



DEPARTMENT OF TRANSPORT
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01-212 3434

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The Rt Hon Sir Geoffrey Howe, QC, MP
Chancellor of the Exchequer
HM Treasury
Treasury Chambers
Parliament Street
LONDON SW1P 3AG

7 September 1982

Dea Seamus

END-YEAR FLEXIBILITY FOR NATIONALISED INDUSTRIES

I have just seen the July correspondence between Nigel Lawson, Patrick Jenkin, John Sparrow and yourself about end-year flexibility for capital spending by nationalised industries.

I need hardly say that I am in favour of any steps we can take to ease artificial restrictions on worthwhile investment. I would myself attach the highest priority to helping central Government programmes in this way. It is in that area that the criticism from Members of Parliament and interests such as the construction industry has been strongest, and the loss of productive work caused by rigid annual cash limits is hardest to defend.

I can also see a case for allowing nationalised industries rather more flexibility for capital spending within the EFL system if suitable means can be devised. But Nigel Lawson's formula might I think be open to manipulation by the industries. It could also lead to difficulty where, as can sometimes happen, the provision taken into account in settling the EFL differs from the industry's investment ceiling.

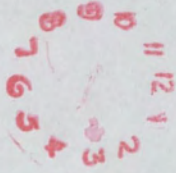
It might be helpful if officials could do some work on the technicalities, therefore, before we return to the subject in the autumn.

Copies of this letter go to those who received Nigel Lawson's letter of 13 July.

Lawson
David

DAVID HOWELL

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EC J.V.
Nat. Ind.

01 211 6402

The Rt Hon Sir Geoffrey Howe QC MP
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

26th August 1982

Ben Goff

END YEAR FLEXIBILITY FOR NATIONALISED INDUSTRIES

Thank you for your letter of 28 July. I have also seen John Sparrow's of 22 July and Patrick Jenkin's of 23 July.

I must confess I am not convinced by the arguments you put forward, at least on the question of capital underspending. Rather than continue the discussion now, I agree that we should return to this and related questions in the autumn.

I am copying this letter to the Prime Minister, other members of E Committee, George Younger and Sir Robert Armstrong.

*Yours ever
Nigel Lawson*

NIGEL LAWSON



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26 AUG 1982



Prime Minister (2)

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Treasury Chambers, Parliament Street, SW1P 3AG extra spending
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The Rt Hon Nigel Lawson MP
The Secretary of State for Energy

28 July 1982 M/S 30/7

In Nigel

END-YEAR FLEXIBILITY FOR NATIONALISED INDUSTRIES

Thank you for your letter of 13 July putting forward ideas for increasing end-year flexibility for the nationalised industries, in particular in respect of their capital spending. John Sparrow in his letter of 22 July has written in support of the latter.

As you know, discussions of the note by officials circulated under C(82)29 have been postponed until the autumn. In view of the close relationship between this paper and the various ideas put forward in your letter it would seem sensible to hold over substantive discussion of your proposal also. However I have to say that I see quite considerable disadvantages in even your more limited proposals concerning capital expenditure. The main objection is that the reasons for shortfall in capital expenditure may not be ones which would justify a carry-over. They may result not from the slowing down of project expenditure but for some other reasons, such as inflation slower than forecast or revised market prospects, for which lower capital expenditure may be the proper commercial response. It would seem wrong to allow any underspending in such circumstances to lead to an additional allocation in the next financial year. I would also expect a scheme such as yours to lead to a marked increase in detailed monitoring of capital and other spending by the industries. In addition to this there is the familiar problem that any scheme of flexibility will lead to increased expenditure overall.

These objections apply a fortiori to the wider scheme encompassing current costs. Indeed it would seem to me illogical to reward economy on current costs by a bonus in

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the following year which might well erode the impulse to greater efficiency.

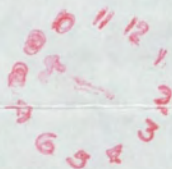
However I am quite willing to look at these ideas again when we return to the subject more generally in the autumn.

I am copying this letter to the recipients of yours.

GEOFFREY HOWE

A handwritten signature, likely of Geoffrey Howe, and a scribble consisting of several horizontal lines.

