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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

NATIONALISED INDUSTRIES

1982 INVESTMENT & FINANCING REVIEW

Memorandum by the Chief Secretary, Treasury

1. The attached review by officials sets out the nationalised industries' claims for additional finance above the baseline levels in Cmnd 8494 adjusted for subsequent agreed changes. These claims are very substantial, amounting in 1983-84 to £1.1 billion above the baseline, £1.1 billion in 1984-85 and £0.3 billion in 1985-86. They arise in broadly equal measure from bids to increase capital programmes and a wish to maintain expenditure in the face of lower forecasts of revenue.
2. I recognise that the status and quality of the figures in the review is extremely variable, depending on the progress of the Corporate Plan discussions. However, in my view, the bids are in aggregate unacceptable. As the review points out, we have in the last two years increased our planned provision for the industries by £800 million and £1300 million respectively. The industries should now generally need less external finance rather than more. More generally the overall spending position in 1983-84 is of course extremely difficult. Bids for additional expenditure already exceed the available contingency margin. If we are not to deny ourselves at this stage any chance of assisting recovery by making

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tax changes in the next Budget, we must seek reductions in some programmes, in order to accommodate increases in others. Clearly the external financing of the nationalised industries is one possible area for savings.

3. It is therefore essential that the levels of external finance for the industries should be reduced below the baseline. Quite apart from the considerations set out above, current bids almost certainly do not represent the totality of the demands for finance that the nationalised industries will make. The possible revision of the financial target for electricity (currently under discussion) could lead to a very substantial additional demand for external finance in each year. Any renewal of the railways dispute will adversely affect the finances both of BR and some other industries and there are worrying developments in the international market for steel which could threaten BSC's position. Therefore even if our ultimate aim was no more than to hold the baseline, at this stage it is essential to aim well below it, say, at something of the order of £500 million in aggregate.

4. How is this to be achieved? Discussions with the industries have not yet reached the stage where I can make specific proposals. Officials need to pursue further discussions with the industries about their bids over the summer so that we are in a position to come to firm decisions in the autumn, both about the levels of EFLs for 1983-84 and about the levels of external finance for 1984-85 years. We need however to take broad decisions now, so that they can both inform the discussions that are to take place and also influence the updated forecasts the industries will be producing after the summer.

5. Although therefore, it is too early for specific proposals, some general guidelines for these discussions can, I believe, be put forward. As the report points out, reductions in current expenditure where these can be achieved represent much the best way of reducing requirements for finance because this puts the spotlight on

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increasing efficiency rather than on cuts in capital investment or tariff increases, both easy and damaging ways out. To this I would also add reductions in working capital: there are some large increases among these bids. The economic assumptions on which the industries' bids are based should also be carefully examined. While we do not want to impose specific figures for either inflation or pay on the industries, we must ensure that they are not seeking an easy life by building undue pessimism into their forecasts. The assumptions about pay particularly need to be scrutinised carefully, given the importance of this sector in setting the tone for the pay round as a whole.

6. While we clearly wish to encourage profitable investment by the industries, it would be a mistake to regard the bids for more investment (which contributes about half of the overall increase) as sacrosanct. I have already referred to growing demands for working capital which may simply reflect inadequate control over stock levels and over the volume of outstanding debts; this should be scrutinised particularly carefully. But more generally care needs to be exercised to ensure that all the projects included within the bids are likely to yield an adequate return and that the programmes as a whole are realistic. The industries are already planning a very sharp increase in investment (26 per cent) this year over the levels achieved in 1981-82 when there was substantial shortfall. A degree of shortfall is not an uncommon occurrence. We must ensure that unreal investment programmes do not provide a cushion which would allow a loss of control over current costs to be accommodated.

7. Lastly I come to tariffs. The rapid increase in nationalised industry prices for much of 1980-81, while to a considerable extent a necessary response to increased oil prices and the need to eliminate past subsidies, represented a very real burden for businesses and ordinary consumers. The prospect this year is rather more encouraging and the review suggests that for the most part the industries do not contemplate substantial real increases over the period under review. The need to maintain firm control

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over borrowing is, of course, an essential part of the Government counter-inflationary strategy. But given that increased tariffs have a strong and direct influence on the retail prices index, I need hardly say that a reduction in external finance which was purchased would not be acceptable.

Conclusion

8. I invite my colleagues:
 - i. To note the threat posed by the substantial bids that the industries have put forward.
 - ii. To agree that for the industries in aggregate we should aim to achieve a reduction below the baseline of £500 million in each of the 3 years.
 - iii. To agree that in order to achieve this objective the financial requirements of each industry must be held to levels in the Paper at a minimum and that there should be a determined effort to make reductions substantially below that level wherever possible in order to achieve the overall reduction of £500 million.
 - iv. To ask officials to pursue discussions intensively with the industries and to report back with firm proposals to achieve the targets in (ii) for us to consider before the end of September.

HM Treasury
1 July 1982

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NATIONALISED INDUSTRIES'

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2nd printing
(incorporating minor
corrections)

NATIONALISED INDUSTRIES' INVESTMENT & FINANCING REVIEW 1982

Decisions Required

1. The Investment & Financing Review (IFR) is the annual forward look at nationalised industries' investment and financing requirements. This report which covers the years 1983-84 to 1985-86 has been prepared jointly by the Treasury and sponsor Departments on the basis of information provided by the industries concerned. It sets out in individual industry Annexes:
 - baseline figures as in Cmnd 8494 as adjusted for agreed subsequent changes
 - industries' bids for any additional finance
 - a commentary on the industries' recent performance and an assessment of the bids.
2. The report which forms part of the annual planning of public expenditure totals provides a basis for Ministerial decisions on the aggregate external financial requirements for nationalised industries. In relation to 1983-84 they provide a basis for fixing the industries' external financing limits (EFLs) in the autumn, taking account of more up-to-date forecasts which the industries provide in September, and any adjustments which may be necessary following further discussions with the industries and corporate plan reviews.
3. Decisions on investment are normally taken on the basis of approving 100 per cent of the agreed investment programme for Year 1 (1983-84), approving 85 per cent of the programme for Year 2 (1984-85) and approving 70 per cent for Year 3 (1985-86). Early decisions help the industries to plan next year's investment sensibly. But in accordance with the procedure adopted last year investment approvals beyond the 85 per cent already approved will need to be delayed until the EFLs are settled in the autumn in order to avoid pre-empting Ministers' room for manoeuvre.
4. This year, for the first time, the Civil Aviation Authority and Regional Water Authorities are included within the scope of the IFR. The Civil Aviation Authority is being formally transferred to programme 5. The water authorities will continue to be shown in the relevant departmental programmes, but they are major trading bodies and it has been agreed to consider their investment and

financing requirements alongside those of the nationalised industries. The National Freight Company, having been successfully transferred to the private sector, no longer appears. Figures beyond 1982-83 are not shown for either the British National Oil Corporation or the British Transport Docks Board as a consequence of their impending privatisation.

