difficult and overwhelming practical objections may emerge, but these can be considered later and in the light of the further discussions between sponsoring Departments and their clients.

9. You have a separate meeting on 4th August to discuss the CPRS's longer term report on Government/Nationalised Industry relations.

CONCLUSIONS

10. In the light of the discussion you will wish to record conclusions:

(i) agreeing that an additional £750 million should be made available to the nationalised industries so reducing their additional bids;

(ii) deciding on how to deal with the remaining bids, probably deciding on Option III subject to the points made by the CPRS and perhaps with the reservation that it should be made clear to the monopoly utilities that they cannot propose excessive price increases;

(iii) inviting the sponsoring Ministers to inform their industries of these provisional decisions so that they can take account of them in their proposals in mid-September for their 1982-83 EFLs.

RTA

Robert Armstrong

30th July, 1981