29 JUL 1982



Prime Minister (2)

GEJV

Not find Policy

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DEPARTMENT OF INDUSTRY
 ASHDOWN HOUSE
 123 VICTORIA STREET
 LONDON SW1E 6RB
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 SWITCHBOARD 01-212 7676

2 RB



Secretary of State for Industry

23 July 1982

The Rt Hon Sir Geoffrey Howe QC MP
 Chancellor of the Exchequer
 HM Treasury
 Parliament Street
 London SW1

ms

Dear Geoffrey,

END YEAR FLEXIBILITY FOR NATIONALISED INDUSTRIES

I am writing to comment on Nigel Lawson's letter to you of 13 July.

2 I support the idea that there should be a complementary range of flexibility in relation to capital expenditure when an industry does not use the whole of its EFL in any particular year, and I would support a figure of 5%.

3 In the existing area of flexibility we already recognise that phasing of capital expenditure cannot be judged so nicely as to comply exactly with a pre-set EFL, and it would seem logical to apply the same principle when there is an underspend.

4 I am less convinced about the idea of using this mechanism to "reward" industries which have made current cost savings. I feel the motivational effect would be slight and that our attitude should be that current cost savings are essential and that management should not receive special rewards for making them.

5 I am copying this letter to the Prime Minister, other members of E Committee, George Younger and Sir Robert Armstrong.

Your ever
 Patrice

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CABINET OFFICE
Central Policy Review Staff

70 Whitehall, London SW1A 2AS Telephone 01-233 7765

Qa 05992

From: John Sparrow
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22 July 1982

The Rt Hon Sir Geoffrey Howe QC MP
HM Treasury
S W 1

Dear Geoffrey,

End Year Flexibility for Nationalised Industries

I have seen Nigel Lawson's letter to you of 13 July and support the proposal to introduce more flexibility where there has been an underspend of capital expenditure cash allocation in any one year. At present when such an underspend is in prospect, nationalised industries are tempted to utilise the full extent of their EFL by inefficient devices such as early payment of suppliers' invoices for current operating costs. If an industry is allocated funds for approved capital expenditure, it is not in anyone's interests to remove the allocation if it is not possible, for whatever reason, to pay for that expenditure in the year in question.

I concur with the suggestion that industries should be permitted to carry forward to the following year some portion, say 5 per cent, of their EFL allocation for capital expenditure. This amount would be added to the following year's EFL; it should be clear that there will be a deduction of the same amount from the current year's EFL.

Nigel Lawson also raises the question of undershoot arising from savings in current costs. Here I believe that the net effect of carry forward would be disincentive, and I do not therefore support that part of his letter.

I am sending a copy of this letter to the Prime Minister, other members of E Committee, the Secretary of State for Scotland, and to Sir Robert Armstrong.

Yours sincerely,
John Sparrow

John Sparrow

cc JV
Prime Minister (2)

Mus 23/7

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Prime Minister (2)

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The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON SW1

13th July 1982

Handwritten signature of Sir Geoffrey Howe

END YEAR FLEXIBILITY FOR NATIONALISED INDUSTRIES

Amongst the changes in the system of financial control of the nationalised industries which you announced in August 1980 was the arrangement under which industries could exceed the current year's EFL within a maximum of 1% of forecast turnover and fixed investment expenditure on condition that the amount of the excess was deducted from the following year's EFL.

Leon Brittan has now circulated a note by officials (under C(82)29) on end-year flexibility for public expenditure programmes, with details of a possible scheme for carrying forward to the following year underspends on capital expenditure.

The reasons for considering this again sympathetically (for example the difficulty of accommodating project expenditure to precise cash limits) are equally valid for expenditure of the same kind by the nationalised industries. I would like to propose that an industry should be allowed to carry forward to the following year an underspend on its capital expenditure allocation to the extent that such underspending is reflected in an EFL undershoot and subject to some suitable maximum, say 5% of the allocation. There would need to be a corresponding increase in the following year's EFL.

While this would not wholly meet the remaining concern of the industries about the incompatibility of rigid EFLs with commercial operations, it would be a useful move which would enable them to plan and manage their capital spending on a more efficient basis.

It is also at least worth considering whether the nationalised industries might not be allowed to carry forward some proportion of any EFL undershoot resulting from savings in current costs, as an additional incentive to them to make such savings.

I am copying this letter to the Prime Minister, other members of E Committee, George Younger and Sir Robert Armstrong.

Handwritten signatures and initials



PHILADELPHIA
PA 19104

3 JUL 1982