CONFIDENTIAL

P.01068

PRIME MINISTER

Nationalised Industries' 1983 Investment and Financing Review

(E(A)(83)4)

BACKGROUND

This memorandum by the Chief Secretary, Treasury, with the accompanying note by officials, is the first stage in consideration by Ministers collectively of the investment programmes and financing requirements of the nationalised industries in the context of the public expenditure survey. Its coverage is much the same as last year, except that, for the first time, expenditure on the Redundant Mineworkers' Pensions Scheme (about £60 million a year) is included, and credit is taken for dividends from British Telecom (BT), on the assumption that the Corporation will be privatised in the autumn of 1984.

2. The salient figures in the review are set out in the Annex to this brief. For ease of comparison with the baseline figures they ignore the changes of coverage mentioned above, unless otherwise stated. E(A)(83)4 does not refer to the reduction in the EFLs of the nationalised industries in 1983-84 announced on 7 July, with other savings, by the Chancellor of the Exchequer. However, the total reduction is only about £57 million. This is de minimis against the industries' turnover and investment programmes.

3. Leaving aside possible receipts of BT dividends, industries are bidding for additional external finance of nearly £700 million in 1984-85 and over £350 million in 1985-86. These bids are due entirely to forecast reductions in internal resources or increased capital requirements other than expenditure on fixed assets (ie either stocks and work in progress or financing items). In both years, forecast expenditure on fixed assets is marginally below baseline. The decline in forecast internal resources is shared by a large number of industries; but the bulk is due to the following four.

	Change in internal resources	
		£ million
	1984-85	1985-86
National Coal Board	- 515	- 307
British Steel Corporation	- 196	- 168
British Telecom	- 190	- 194
British Shipbuilders	- 91	- 76

4. In 1986-87 (for which the baseline is simply an arithmetical construct produced by increasing the 1985-86 figures by 3 per cent), the industries are bidding in aggregate for some £700 million less external finance than the baseline; this is largely due to forecast internal resources being better than the baseline: the main contributors are electricity (nearly £400 million), gas (over £300 million) and airways (nearly £100 million).

5. The figures for individual industries are of varying quality; and relatively few appear to have been discussed in depth with the industries. The Chief Secretary argues that although there are some encouraging trends - in particular, the trend of external financing requirements (EFRs) is downwards - the overall position is not acceptable, and that the bids for additional finance should be rejected. Indeed, he suggests that, particularly in view of likely difficulties on public expenditure more generally, Ministers should go further and require reductions below the baseline of at least £500 million in 1984-85 and £900 million in 1985-86; and that reductions of £1 billion beyond what the industries are offering should be secured in 1986-87. These proposals, if successful, would produce the following total EFRs.

	EFRs: Chief Secretary's proposals		
			£ million
	1984-85	1985-86	1986-87
Baseline	2563	2092	2155
Proposal	2063	1192	447
(Industries' bids)	3254	2455	1447

As already noted, the figures ignore possible BT dividends.

6. In order to achieve these reductions the Chief Secretary suggests that industries should be pressed to make reductions in current costs; to economise on working capital; to sell fixed assets; and to avoid over-pessimistic economic assumptions. Investment bids should be scrutinised to ensure that they are realistic and based on profitable projects.

7. If these general proposals are approved, officials would hold discussions with the industries and report back with firm proposals for Ministers to consider in the autumn.

MAIN ISSUES

8. It is unlikely that the Sub-Committee will dissent from the proposition that a significant reduction in the total of bids from the industries is necessary: as the Chief Secretary observes, many of the figures should probably be regarded as opening bids in a negotiation with the Government. The main issues are:

i. Is the scale of reduction proposed by the Chief Secretary broadly acceptable?

ii. What should be the general guidelines for discussions with the industries, particularly on earnings assumptions?

Scale of reduction

9. The Chief Secretary's proposal - a reduction of £1 billion a year in the industries' bids for each of the 3 years - is ambitious. There is a balance to be struck. On the one hand, you will probably wish to give the Chief Secretary as much backing as possible in his discussions with sponsoring Ministers. It is also desirable to set demanding EFLs so as to maximise the pressure for economy. On the other hand, it stores up trouble if public expenditure plans are laid on an unrealistic basis. Nationalised industry EFLs are a less effective means of control than departmental cash limits; and if the new baseline eventually agreed is too optimistic it will not hold. The outturn is always difficult to forecast. EFLs were undershot in 1982-83 and the Chief Secretary expects a further undershoot in the current year. There was however an overshoot in 1981-82.

