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E(81) 26th Meeting

COPY NO

58

CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

MINUTES of a Meeting held at
10 Downing Street on
FRIDAY 31 JULY 1981 at 9.30 am

PRESENT

The Rt Hon Margaret Thatcher MP
Prime Minister

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer

The Rt Hon Lord Soames
Lord President of the Council

The Rt Hon James Prior MP
Secretary of State for Employment

The Rt Hon John Nott MP
Secretary of State for Defence

The Rt Hon Peter Walker MP
Minister of Agriculture, Fisheries
and Food

The Rt Hon John Biffen MP
Secretary of State for Trade

The Rt Hon David Howell MP
Secretary of State for Energy

The Rt Hon Leon Brittan QC MP
Chief Secretary, Treasury

THE FOLLOWING WERE ALSO PRESENT

The Rt Hon Francis Pym MP
Chancellor of the Duchy of Lancaster
and Paymaster General

The Rt Hon George Younger MP
Secretary of State for Scotland

The Rt Hon Nicholas Edwards MP
Secretary of State for Wales

The Rt Hon Mark Carlisle QC MP
Secretary of State for Education
and Science
(Item 2)

The Rt Hon Norman Fowler MP
Secretary of State for Transport

The Rt Hon Tom King MP
Minister of State, Department of
the Environment (Minister for
Local Government and
Environmental Services)

SECRETARIAT

Sir Robert Armstrong
Mr D J L Moore
Mr D J Bostock

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1. NATIONALISED INDUSTRIES: 1981 INVESTMENT AND FINANCING REVIEW

The Committee discussed a Memorandum by the Chief Secretary, Treasury (E(81) 79) and a Note by the Central Policy Review Staff (CPRS) (E(81) 81) on the 1981 Nationalised Industries' Investment and Financing Review.

THE CHIEF SECRETARY, TREASURY said that the nationalised industries had put forward bids for external finance which exceeded the cash equivalent of the figures in the 1981 Public Expenditure White Paper (Cmd 8175) by £2.5 billion in 1982-83, £3.2 billion in 1983-84 and £3 billion in 1984-85. The additional bids were partly the result of higher investment plans but mainly the result of lower forecasts of revenue and internal resources, because of the recession. There might be additional pressure for increased external finance when the plans of the British Steel Corporation, British Shipbuilders, British Rail and the National Coal Board (NCB) had been fully considered; and because the industries' assumptions on the speed and size of economic recovery were optimistic. Offsetting cuts on other public expenditure programmes would be damaging, but if the nationalised industries' bids were allowed without offsetting cuts they would lead to higher taxation and interest rates to the detriment of private industry. He was prepared to agree to an increase of £750 million in each year from 1982-83 to 1984-85 in the external finance available to nationalised industries with an offsetting reduction in the Contingency Reserve, as a response to the adverse trading circumstances in which most of the industries found themselves; but to go further would be to condone the industries' continuing unwillingness to make the kind of adjustments which tight economic circumstances had forced on the private sector. The £750 million might be allocated, and the industries' forward plans revised downwards (by £1.75 million in 1982-83, £2.45 million in 1983-84 and £2.25 million in 1984-85) in one of three ways. The first would be to restrict the industries' investment in 1982-83 and 1983-84 to 85 per cent of the levels in Cmd 8175 and to a broadly similar aggregate figure in 1984-85, making it clear to the industries that the Government would be prepared to approve higher levels of investment only to the extent that they could be covered by increased internal resources. This was the only certain way of achieving reductions in the industries' demand for external finance; its disadvantage was that the industries would present it as a damaging assault on capital expenditure. The second approach was to seek reductions in the

industries' forecasts current costs of about 5 per cent in 1982-83, 7 per cent in 1983-84 and $5\frac{1}{2}$ per cent in 1984-85, with the industries left to decide what changes to make in their plans within the limited additional finance allowed. Reductions in capital programmes should only take place to the extent that reductions in operating costs were unobtainable. This approach concentrated on the industries' greatest weakness relative to the private sector; on the other hand the savings might not be achieved if the industries committed too much of their investment at an early stage and then came back for extra finance if they failed to make forecast savings in current costs. The third option, which he favoured, was to seek current cost savings of 6 per cent, 8 per cent and 6 per cent in 1982-83, 1983-84 and 1984-85 respectively from most industries in order to limit the reductions required from those most exposed to market forces, whose room for manoeuvre was most limited and which had already taken steps to cut back their investment and labour forces. Whichever option was adopted it was necessary to take decisions now so that the industries could be told of them before the summer holidays and base their revised forecasts for 1982-83 and later years on the amount of external finance likely to be available.