Nature of This Year's IFR

5. This year's IFR takes place in a somewhat different context from that of earlier years. The CPRS report and the Chancellor of the Exchequer's proposals in E(NI)(81)4 are leading to the introduction of an annual appraisal for each industry comprising a review of past performance and an examination of an up-to-date Corporate Plan. Some industries are more advanced in this process than are others. By next year's IFR, the corporate planning cycle should have been altered to ensure that so far as possible all industries' plans and prospects as businesses have been discussed in advance of the IFR in order better to inform Ministerial decisions. This will leave the IFR as the method by which the industries' aggregate impact on public expenditure is assessed and controlled.

6. This year's IFR takes place during the changeover to the new system. Some of the information drawn on in this report has arisen from performance review and Corporate Plan discussions; other information has not yet been properly assessed. The text of individual Annexes makes clear the status of the figures and sets out progress on Corporate Plan discussions. It should be noted that the figures are those supplied by the industries themselves; they have not in all cases been subject to refinement by sponsor Departments or the Treasury. Thus they do not yet provide a consistent basis for comparing one industry with another.

The Aggregate Position

7. This report focuses on the industries' additional bids for public expenditure over and above previously agreed baseline figures. The financing figures which result from the industries' planning procedures are inherently volatile. The external financing requirement is the residual between two much larger flows comprising capital requirements, of the order of nearly £8bn in 1982-83, and internally-generated funds, of the order of £5bn. Relatively

small percentage changes in the two large flows can have a large effect on the need for external finance. The Government has made additional finance available to the industries for two successive years. With the economy moving out of recession, it might have been expected that industries' overall demands on public expenditure would be decreasing rather than increasing. In any event, given the context of this year's review the overall aim must be to reduce the industries' requirements for external finance to the lowest practicable level.

8. Industries' aggregate additional bids over the baseline are as follows:

TABLE 1

Summary of aggregate bids

	£ million		
	<u>1983-84</u>	<u>1984-85</u>	<u>1985-86</u>
Baseline figures (Cmnd 8494) adjusted for agreed subsequent changes eg NIS	3,082	2,535	2,621
<u>Additional industry bids</u>			
Capital requirements	+502	+399	+468
Internal resources	-634	-731	+178
External finance	+1,136	+1,130	+291

Individual industry figures are summarised in Table 2 (on page 10) which gives baseline data, and Table 3 (on page 11) which sets out additional bids. The above table assumes BNOC and the British Transport Docks Board are privatised by the end of 1982-83. If not, the aggregate bid for 1983-84 would need to be adjusted by -£0.1m BNOC and -£5m British Transport Docks Board. Baseline figures for 1985-86 generally represent a 4 per cent increase on 1984-85 (the standard PES assumption).

9. The excess over the adjusted Cmnd 8494 figures is the result of two main factors working in combination:

- (i) an increase in planned capital requirements (£502m in 1983-84, plus £399m in 1984-85, plus £468m in 1985-86). Table 4 (on page 12)

sets out individual industries' planned expenditure on fixed assets.

(ii) Expected shortfalls in expected internal resources. Individual industries' expectations are set out more fully below. In total, expected shortfall on internal resources accounts for 56 per cent of aggregate additional bids in 1983-84 and 65 per cent in 1984-85. There is no aggregate shortfall in 1985-86.

10. A preliminary breakdown of aggregate additional bids for external finance into grants, leasing and borrowing is as follows:

£m	<u>1983-84</u>	<u>1984-85</u>	<u>1985-86</u>
cash terms			
Grants	539	571	513
Leasing	4	11	-3
Short term borrowing	61	71	-243
Long and medium term borrowing (and PDC)	532	477	24
	<u>1136</u>	<u>1130</u>	<u>291</u>

Summary Analysis of Individual Additional Bids

11. A brief analysis of the bids is given below. It describes how the difference between the bids and the baseline has arisen, but it does not distinguish between bids which arise from an agreed Corporate Plan and those which are at present unexamined. The Annexes provide further detail. Ninety-one per cent of the total additional external financing bid in 1983-84 comes from 5 industries: National Coal Board (38 per cent of total), British Telecom (21 per cent), Electricity Supply Industry (15 per cent), Post Office (9 per cent) and South of Scotland Electricity Board (9 per cent). (The provisional nature of the NCB figures here and elsewhere is explained in Annex 1).

12. By 1984-85, the Electricity Supply Industry bid has dropped significantly. Eighty-four per cent of the total additional bid for 1984-85 is accounted for by the National Coal Board (29 per cent of total), British Telecom (23 per cent), British Gas Corporation (17 per cent), South of Scotland Electricity Board (9 per cent) and Post Office (7 per cent).

13. By 1985-86, total additional bids drop slightly (and are significantly offset by some decreased bids - see paragraph 18). Major additional bids are put forward by the National Coal Board (35 per cent of total, British Rail

(25 per cent) and British Telecom (24 per cent).

14. Just under half the total additional bid in 1983-84 is for increased capital requirements (£502m). The National Coal Board seeks £183m extra for fixed assets and £62m for working capital. Electricity Supply wants to increase working capital by £121m (mainly attributable to an expected deterioration in the debtors/creditors balance.) Bids for increased expenditure on fixed assets come from British Telecom (£135m) and the Post Office (£73m). The South of Scotland Electricity Board expects to spend £48m more in that year at Torness and wants to increase working capital by £32m.

