Nat Ind Coal Pt 7.

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MR. MOUNT

c. Mr. Walters
Mr. Scholar

NCB's EFL for 1983/84

You and Alan will wish to see the attached letter from Mr. Lawson to the Chief Secretary, proposing an increase in the NCB's External Financing Limit from the provisional figure set last year of £960 m. to £1209 m., (The terminology in the letter is puzzling at first sight: the EFR is the External Financing Requirement, which is the estimate before the limit is set; the IFR is the Investment and Financing Review, a large document which reviews annually the prospects for nationalised industry financing; the situation is made worse by Mr. Lawson using IFR instead of EFR in the third paragraph.)

In the Prime Minister's absence, we shall have to leave it to the Chief Secretary to have the first go at this proposal, in his bilateral meeting tomorrow. But the Prime Minister will certainly take a close interest in the outcome when she returns. I have discussed the position with the Treasury. They do not see much room for reducing the EFL below the £1200 m. figure, save to the extent that Mr. Lawson can persuade the NCB to accept a lower figure for capital investment. There might be £20-30 m. slack there; otherwise the only scope for substantial savings would arise from an accelerated programme of pit closures. Indeed, some of the assumptions in even the £1200 m. figure are probably optimistic, e.g. over the present rate of closures and on productivity.

Mr. Scholar may wish to note that we will probably have something to say about this, and its relation to the breakdown of today's pay negotiations, but not - unless he advises to the contrary - for the Delhi box.

J.M.M. VEREKER

23 September 1982

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c/c JV

Prime Minister ②

MCS 21/9

01 211 6402

The Rt Hon Leon Britton QC MP
Chief Secretary to the Treasury
HM Treasury
Parliament Street
London
SW1

21 September 1982

MS

Dear Chief Secretary,

NCB'S EFL FOR 1983-84

I am writing about the NCB's EFL 1983-84, which I hope we can discuss at our bilateral on 24 September.

In the past few days the Board have sent my Department new and even more gloomy forecasts of sales and revenues. These have been copied to your officials.

As a result of the continuing recession in Britain and a substantial weakening of export markets, the Board now expect:-

a. to sell 108.5m tonnes in the UK in 1983-84 compared to 113mt in the current year. 2mt of the latter figure represented delayed sales to the CEGB as a result of the earlier ASLEF strikes. In a number of their markets, notably the industrial and coke oven markets, the expected price increase in November will be well below the rate of inflation;

b. to export some 8mt compared with 8.7mt in the current year - exports were originally forecast to amount to 11mt in 1983-84. The price per tonne achieved by exports in 1983-84 is forecast to be some £3/t lower than in the current year. The price could weaken further.

I believe that we can reduce the Board's proposed IFR of £1438m substantially even after taking account of the latest reduction of £90m in their forecast revenues. My proposals are in Annex A. They are based on a level of inflation of around 7½% this October and 6½% next autumn, affecting both the Board's prices and their pay settlements. (I have assumed settlements of 8% on basic rates and 6½% on earnings in November 1982 and 6½% on rates in November 1983.) I also assume that there will not be a strike this autumn.

I have carefully considered what assumptions to make about NCB's revenues. Their EFR bid of £1438m was clearly over-optimistic on both the volume of sales and prices. On this basis, I had it in mind to propose an EFR of below £1200m, involving savings of £345m, which however would have been offset by an allowance of £100m on account of reduced revenues. The latest deterioration of £90m reported by the Board changes the position. I had discounted £25m of this in the proposed EFR of £1200m. As for the remaining £65m of the £90m, I would propose that we should look for savings of a further £45m, mostly in the Board's capital investment programme. The overall result is total savings of £389m, against which £160m should be offset for lower revenues, producing net savings of £229m. The EFL would be £1209m; the capital expenditure approval £900m.

I have, of course told the Board that we should like them to aim to produce net savings of £478m, to bring their EFR in line with the IFR figure of £960m. Norman Siddall and his colleagues have made it clear that this figure is quite unrealistic. This is hardly surprising, as with Treasury agreement the very provisional nature of this figure was noted in E(82)55 this July and in previous papers. Consequently, while we must get the EFL as low as possible, we must accept that £960m never was a realistic target and certainly is not realistic in present circumstances.

E(82)55 also referred to the NCB's new Corporate Plan. Until we receive that plan at the end of October there are no better provisional figures for 1984-85 and 1985-86 than the PES baselines included in E(82)55.