MR IBBS said that the CPRS recommended that the increase in nationalised industries' external finance above the Cmnd 8175 level should be limited to £750 million by selective cuts, broadly on the lines of the third approach which the Chief Secretary had described; although there might be practical difficulties, for example union pressure, in concentrating the heaviest cuts on the current costs of non-competing industries. Each industry should be expected to find cuts from working capital, current costs and fixed investment, roughly in that order of priority, with planned investment left as near intact as possible. The Government should hold back investment approval beyond the 85 per cent provisional authorisation for 1982-83 for each industry until it produced a detailed plan for delivering the required overall savings; this was the only way in which the Government could put sufficient pressure on the industries.

The following were the main points made in discussion -

- a. There was undoubtedly scope for substantial improvements in efficiency in the nationalised industries. Many private sector firms had achieved operating cost reductions of the same proportion as those sought by the

Chief Secretary. A number of industries were assuming annual increases in the pay bill of more than 10 per cent. On the other hand, there was no point in setting unrealistically low external financing limits (EFLs). Nationalised industries were constrained in ways which private industry was not: they could not be wound up; some were kept in existence, or obliged to trade on adverse terms, for reasons of social policy. There were significant differences in the circumstances of individual industries; and some were not seeking to increase the provision made for them in Cmnd 8175. Simple formula cuts should therefore be avoided.

- b. Plans for productive investment by the nationalised industries which was likely to earn the required rate of return should not be cut. Such investment should not be regarded as "crowding out" investment by the private sector. On the contrary, private industry and employment would be adversely affected by reductions in nationalised industry investment. There was support in the City and elsewhere for seeking ways to finance profitable nationalised industry investment outside the Public Sector Borrowing Requirement (PSBR) and thus shielding it from the effect of cuts in public expenditure. Reductions in productive investment by the industries would also tend to cast doubt on the Government's assertions that the economy was beginning to emerge from the recession and to discourage private sector investments. On the other hand, increased investment accounted for only some £400 million of the industries' additional bids for 1982-83, and the Government could thus present an increase of £750 million in the industries' external finance as more than allowing for their planned investment.

- c. There was a danger that nationalised industry managers would regard as an attack on their competence attempts by the Government to suggest that operating costs could be held to a lower level than the industries themselves expected. Sponsoring Departments should try to identify particular respects in which the industries' forecasts and assumptions could be questioned: what was wanted was a reasonable discussion with the industries, not a confrontation which would lead to the Government's being blamed for every unpopular decision which an industry took.

d. There was scope for more use of management consultants in assisting the nationalised industries to increase their efficiency; in particular there was a strong case for an early investigation into the NCB. The Monopolies and Mergers Commission (MMC) already employed consultants in its investigations of nationalised industries, and their findings could be enforced; but the industries tended to regard MMC investigations as challenges to, and criticisms of, their management, and in some cases more might be achieved by consultants who worked with management to find ways of increasing efficiency. The American firm Theodore Barry, which followed this approach, had never failed to identify substantial operating savings; the suggestion that they might be used to investigate the efficiency of some of the nationalised industries had been first made in November 1980 and it was disappointing that Departments were still unable to reach agreement on this.

THE PRIME MINISTER, summing up the discussion, said that the Committee agreed that an additional £750 million should be provided for the nationalised industries' external finance in each of 1982-83, 1983-84 and 1984-85 and that every effort should be made to eliminate their demands beyond that level so that figures for 1982-83 and for the later years could be set on a basis consistent with the Chief Secretary's proposals. The Committee preferred the third of the Chief Secretary's options for allocating the additional funds and distributing savings subject to the points made on it by the CPBS. Ministers should discuss with the industries they sponsored how those savings could be achieved, taking into account the circumstances of each industry, the likely repercussions on private sector industry and on other public expenditure programmes, and the scope for squeezing current costs by more realistic assumptions for increases in the pay bill by improvements in the comparatively poor record in finding operating savings of those industries which were not exposed to competitive pressure. Each sponsor Minister could alter the balance of overall savings between his industries if he chose. The industries should be told that the Government would hold back investment approval in 1982-83 beyond the 85 per cent provisional authorisation for each industry until they produced detailed plans for delivering the required savings. The Committee also agreed that there was more scope for the use of management consultants, not necessarily reporting to the MMC, for advising on ways for improving the efficiency and reducing the operating costs of nationalised industries.