15. The additional capital requirement bid drops to £399m for 1984-85 and is mainly accounted for by the National Coal Board seeking to increase fixed asset expenditure by £272m (with some simultaneous decrease in working capital) and British Telecom by £240m likewise. The South of Scotland Electricity Board again wants to increase expenditure on Torness (by £49m) and to increase working capital (by £22m). Regional Water Authorities seek to increase their capital investment by £75m (but propose to fund most of this from a substantial increase in internal resources).

16. For 1985-86, the National Coal Board, British Telecom, Regional Water Authorities and the Electricity Supply Industry are all bidding for major additional capital. (The water authorities and the Electricity Supply Industry propose to fund this with internal resources.)

17. The National Coal Board (£186m), British Airways (£119m) and British Telecom (£102m) expect the largest shortfalls in internal resources in 1983-84. The increased aggregate shortfall in 1984-85 mainly comes from the British Gas Corporation (£214m) because of lower demand expectations. Other increases in shortfall are spread throughout many other industries. By 1985-86, the position changes significantly and additional increased shortfall drops to £330m (not counting offsets). British Rail (£142m) is by then the major contributor to shortfall.

Decreases in Financing Requirements

18. Over the review period as a whole, British Airways expects to better its baseline by £223m (because of lower fixed asset expenditure). Although the

Electricity Supply Industry has additional bids of £193m in 1983-85, it is £167m below baseline in 1985-86 (because of expected improvements in internal resources). The Scottish Transport Group and British Rail are both slightly below baseline in 1983-84 and 1984-85.

Economic Assumptions

19. In accordance with past practice, industries have made their own assumptions about the economy. These are summarised in Tables 5-8. In contrast to last year, the industries' working assumptions on economic growth are now rather more pessimistic than the Treasury's though except for 1985-86 they are generally within the range of outside forecasts. The Electricity Supply Industry is among the most pessimistic though its forecast was made some time ago. The extreme pessimism in respect of 1985-86 is caused by British Telecom's swing from relative optimism to a 1.5 per cent fall in GDP that year.

20. The industries' inflation assumptions are also more pessimistic than the Treasury's, though again within the outside forecasters' range. Generally the industries assume fairly steady inflation in the 9-10 per cent range, though the National Coal Board figures show a rising trend. After allowing for each industry's differing inflation assumptions, pay assumptions for nationalised industries employees as a whole are broadly in line with pay assumptions for the overall economy. Nominal pay increases are broadly similar to the Treasury's assumptions but because of the industries more pessimistic view of inflation this translates into somewhat lower real increases. After a real earnings fall averaging 1.5 per cent this year, the industries generally anticipate increases of between 0 and 1 per cent in each year. At the end of the range the Post Office envisage a pay rise of nearly 4 per cent in 1983-84 and National Giro-bank nearly 5 per cent in 1984-85 both in real terms. The British Gas Corporation forecasts a zero real increase in each year. Every 1 per cent change in nationalised industries earnings changes the aggregate external finance requirement by some £150m in 1983-84.

21. The industries' tariff assumptions have been substantially revised, mainly reflecting their changed assumptions on inflation. (Figures for electricity are provisional: electricity pricing is currently under study by the industry

and by Departments). Table 8 shows the assumptions for a number of the industries both in nominal terms and after deflating by their RPI assumptions. Substantial real increases are confined to British Rail in 1983-84 and to the National Bus Company in 1984-85 and 1985-86. British Telecom is forecasting real decreases in each year; the National Coal Board, British Gas Corporation and Post Office in at least one year. Taken together the industries' tariffs will increase only slightly faster than the RPI in 1983-84 and may well reverse this in the two later years (see Table 9). Every 1 per cent change in tariff changes the aggregate external finance requirement by some £400m in 1983-84.

Reducing Industries' Requirements for External Finance

22. As a preliminary step because of the differing status of industries' figures (see paragraph 6 above), officials should scrutinise further all additional bids that have been put forward. This should be done through the outstanding performance and Corporate Plan reviews; otherwise it should be done in bilateral IFR discussions. In the case of British Rail further consideration of the investment and finance figures must await the outcome of the Serpell Review. Secondly, as paragraphs 19 and 20 indicate, the economic assumptions that underlie industries' bids are not wholly in line with the Government's view of how the economy is expected to develop. These differences should also be discussed with the industries although generally they are not particularly large and the scope for savings by making adjustments may be fairly small.

23. In considering the aggregate position, Ministers may wish to consider how any reduction to the total figures might be achieved and to guide officials in their further discussion with industries. The main areas for reducing requirements are in:

- (i) Reducing current costs. This is attractive because it does not simply transfer the burden to the consumer or the Government. The scope for reductions varies considerably between industries; in some, substantial economies could be achieved, particularly for industries insulated from competitive pressures, in others considerable headway has been made in the past year under the stimulus of market pressures and tight EFLs. Some industries will argue however that the benefit of reductions in current costs should be passed onto the consumer in the form of lower prices and not reflected in lower external financing requirements.

(ii) Increasing tariffs. This is a possible course in the case of monopoly industries but the effect on the RPI and on industry is unwelcome. The gap between the rate of increase of nationalised industry prices and the RPI has narrowed recently, after the very rapid increases in the industries' prices during 1980 and 1981. Most prices are at, or close to, economic levels. The main exception is gas where a further real increase in prices would be justifiable. For water and buses the financial targets are already likely to bring some real increases.

(iii) Cutting investment. As mentioned earlier, industries have already had approval for up to 85 per cent of the investment programmes set out in Cmnd 8494 but, in principle, investment could be held at this level. Investment shortfall is common and there was a substantial shortfall below plans in 1981-82. Where the profitability of industries' investment programmes are doubtful, there may be scope for reduction following detailed examination of corporate plans and, even in approved programmes on grounds of realism. However substantial cuts in investment, where this can be justified in terms of improved productivity and better financial performance should, if possible, be avoided.

It should be emphasised that the differing bases of the figures in the report made it unsuitable to seek uniform reductions from all the industries at this stage.

Conclusion

24. Ministers are invited:

- (i) To note the additional bids for external finance submitted by the nationalised industries.
- (ii) To decide the extent to which additional bids can be accommodated and whether aggregate expenditure is to be held at present baseline figures or below.
- (iii) To give guidance to officials on how any reductions in aggregate figures should preferably be made in preparation for subsequent discussions

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and decisions to be taken on EFLs for 1983-84 and the level of individual industries' external financing requirements and investment programmes for future years.

