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MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

NATIONALISED INDUSTRIES
1981 INVESTMENT AND FINANCING REVIEW

Note by the Central Policy Review Staff

1. In E(81)79 the Chief Secretary proposes a reduction of £1 $\frac{3}{4}$ bn. in nationalised industries present plans for 1982/83. There are two problems - how to allocate this cut among the industries, and how to ensure that the industries actually make the cuts allocated to them.

2. The CPRS believes that cuts should be determined on a selective basis, i.e. essentially as suggested in the Chief Secretary's option (iii), but with some changes in the individual figures to take account of points such as those raised below under 'Allocation'. However, to ensure delivery of the cuts we believe that the first approach to an industry should be on the basis that the balance of investment will not be approved until other savings of the amount required have been reliably identified.

A. Allocation

3. The CPRS suggests that in deciding how to share out the cuts, Ministers will want to bear in mind the following considerations:

(a) Investment. In general, planned investment is commercially attractive and offers reasonable rates of return. There is strong pressure to maintain and step up the industries' investment programmes. To cut in proportion to planned investment - option (i) - would penalise the growth industries, notably BT (40 per cent of the total in 1982/83).

(b) Competitive Industries. Some of the industries facing the toughest international competition (e.g. BSC) are already strongly cutting back their current costs, so arguably may have less scope for further economies as envisaged in option (ii).

(c) Union power. Option (iii), concentrating the heaviest cuts on the current costs of non-competing industries such as NCB, may run up against the strength of the NUM in resisting pit closures.

4. We think Ministers would broadly agree that each industry should be expected to find its allocated cuts from some mix of working capital, current costs and fixed investment, roughly in that order of priority - that is, leaving investment as near intact as possible. In particular we believe that emphasis on reducing working capital has not hitherto been as great as it should be. Ideally, as E(81)79 says, in allocating the investment cuts Ministers would select the lowest-priority items from each industry; in allocating cuts in current costs achievability needs to be taken into account. In practice there is not enough time, or central expertise, to carry this through in detail. Our report on Government/nationalised industry relations will make proposals which should provide some help in future years.

5. Therefore Ministers will have to make some allocation of cuts on the basis, we suggest, of the Treasury's option (iii), but with some modification of individual figures to take rough account of priorities and what is achievable. We agree that after the allocation each sponsor Minister should still be free to alter the distribution of cuts among his industries; and each industry would of course have to make its own judgement of priorities in achieving its required total savings.

B. Ensuring delivery of Cuts

6. There is only one way to ensure that the industries stay within the limit. This is to hold back investment approval (the remaining 15 per cent tranche for 1982-83) for each industry until it produces a detailed plan for delivering the required overall savings. Assessment of how realistic these plans are will require a degree of business judgement in sponsor Departments - an aspect again referred to in our report on nationalised industries.

7. The initial threat to investment will result in an outcry about lost profitable opportunities, destroying private-sector jobs and so on. But if the Government is to obtain the cuts, the outcry must be firmly withstood so that investment is only re-instated when there is good evidence that corresponding current cost savings can be achieved. This is what

a private-sector company would do if it had to take action to stay within its overdraft limit.

Cabinet Office

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