10. It may be that the right course will be to accept the Chief Secretary's proposals as a basis for opening the discussions but to bear in mind, in other parts of the Public Expenditure Survey, that the proposed savings may not be delivered in full.

Guidelines for the discussions

11. The Sub-Committee will probably agree that the guidelines for the discussions should be as proposed in paragraphs 7 and 8 of the Chief Secretary's paper, ie pressure for reductions in current costs and in working capital, and for sales of fixed assets wherever practicable; close scrutiny of the economic assumptions; and insistence on investment programmes which not only earn an adequate return but can also be realistically achieved within the timescale.

12. The Sub-Committee will however wish to consider carefully what should be said to the industries about their assumptions for earnings increases. (Table H on page 18 of the report by officials). Their forecasts for nominal earnings are, as the table shows, broadly in line with outside forecasts for the economy as a whole. Their forecasts for real earnings are actually more tough than outside forecasts. On average they are forecasting no real increase and some industries (coal, gas, steel, Post Office, and shipbuilders) are assuming real reductions. The Government will wish to encourage the industries to adopt a stringent approach to pay increases and the EFL discussions provide one of the ways of getting this message across. It will therefore be right to press the industries to adopt suitably demanding targets for earnings increases. On the other hand, the Government will need to keep in mind, in the context of the Public Expenditure Survey as a whole, that the public trading sector has a poor record in containing pay and that EFLs which rest on assumptions that the industries will do markedly better in the future may well be overshot.

Points on particular industries

13. You will not wish to go into much detail on individual industries. British Shipbuilders is to be discussed later the same day by E(NI); it is hoped that there will be discussions before the recess of gas and coal; and there is an official group (MISC 94) studying future railway policy. Thus several of the 'problem' industries are already under collective scrutiny.

HANDLING

14. You will wish to ask the Chief Secretary, Treasury to introduce his memorandum. You might then invite the Ministers with sponsoring responsibilities - Secretaries of State for Energy, Scotland, the Environment, Trade and Industry, and Transport - to comment, both generally and from the standpoint of the industries for which they are responsible. The Chancellor of the Exchequer may wish to comment on the economic assumptions, as well as more generally; the Secretary of State for Employment may, in particular, wish to comment on the pay assumptions.

CONCLUSIONS

15. You will wish the Sub-Committee to reach conclusions on the following:

i. whether the target for aggregate reductions below the baseline should be as proposed by the Chief Secretary, ie £500 million in 1984-85, £900 million in 1985-86, and £2 billion in 1986-87;

ii. whether the guidelines for the discussions with the industries should be on the lines proposed in paragraphs 7 and 8 of the Chief Secretary's paper;

iii. whether officials should pursue discussions with the industries on the basis of i. and ii. above and should report back with firm proposals for Ministers to consider in the autumn.

PLG

P L GREGSON

13 July 1983

ANNEX

Nationalised industries' capital requirements 1983-84 to 1986-87

£ million

	1983-84		1984-85			1985-86			1986-87		
	Forecast outturn		Baseline	Bid	Total	Baseline	Bid	Total	Baseline	Bid	Total
Capital requirements											
Fixed assets	7427		8166	- 7	8159	8406	- 30	8376	8660	+ 61	8722
Other	63		218	-177	41	76	+ 80	156	78	+ 41	149
TOTAL	7490		8384	-184	8200	8482	+ 50	8532	8738	+ 102	8840
Internal resources	-4404		-5820	+875	-4945	-6389	+314	-6076	-6583	- 810	-7392
External financing requirement	3086*		2563	+691	3254	2092	+ 363	2455	2155	- 708	1447
BT dividends				-180	3074		-260	2195		- 320	1127

* Before 7 July reductions

Notes

(a) + increases EFR, - reduces EFR

(b) Items may not sum to total because of rounding