Table 2 Baseline data for all industries^a

£ million cash terms

Industry	Capital Requirements			Internal Resources			External Finance		
	1983-84	1984-85	1985-86	1983-84	1984-85	1985-86	1983-84	1984-85	1985-86
National Coal Board	908	953	991	-52	4	4	960	949	987
Electricity Supply Industry (E&W)	1553	1775	1846	2015	2318	2411	-462	-543	-565
N Scotland Hydroelectric Board	57	58	60	54	63	66	2	-6	-6
S Scotland Electricity Board	337	343	357	107	125	130	230	218	227
British Gas Corporation	1106	1108	1152	991	1228	1277	115	-120	-125
British Steel Corporation ^b	316	335	348	116	325	338	200	10	10
British Telecom	2415	2645	2751	2100	2330	2423	315	315	328
Post Office (Postal)	124	137	142	162	175	182	-38	-38	-40
National Girobank	8	11	11	8	11	11	-	-	-
British Airways	338	395	411	246	305	317	92	90	94
British Airports Authority	204	193	201	168	174	181	36	19	20
Civil Aviation Authority	36	37	39	18	22	23	19	15	15
British Railway Board	221	221	230	-772	-821	-854	993	1042	1084
British Waterways Board	4	5	5	-38	-41	-43	42	46	48
National Bus Company	70	84	87	-1	13	13	71	71	74
Scottish Transport Group	15	16	16	-9	-9	-10	23	25	26
British Shipbuilders	100	98	102	2	41	43	98	57	59
TOTAL	7812	8412	8749	5115	6262	6513	2697	2150	2236
Regional Water Authorities	730	767	797	345	382	412	385	385	385
TOTAL ALL INDUSTRIES	8542	9179	9546	5460	6644	6925	3082	2535	2621

Notes

- a. Baseline is Cmnd 8494 adjusted for subsequent agreed changes
 b. British Steel Corporation has no IFR figures available for 1985-86
 c. Some totals differ due to rounding

Table 2
Baseline data for all industries^a

Table 3 Additional bids for all industries

£ million cash terms

Industry	Capital Requirements Additional Bid			Internal Resources (Shortfall)			External Finance Additional Bid		
	1983-84	1984-85	1985-86	1983-84	1984-85	1985-86	1983-84	1984-85	1985-86
National Coal Board	+245	+188	+281	(186)	(169)	+24	+431	+357	+257
Electricity Supply Industry (E&W)	+121	-32	+114	(45)	(59)	+281	+166	+27	-167
N Scotland Hydroelectric Board	+2	-8	+2	(3)	(10)	(16)	+6	+2	+18
S Scotland Electricity Board	+80	+71	-68	(17)	(37)	(49)	+97	+109	-19
British Gas Corporation	-7	-4	-68	(66)	(214)	+55	+59	+210	-123
British Steel Corporation	+7	+35	-	+7	(46)	-	-	+81	-
British Telecom	+135	+204	+197	(102)	(74)	+26	+237	+278	+171
Post Office (Postal)	+73	+61	+38	(31)	(21)	(7)	+104	+82	+45
National Girobank	+3	+1	+3	+3	+1	+3	-	-	-
British Airways	-119	-200	-198	(119)	(102)	(73)	-	-98	-125
British Airports Authority	-30	+4	-21	(41)	(21)	(35)	+11	+25	+14
Civil Aviation Authority	-5	-3	-2	(5)	(3)	(2)	-	-	-1
British Railways Board	-32	-14	+41	(29)	(10)	(142)	-3	-4	+183
British Waterways Board	-	-	-	(1)	(3)	(6)	+1	+3	+6
National Bus Company	-7	-6	+12	(10)	(9)	+2	+3	+3	+10
Scottish Transport Group	+1	+2	+9	+4	+4	-	-2	-2	+9
British Shipbuilders	+10	+25	+18	-	+4	+13	+10	+21	+5
TOTAL	+477	+324	+357	(642)	(770)	75	+1119	+1094	+283
Regional Water Authorities	+25	+75	+111	+8	+39	+103	+17	+36	+8
TOTAL ALL INDUSTRIES	+502	+399	+468	(634)	(731)	+178	+1136	+1130	+291

Notes

a. British Steel Corporation has no IFR figures available for 1985-86

b. Some totals differ due to rounding

Table 4 Industries' Expenditure on Fixed Assets in the UK

£ million cash terms

Industry	1977-78	1978-79	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86
National Coal Board	364	495	674	810	819	886	1122	1258	1368
Electricity Supply Industry (E&W)	671	715	834	1055	1167	1370	1558	1678	1900
N Scotland Hydroelectric Board	63	48	44	42	60	51	43	42	56
S Scotland Electricity Board	43	53	65	132	295	349	475	448	315
British Gas Corporation	235	280	402	570	534	914	913	876	841
British Steel Corporation (a)	502	334	289	178	187	204	242	260	244
British Telecom	844	993	1215	1545	1460	2089	2500	2725	2945
Post Office (Postal)	35	42	64	76	111	130	177	203	187
National Girobank	1	5	5	8	6	9	7	7	8
British Airways	202	219	289	267	174	209	213	198	213
British Airports Authority	37	33	54	78	84	135	170	190	180
Civil Aviation Authority	14	23	12	23	24	30	26	30	34
British Railway Board	276	349	388	334	305	329	348	389	487
British Waterways Board	2	2	5	6	7	5	4	5	5
National Bus Company	46	54	60	59	50	55	58	72	92
Scottish Transport Group	10	17	16	16	15	14	16	17	24
British Shipbuilders	20	27	18	17	32	49	74	103	100
TOTAL	3365	3689	4435	5168	5310	6828	7946	8500	8999
Regional Water Authorities	478	518	590	658	656	717	767	849	919
TOTAL ALL INDUSTRIES	3843	4207	5025	5826	5966	7545	8713	9349	9918

Notes:

- a British Steel Corporation has no IFR figures available for 1985-86
b Some totals differ due to rounding

TABLE 5

NATIONALISED INDUSTRIES GDP ASSUMPTIONS (% change)