The Public Expenditure Survey Report included an additional bid of £17m for the Redundant Mineworkers' Payments Scheme and social grants (of this, £15m was for the RMPS). The Report warned that the figure was subject to considerable uncertainty and that the assumption about redundancies would need to be considered later in the year. The latest information on and forecast of redundancies have increased the additional bids to £37m for 1983-84 of which £29m is for the RMPS. This addition is due to the NCB's success in reducing manpower in the industry by more than they anticipated last year. Last year's figures were based on 7000 redundancies in 1981-82, 6,500 in 1982-83, and 5500 in 1983-84. In fact the Board made over 10,000 people redundant in grades eligible for RMPS in 1981-82, and estimates for 1982-83 and 1983-84 are 8000 in each year. However, about £10m should be offset by additional receipts from the ECSC in partial reimbursement of RMPS expenditure. As the separate note on Offsetting Savings explains, although payments under the RMPS do not form part of the NCB's external finance, nevertheless they are as much support of the coal industry as are social grants, and must be seen in this context.

I am sending copies of this letter to the Prime Minister, Norman Tebbit, Sir Robert Armstrong and John Sparrow.

Yrs sincerely

J.P. Clark

pp NIGEL LAWSON

(Approved by the Secretary of State and signed in his absence.)

Annex A

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(to letter to Chief Secretary)

Background

1. Key figures are:

| | 1983-84 | £m Cash 1984-85 | 1985-86 |
|---|---|---|---|
| i. External Financing Limit | | | |
| Public Expenditure baseline | 960 | 949 | 987 |
| Original NCB bid | 1391 | 1306 | 1244 |
| Current NCB bid | 1438 | 1263 | 1179 |
| ii. Capital investment | | | |
| Public Expenditure baseline | 939 | 986 | - |
| Original NCB bid | 1122 | 1258 | 1368 |
| Current NCB bid | 1090 | 1225 | 1339 |

2. Notes

i. PE Baseline. These were provisional figures adopted for planning purposes by E Committee last Autumn. They were derived by adjusting NCB's July 1981 Development Plan costs for assumed lower inflation, but without compensatory adjustments and revisions.

ii. Original NCB bid. These are figures from the NCB's July 1981 Development Plan re-valued. These were the best figures available to NCB in May as an input to the IFR.

iii. Current NCB bid. These are figures prepared by NCB in July and incorporating their best estimate at the time.

3. Difference between NCB's original bid and current bid

NCB's July 1981 original bid figures were based on an unrealistic view of market prospects. The revised bid takes account of lower forecast disposals (6.5mt lower in 1983/84) and coal prices depressed in real terms, offset by cost savings which result, in particular, from continuing manpower rundown, a further moderate wage settlement, and a higher rate of output reduction than envisaged in the development plan.

4 Possible Adjustments in 1983-84 bid

Possible adjustments fall into two categories:-

a savings which result from changed assumptions since NCB prepared their current bid. We have assumed inflation at 7½% in 1982-83 and 6½% in 1983-84, compared with the 9% assumed by the Board in each case. Lower inflation assumptions affect expenditure on wages and related costs, on other operating costs, on capital expenditure and on interest costs, but also reduce NCB's internal resources;

b savings which result from "real" savings requiring action on the Board's part. These are: higher rate of manpower rundown, reduced capital expenditure, and unallocated savings requiring further reductions in other operating costs and savings in working capital.

5 Lower sales, and lower inflation assumptions since NCB's current bid was prepared, affect NCB's coal prices and cash receipts. An offsetting adjustment of £160m is needed to reflect worsened prospects since their current bid was prepared, including the latest deterioration of £90m of which they have told us in the last few days.

6 The following table shows the effect of these adjustments. The end result would be an EFL of £1209m and a capital investment allocation of £900m. The Deficit Grant Limit would be £470m.

ANNEX TO LETTER TO CHIEF SECRETARY

EFL

| | | £m |
|---|---|---|
| NCB Bid | 1438 | |
| Of which capital expenditure | | 1090 |
| Proposed Adjustments | | |
| - A. Revised assumptions | | |
| - Wages ($6\frac{1}{2}$% on earnings in November 1982: 5% on earnings November 1983) | 56 | |
| - Lower inflation on other operating costs | 48 | |
| - Lower interest | 25 | |
| - Lower inflation on capital expenditure | | 20 |
| Total effect of revised assumptions | 149 | |
| - B. Policy changes | | |
| - Lower capital expenditure | | 170 |
| - Faster manpower reduction | 20 | |
| - Unallocated savings | 50 | |
| Total policy changes | 240 | |
| Total savings | 389 | |
| Offset by lower revenues | (160) | |
| Proposed EFL | 1209 | |
| Of which capital expenditure | | 900 |