The Committee -

1. Agreed that an additional £750 million should be provided for the nationalised industries' external finance in each of the three years beginning in 1982-83.
2. Invited the Ministers sponsoring nationalised industries -
 - i. to agree with the industries how the savings indicated in Annex III of E(81) 79 should be found, taking account of the Prime Minister's summing up of their discussion;
 - ii. to consider urgently, in consultation with the Secretary of State for Trade and the Chief Secretary, Treasury, the scope and need for greater use of the services of management consultants to advise on the management of nationalised industries.

2. CONTROLLING PUBLIC TRANSPORT SUBSIDIES

The Committee considered a Memorandum by the Secretary of State for Transport (E(81) 82) on the control of public transport subsidies. Their discussion and conclusions reached are recorded separately.

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

LIMITED CIRCULATION ANNOTATED
E(81) 25th Meeting Minutes
FRIDAY 31 JULY 1981 at 9.30 am

CONTROLLING PUBLIC TRANSPORT SUBSIDIES

The Committee considered a memorandum by the Secretary of State for Transport (E(81) 82) on the control of public transport subsidies.

The SECRETARY OF STATE FOR TRANSPORT said that the proposals of the Greater London Council (GLC) and of the English Metropolitan Authorities for massive subsidies to change low fare policies by London Transport (LT) and by the Passenger Transport Executive (PTEs) could result in additional public expenditure of around £100 million in 1981-82, of over £450 million in 1982-83 and of increasing amounts thereafter.

The financing of these additional subsidies would mean heavy burdens on the ratepayers, including industrial and commercial ratepayers. The GLC were also planning to introduce a 4 day working week for LT and, if this were implemented, it would lead to further increases in the pay bill not only of LT but of other transport operators and of other industries competing for labour in the same areas. To use existing provisions for withholding grants would only add to the burden on the ratepayers. It might be necessary to act urgently to prevent the implementation of low fare policies if there were delays it would prove impossible to retrieve the position because of the difficulty of imposing sufficiently high real fare increases. He recommended amendments to the transport legislation already planned, to enable him to withhold the grants and loans received by LT and by PTEs and to enable him to appoint and to dismiss board members where necessary. These provisions

Cabinet Office
5 August 1981

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MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

LIMITED CIRCULATION ANNEX
E(81) 26th Meeting Minutes
FRIDAY 31 JULY 1981 at 9.50 am

SECRET

2. CONTROLLING PUBLIC TRANSPORT SUBSIDIES

THE COMMITTEE considered a memorandum by the Secretary of State for Transport (E(81) 82) on the control of public transport subsidies.

THE SECRETARY OF STATE FOR TRANSPORT said that the proposals of the Greater London Council (GLC) and of the English Metropolitan Authorities for massive subsidies to finance low fare policies by London Transport (LT) and by the Passenger Transport Executives (PTEs) could result in additional public expenditure of around £265 million in 1981-82, of over £450 million in 1982-83 and of increasing amounts in later years. The financing of these additional subsidies would mean heavy additional burdens on the ratepayers, including industrial and commercial ratepayers. British Rail, the National Bus Company and other private bus operators might be forced to adopt similar artificially low fare policies or to lose custom, and their finances would suffer. The GLC were also planning to introduce a 35 hour working week for LT and, if this were implemented, it would lead to further increases in the pay bill not only of LT but of other transport operators and of other industries competing for labour in the same areas. To use existing procedures for withholding grants would only add to the burden on the ratepayers. The right course was to act urgently to prevent the implementation of low fare policies; if there were delays it would prove impossible to retrieve the position because of the difficulty of imposing sufficiently high real fare increases. He recommended additions to the transport legislation already planned, to enable him to limit the grants and loans received by LT and by PTEs and to enable him by order to appoint and to dismiss board members where necessary. These provisions