	1982-83	1983-84	1984-85	1985-86
National Coal Board	0	1.5	1.5	1.5
Electricity Supply Industry	0	1.0	2.0	1.0
North of Scotland Hydro	0.3	1.2	1.5	1.5
South of Scotland Elec ^y	1.8	2.0	2.0	1.7
British Gas Corporation	2.0	2.9	1.4	0.9
British Steel Corporation	2.5	2.0	3.2	n.a.
British Telecomm	1.5	3.0	2.5	-1.5
Post Office	1.4	2.5	2.0	0.5
Giro	1.3	2.5	2.0	0.5
British Airways Board	0.5	1.5	2.0	1.5
British Airports Authority	1.9	1.9	2.0	1.9
British Railways Board	1.0	1.7	1.7	1.5
British Waterways Board	1.5	1.5	1.6	1.4
National Bus Company	0.6	1.3	2.2	1.4
Scottish Transport Group	n.a.			
British Shipbuilders	n.a.			
N.I. average ⁽¹⁾	1.0	2.0	1.9	0.5
Others ⁽²⁾	-0.4/+1.5	0.4/3.0	0.6/2.0	1.3/1.6

(1) Weighted by turnover

(2) Range of outside forecasts (calendar years)

TABLE 6

NATIONALISED INDUSTRIES' RPI ASSUMPTIONS (% change)

	1982-83	1983-84	1984-85	1985-86
National Coal Board	10	9	10	11
Electricity Supply Ind.	10	10	10	10
North of Scotland Hydro	11	10	9.5	9
South of Scotland Elec.	10	10	9	9
British Gas Corporation	10	8	8	8
British Steel Corporation	10	10	10	n.a.
British Telecomm	11	10	10	10
Post Office	9.5	9	9	9
Giro	10.5	10	10	10
British Airways Board	11	11.5	12	11.5
British Airways Authority	10	10	7.5	7.5
British Railways Board	10.9	10.2	9.6	9.6
British Waterways Board	9	10.1	10	9.8
National Bus Company	10	10	10	10
Scottish Transport Group	n.a.			
British Shipbuilders	n.a.			
N.I. average ⁽¹⁾	10	9.6	9.7	9.8
Others ⁽²⁾	(8.5)/10.9	(6.2)/10.4	(7.9)/10.9	(9.4)/(10.8)

(1) Weighted by turnover

(2) Range of outside forecasts (calendar years). Figures in brackets are QPI forecasts.

TABLE 7

NATIONALISED INDUSTRIES' OWN AVERAGE EARNINGS ASSUMPTIONS (% change)

	Nominal				Real ⁽¹⁾			
	1982-83	1983-84	1984-85	1985-86	1982-83	1983-84	1984-85	1985-86
National Coal Board	8.0	9.0	11.2	12.1	-2	0	1.2	1.1
Electricity Supply Ind	8.3	11.2	11.0	11.0	-1.7	1.2	1.0	1.0
North of Scotland Hydro	7.3	10.0	10.0	9.0	-3.6	0	0.5	0
South of Scotland Elec	7.3	10.0	10.0	9.0	-2.7	0	0.9	0
British Gas Corp.	8.0	8.0	8.0	8.0	-2.0	0	0	0
British Steel Corp.	n.a.							
British Telecomm	10.3	10.8	11.7	9.7	-0.7	0.8	1.7	-0.3
Post Office	7.2	12.8	9.8	11.1	-2.3	3.8	0.8	2.1
Giro	13.2	11.0	15.0	7.5	2.4	1.0	4.9	-2.5
British Airways B'd	6.7	12.9	12.1	11.4	-3.9	+1.3	+0.1	-0.1
British Airports Auth ^y	10.7	10.0	9.5	7.5	-2.7	0	1.9	0
British Railways B'd	11.2	9.7	11.4	12.8	+0.3	-0.5	1.6	2.9
British Waterways	8.0	8.5	9.5	8.7	-0.9	-1.6	-0.5	-1.1
National Bus Company	7.7	10.3	10.0	10.0	-2.1	0.3	10.0	10.0
N.I. average ⁽²⁾	8.6	10.2	10.7	10.5	-1.5	0.6	1.0	0.7
Others ⁽³⁾	9.3/10.6	8.6/11.5	8.6/12.0	9.8/11.5	-1.4/+1.9	-0.3/+2.3	-0.2/+1.9	0.4/0.6

(1) Deflated by each industry's own RPI assumptions (see Table 6)

(2) Weighted by turnover. Excludes Scottish Transport and British Shipbuilders.

(3) Range of outside forecasts (calendar year).

	RPI Weights (total RPI=1000)	Nominal				Real			
		1982-83	1983-84	1984-85	1985-86	1982-83	1983-84	1984-85	1985-86
National Coal Board	9	9.0	8.7	9.3	11.2	-0.9	-0.2	-0.7	+0.2
Electricity (England and Wales)		10.4	9.6	8.4	9.6	-0.4	+0.4	-1.4	0
North of Scotland Hydro Board		8.5	10.0	10.0	9.0	-2.3	+0.1	+0.4	0
South of Scotland Electricity		9.0	10.0	10.0	9.0	-0.9	0	+0.9	0
Electricity - weighted sum ⁽³⁾	28	10.2	9.6	8.6	9.5	-0.5	+0.4	-1.2	0
British Gas Corporation	20	24.1	12.0	7.7	9.5	12.8	3.7	-0.3	1.4
British Telecom ⁽⁴⁾	16	7.6	5.1	8.2	3.2	-3.1	-2	-2	-6
Post Office	2	7.5	8.0	9.0	9.0	-1.8	-0.9	0	0
British Railways Board	5	9.9	16.5	11.2	11.4	-0.9	+5.7	+1.5	+1.6
National Bus Company	4	10.0	10.3	14.3	15.0	0	+0.3	+3.9	+4.5
Memo: Water Authorities ⁽⁵⁾	8	11.0	8.9	10-11	12-13	+1.4	-0.5 - +0.5	+1.4 - +2.3	+3.7 - +4.6

Notes: 1. From Corporate Plan, IFR or Supporting information

2. The changes in tariff shown in this table reflect average increases comparing one year with another - they do not indicate the extent of the price increase proposed for the year.

3. Weighted together by turnover figures:

	£m
ESI (E+W)	7112
NSHEB	243
SSEB	625
	7980

4. This table is based on the tariff charges assumed for the corporate plan. The extent of BT's tariff increase in November 1982 is under discussion.

5. Water authorities' domestic charges are likely to rise by 1-2% more than average charges, due to tariff restructuring. A range is shown because the figures are very uncertain, particularly for later years.

TABLE 9

CONTRIBUTION BY INDIVIDUAL INDUSTRIES TO THE REAL CHANGE IN
NI PRICES

	Weight in RPI (total RPI = 1000)	1982-83	1983-84	1984-85	1985-86
National Coal Board	9	-0.1	0	-0.1	0
Electricity	28	-0.2	0.1	-0.4	0
British Gas Corporation	20	3.0	0.9	-0.2	0.4
British Telecomm	16	-0.6	-0.4	-0.4	-1.1
Post Office	2	0	0	0	0
British Rail	5	-0.1	0.3	0.1	0.1
National Bus	4	0	0	0.2	0.2
Weighted real increase in prices (1) (2) (3)	84	+2.1	+0.9	-0.7	-0.4

(1) The weighted total does not include London Transport or the Water Authorities, both of which figure in the normal NI price series.

(2) The weighted total is the sum of the real increases in individual industry tariffs shown in Table 8.

(3) Figures may not sum because of rounding.

Individual Industry Annexes

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- Annex 2 - Electricity Supply Industry (England and Wales)
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1. NATIONAL COAL BOARD

TABLE

BASELINE	£m	1982-83	1983-84	1984-85	1985-86
Total capital requirements		782	908	953	991
Total internal resources		-180	-52	4	4
Total external finance		962	960	949	987

ADDITIONAL INDUSTRY BIDS	£m	1983-84	1984-85	1985-86
Fixed assets in UK		183	272	343
Working capital		62	-83	-64
Other		-	-1	2
TOTAL CAPITAL REQUIREMENT ADDITIONAL BID		245	188	281
INTERNAL RESOURCES ADDITIONAL (SHORTFALL)		(186)	(169)	24
Grants		484	460	344
Leasing		14	16	17
Short-term borrowing		-	-	-
Long and medium term borrowing		-67	-119	-104
TOTAL EXTERNAL FINANCE ADDITIONAL BID		431	357	257

ASSUMPTIONS 1981-82 = 100, for indices	1982-83	1983-84	1984-85	1985-86
GDP (index number)	100.0	101.5	103.0	104.6
% inflation	10	9	10	11
% change in industry tariff	9.0	8.7	9.3	11.2
% change in industry average earnings	8.0	8.8	11.5	12.2
Manpower	257,200	248,900	243,900	237,100
Unit labour costs	104.5	108.0	116.5	124.5
Output (index number)	99.5	101.5	101.5	103.0

1 NATIONAL COAL BOARD

1. Status of Bids

1. The policy letter to the NCB's new Chairman requested the preparation, as a priority task, of a properly worked out Corporate Plan. This plan is to be submitted by the end of October and will then have to be considered in detail. The Board are to discuss with the Department the results of preliminary work on the plan in July and August and this will need to be taken into account in setting EFRs in the Autumn.

2. The figures given in the IFR are therefore provisional. They are drawn from the NCB's 1981 draft Development Plan figures adjusted for slight downward changes in medium-term inflation assumptions. This plan was not used for the White Paper. The EFL set for 1982-83 was about £300m below the figure proposed in the Plan.

2. Recent Performance

3. For 1981-82 the Board's EFR of £1,225m was consistent with their EFL of £1,117m taking account of the effects of the ASLEF dispute which cost NCB £121m in that financial year.

4. Real revenues have remained weak; a substantial increase in exports has helped offset a decline in UK sales in volume terms, but at lower average realisations. Unit costs rose by $1\frac{1}{2}$ per cent in real terms in 1981-82 - less than the Development Plan assumed.

5. Productivity, as measured by OMS, improved by 3.4 per cent in 1981-82. Colliery manpower was reduced by 12,000.

6. Loss after interest was £455m, within the limit of £467m set for deficit grant.

3. Assessment of Economic Assumptions

7. The Board assume a 10 per cent rate of inflation in 1982-83, followed by 9 per cent, 10 per cent and 11 per cent in the three subsequent years. A modest

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increase in GDP is assumed, leading to a rise in electricity consumption of approximately 1 per cent per year which in turn is expected to maintain NCB disposals to the CEGB at present levels.

8. NCB expect coal prices in general to follow the assumed rates of inflation, but some weakening of coke prices is expected. This assumption may be optimistic.

9. In 1982-83 the overall wages bill is expected to increase by around 7 per cent; earnings per head will be somewhat higher due to the continuing reduction in manpower levels. In subsequent years a modest real wage increase per head is assumed.

Additional Bids

10. Coal market prospects have substantially worsened. The Board plan to reduce output below Development Plan levels to minimise stockbuild and to offset the increases in unit costs which this will cause, by continuing cost saving measures. They believe that as a result their internal resources will be broadly in line with the IFR bids.

11. Capital investment figures are those in the Board's Development Plan, and are in line with the Board's bid for 1982-83 which was subsequently reduced by some £130m.

2 ELECTRICITY SUPPLY INDUSTRY (ENGLAND AND WALES)

TABLE 2.1

BASELINE	£m	1982-83	1983-84	1984-85	1985-86
Total capital requirements		1,332	1,553	1,775	1,846
Total internal resources		1,575	2,015	2,318	2,411
Total external finance		-243	-462	-543	-565

ADDITIONAL INDUSTRY BIDS	£m	1983-84	1984-85	1985-86
Fixed assets in UK		-	-66	88
Working capital		121	34	26
Other		-	-	-
TOTAL CAPITAL REQUIREMENT ADDITIONAL BID		121	-32	114
INTERNAL RESOURCES ADDITIONAL (SHORTFALL)		(45)	(59)	281
Grants		-	-	-12
Leasing		-11	-3	-
Short-term borrowing		-43	-138	-173
Long and medium term borrowing		220	168	18
TOTAL EXTERNAL FINANCE ADDITIONAL BID		166	27	-167

ASSUMPTIONS 1981-82 =100, for indices	1982-83	1983-84	1984-85	1985-86
GDP (index number)	100.0	101.0	103.0	104.0
% inflation	10.0	10.0	9.9	9.8
% change in industry tariff	10.1	9.9	8.4	9.6
% change in industry average earnings/ employee	8.1	11.2	11.0	11.1
Manpower	142,600	138,700	135,500	133,300
Unit labour costs (index no)	105.0	112.8	121.4	131.1
Output (index number)	99.3	99.9	100.9	101.9

2 ELECTRICITY SUPPLY INDUSTRY (ENGLAND AND WALES)

1. Status of Bids

The industry's figures derive from a full re-assessment of financial requirements in the light of their 1982 Capital Expenditure proposals, an interim review of last October's sales forecasts, and up-dates of other key cost and revenue assumptions. The figures are subject to a number of uncertainties, most notably:

(a) Electricity price levels; the industry's bids assume continuation of their present approach to pricing. No financial target has yet been set for the period starting in 1983-84. Pricing policy is under study within the industry and independently. Preliminary indications of an appropriate level of prices may be put forward within the next month.