would need to be enacted in time to be brought into effect at the beginning of the financial year, 1982-83. To reduce the possibilities of pre-emptive action by the GLC and the Metropolitan Authorities, it would be important for the Government not to reveal its legislative intentions until the latest possible moment in the autumn. Legislation on these lines would undoubtedly be contentious, but it was essential to protect the ratepayer and to avoid the serious financial consequences of doing nothing; he would defend the proposals on the grounds that they enabled him to impose financial limits similar to those applying to the nationalised industries. He invited the Committee to agree that he should now arrange for further work to be put in hand by his Department, in consultation with the Department of the Environment and the Treasury, on the additional legislative provisions. He would make further, and more detailed proposals, in September.

THE MINISTER OF STATE, DEPARTMENT OF THE ENVIRONMENT, said that he agreed that the Secretary of State for Transport's proposals should be examined further to ensure that they could be made to work in practice and on the understanding that the decision whether to implement them would be taken in September when the Secretary of State for the Environment would be putting forward his proposals for controlling local government finance; in particular on the withholding of grant in 1981-82, on interim measures to increase in the life-time of this Parliament the accountability of local authorities, and on the longer term alternatives to the present domestic rating system. He had asked for an urgent examination of the possibility of enacting the proposed interim measures in time for them to take effect at the beginning of the financial year 1982-83, rather than in 1983-84 as had been previously assumed.

In discussion the following were the main points made -

- a. If the Government were to intervene as proposed, the Leader of the GLC would be encouraged to claim that the Government had stepped in to stop him giving cheaper fares to Londoners; the Metropolitan Authorities would mount similar arguments. It might be better to let the GLC try to implement their low fares policy and to leave it to the local electorate and to moderate opinion in the local Labour Parties to deal with those responsible for the consequences; it was already evident that moderate opinion in the GLC was preventing the implementation of some of the more extreme policies proposed

by the leadership. This approach would avoid the risk of a constitutional confrontation between central and local government. The Conservative Party had traditionally been in favour of devolving responsibility to local authorities, and this might still prove to be the better policy for the longer term. The Secretary of State for Transport's proposals should be considered further in the context of these wider questions of the relationships between Central and Local Government and of policy on the rates.

b. On the other hand, irrespective of the proposed legislation, LT fares would be ~~increased~~^{decreased} by 25 per cent in October 1981 and this would lead to supplementary rate demands. When that happened it would be clear that responsibility for it lay with the GLC, and with any Metropolitan Authorities which acted similarly, but the Government would be expected to be ready with countervailing action. That pointed to having ready for introduction a Bill on the lines proposed by the Secretary of State for Transport; this Bill would be contentious but the Government would be on firm political ground in fighting for its implementation.

c. In the meantime, further work was necessary on the details of the legislation, to ensure that it could be made to work, and on the tactics for dealing with local authority opposition to it. The Secretary of State for Scotland's experience of dealing with Lothian Regional Council might be useful in this respect.

THE PRIME MINISTER, summing up the discussion, said that the Committee agreed that the Secretary of State for Transport should prepare legislative provisions on the lines which he had proposed in E(81) 82. This work should be carried forward in strict confidence and on a contingency basis; the Committee recognised the practical and political difficulties of implementing it, and they would take firm decisions in September when they would also consider the proposals which the Secretary of State for the Environment would be putting forward for controls on local government finance. The Committee recognised that, if legislation were to

be enacted by the beginning of the 1982-83 financial year, either as proposed by the Secretary of State for Transport or to give earlier effect to the interim measures which the Secretary of State for the Environment was putting forward, it would need to be introduced as soon as possible and to reach the House of Lords by early February 1982; it would have to be at the expense of other legislation in the 1981-82 Programme and it would be necessary to give further consideration to which Bill should be dropped.

The Committee -

Invited the Secretary of State for Transport, in consultation with the Secretary of State for the Environment and the Chief Secretary, Treasury, to prepare, on a contingency basis, legislative provisions to control public transport subsidies on the lines recommended in his memorandum E(81) 82, and to report further in September.

Cabinet Office

3 August 1981