(b) Load forecasts, full revision of which will begin in the next two or three months.

(c) The level of fuel stocks. It is assumed that there will be no net change in stocks in 1983-84 and later years. At present the industry's corporate plan does not present strategic options and is produced rather late in the annual planning cycle and after the IFR. The Department of Energy are discussing with the Council the possibility of moving from 1983 towards a corporate planning approach on the CPRS model.

2. Recent Performance

2. Taking into account the provisional outturn for 1981-82 (a return of 1.9 per cent) the industry expects to meet its financial target of 1.7 per cent on net assets valued at current cost over the period 1980-81 - 1982-83. No performance aim has yet been set for the industry, but provisional figures indicate that controllable costs were reduced by about 0.5 per cent between 1980-81 and 1981-82 a better result than forecast, and consistent with current discussions with the industry of a possible target for reduction of controllable costs in future years. Provisional outturn against the 1981-82 EFL of (£165 million) was (£223 million): an over-achievement of £58 million. In the industry as a whole investment fell short of investment approval of £42 million in 1980-81 and £37 million in 1981-82. The Department is carrying out a performance review of the industry.

3. Assessment of Industry's Economic Assumptions

3. The industry's assumptions on GDP growth and inflation growth are both a little more pessimistic than the mean of external forecasters. The former factor may lead, as noted, to changes in the industry's load forecasts in the Autumn. The industry's finances are not sensitive to small changes in the forecast rates of inflation. The forecast increase in average earnings in the industry over the whole period is slightly above that expected for the economy as a whole. The workforce is forecast to reduce by $8\frac{1}{2}$ per cent from 31-3-82 to 31-3-86. Unit labour costs, taking manpower reductions and improved productivity into account, are forecast to increase by 31 per cent from 1981-82 to 1985-86, as compared with forecast RPI increase of 46 per cent. Reflecting recent downward revisions of sales forecasts, output is expected to increase by less than 1 per cent in 1983-84, and by about 1 per cent thereafter. The industry's prices have been forecast to increase rather slower than inflation, which also produces a rate of return similar to that being earned in the current financial target period. As noted, pricing policy is currently under review and these estimates are provisional.

4. Additional Bids

1983-84

4. The additional working capital requirement is attributable mainly to a deterioration in the debtors/creditors balance. This is partly offset by a forecast improvement in internal resources of £55 million, the effect of which is however in turn more than outweighed by the expected cost of the continuation of the new load management arrangements for large industrial consumers, estimated at £100 million (compared with £87 million in 1982-83). This produces a net reduction in internal resources of £45 million, and a total additional external financing requirement (actually, reduced repayment) of £166 million.

1984-85

5. Fixed assets show a forecast reduction of £66 million, mainly attributable to a later assumed start date (Spring 1984) for construction of the Sizewell B power station. This has led to a reduced capital requirement. As in 1983-84, internal resources are forecast to improve, by £51 million, but this is more than offset by the cost of load management, put at £110 million. The total additional external financing requirement is £27 million.

1985-86

6. Capital requirements show an increase of £114 million, but internal resources improve by £281 million, producing increased repayments of external finance of £167 million.

7. Some general observations on the estimates are appropriate :

- (i) The baseline figures adopted for the White Paper were discussed with the industry but not formally accepted by them, since a number of somewhat arbitrary adjustments to earlier figures had to be made, without the benefit of a full review. This makes more difficult the explanation in detail of changes from baseline.
- (ii) What appear large changes in capital requirements, costs and revenues can in fact be caused by small percentage changes in the total scale or incidence of costs and revenues represented by an industry with a current turnover of almost £9000 million pa. Net changes are in fact in most cases the product of a number of changes to cost or revenue components, in both directions.
- (iii) The status and quality of the estimates for 1985-86 - especially with regard to comparisons with the baseline - are inevitably of lower quality than those for earlier years.
- (iv) The Department is exploring with the industry the sensitivities of the estimates and the changes in economic assumptions. It will also be discussing the CEGB's Area Board's capital programmes including the robustness of estimates of spend on power stations which account for over 50 per cent of the industry's programme in 1983-84 and 1984-85.

3. NORTH OF SCOTLAND HYDRO-ELECTRIC BOARD

ANNEX 3/4

TABLE 3.1

BASELINE	£m	1982-83	1983-84	1984-85	1985-86
Total capital requirements		61.5	56.7	57.6	60
Total internal resources		52.8	54.4	63.4	66
Total external finance		8.7	2.3	-5.8	-6

ADDITIONAL INDUSTRY BIDS	£m	1983-84	1984-85	1985-86
Fixed assets in UK		-5.5	-5.4	6.4
Working capital		7.6	-1.7	-4.4
Other		0.3	0.2	-0.4
TOTAL CAPITAL REQUIREMENT ADDITIONAL BID		2.4	-7.9	1.6
INTERNAL RESOURCES ADDITIONAL (SHORTFALL)		(3.4)	(10.1)	(15.9)
Grants		-	-	-
Leasing		-	-	0.3
Short-term borrowing		-	-	-
Long and medium term borrowing		5.8	2.2	17.2
TOTAL EXTERNAL FINANCE ADDITIONAL BID		5.8	2.2	17.5

ASSUMPTIONS 1981-82 = 100, for indices	1982-83	1983-84	1984-85	1985-86
GDP (index number)	100.3	101.5	103.0	104.5
% inflation	11	10	9.5	9
% change in industry tariff	8.5	10	10	9
% change in industry average earnings/ employee	7	10	10	9
Manpower	4,010	3,950	3,890	3,860
Unit labour costs	102.9	110.1	117.1	124.3
Output (index number)	101.0	102.3	104.2	106.1

4. SOUTH OF SCOTLAND ELECTRICITY BOARD

ANNEX 3/4

TABLE 4.1

BASELINE	£m	1982-83	1983-84	1984-85	1985-86
Total capital requirements		304	337	343	357
Total internal resources		93	107	125	130
Total external finance		211	230	218	227

ADDITIONAL INDUSTRY BIDS	£m	1983-84	1984-85	1985-86
Fixed assets in UK		48	49	(99)
Working capital		32	22	31
Other		-	-	-
TOTAL CAPITAL REQUIREMENT ADDITIONAL BID		80	71	(68)
INTERNAL RESOURCES ADDITIONAL (SHORTFALL)		(17)	(37)	(49)
Grants		-	-	-
Leasing		-	-	-
Short-term borrowing		7	7	7
Long and medium term borrowing		90	102	(26)
TOTAL EXTERNAL FINANCE ADDITIONAL BID		97	109	(19)

ASSUMPTIONS 1981-82 = 100, for indices	1982-83	1983-84	1984-85	1985-86
GDP (index number)	101.8	103.8	105.9	107.7
% inflation	10	10	9	9
% change in industry tariff	9	10	10	9
% change in industry average earnings/ employee	9	10	10	9
Manpower	12,900	12,800	12,800	12,900
Unit labour costs	105.6	111.3	122.0	133.4
Output (index number)	101.2	103.6	105.1	107.4

3/4 Scottish Electricity Boards

1. Status of Bids

In this as in previous years, both Boards are using the IFR as their main exercise in strategic thinking. The bids, therefore, represent the outcome of the Boards' considered reappraisal of prospects and plans.

2. Following the CPRS report, the Secretary of State has held preliminary discussions with the Chairmen of both Boards to discuss corporate planning and detailed talks between officials on the possibility of adopting a more formal corporate planning approach on the CPRS model are scheduled for early July. This year, official discussions of the IFR returns were extended to cover certain strategic issues facing the Boards over the next few years; these included closure of power stations, link with England, and storage and reprocessing of nuclear fuel. The Secretary of State plans to put a paper to his colleagues on the Boards' strategy during July.

3. The Scottish Office intend to agree a financial target with the Boards for the period starting April 1983 and to reach agreement in July on performance aims for the period 1982-83 to 1984-85.

2. Recent Performance

4. Financial targets and performance aims have not yet been agreed by the Boards. The Scottish Office are carrying out a performance review of the Boards which is expected to be complete by the end of July.

5. A preliminary assessment shows in terms of generation and transmission performance, real costs per unit sent out have fallen by approx 2% a year over the 3 years to 1980-81, but that unit distribution and other costs have increased throughout the same period particularly in 1980-81 as a result of a fall in sales.

6. The Boards' combined sales fell by just under 3% between 1979-80 and 1981-82 and are expected to fall further this year mainly as a result of the closure of the Invergordon smelter. Both in 1980-81 and 1981-82, the Boards'

investment fell well short of their investment approvals (by 3.4 and 18.1 per cent respectively) and stayed well within their EFLs (by £7.4m and £18.3m).

7. Tariffs are some 10-15% below average tariffs in England and Wales for domestic consumers; the differential in tariffs for industrial consumers is considerably less.

3. Assessment of Industries' Economic Assumptions

8. The two Boards have adopted slightly different assumptions on GDP, inflation and interest rates. The assumptions of GDP are well within the range of independent forecasts although the growth rate assumed for 1982-83 by NSHEB looks somewhat low. The forecasts for inflation envisage only a small reduction over the period. Both Boards assume that after 1982, coal prices will rise by 2½% a year in real terms and oil prices by 5% a year. These assumptions contrast with the industry in England and Wales which is assuming no real increases in fossil fuel prices.

9. The Boards are assuming an annual increase in sales of 1.75% on average over the 5 years from 1981-82; this is significantly higher growth than is assumed by the industry in England and Wales.

4. Additional Bids

10. The greater part of the additional bid in 1983-84 and 1984-85 reflects a revision in the Estimates of expenditure on the Torness nuclear station, including associated transmission work. A review last year following the placing of the most important contracts led to a reallocation of forecast expenditure from 1981-82, 1982-83 and 1985-86 into the 2 years 1983-84 and 1984-85. The changes are reflected in increases both in fixed asset expenditure and in other capital expenditure (accrued liabilities and contract retentions). The revised Estimates are based on the assumption that construction will proceed to programme. Although there has been no slippage to date, the safety margin built into the programme for the production of boilers has been eroded due to difficulties at the factory and any further delays in this area may be reflected in progress on the project as a whole.

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11. The other main component of the additional bids for external finance is a reduction in internal resources. This reflects partly lower sales forecasts but mainly the assumption that tariff increases will match or be lower than increases on the RPI. Given the assumption that fossil fuel prices will rise significantly in real terms over the period, this implies a reduction in the rate of return on capital in CCA terms.

12. Torness accounts for about 80% of the Boards' combined capital programme in the IFR period. Further information is being sought on the implications of a slow-down in construction (whether involuntary or deliberate). The scope for other capital savings seems limited. The sensitivity of the external financing estimates to changes in economic assumptions is also being explored with the Boards. The Scottish Office is examining with the Boards the scope for reducing estimates of operating costs.

13. The bids assume that the Invergordon smelter remains closed. In addition to the bids set out in the table, the Boards have asked the Government to alleviate the interest burden arising from the purchase of the smelter tranche of Hunterston B power station in 1981-82 for £99m. The Boards have requested relief amounting to some £5.5m to £6.5m a year in the IFR period.

5. BRITISH GAS CORPORATION

TABLE 5.1

BASELINE	£m	1982-83	1983-84	1984-85	1985-86
Total capital requirements		1082	1106	1108	1152
Total internal resources		1165	991	1228	1277
Total external finance		-83	115	-120	-125

ADDITIONAL INDUSTRY BIDS	£m	1983-84	1984-85	1985-86
Fixed assets in UK		-3	-	-70
Working capital		-4	-4	2
Other		-	-	-
TOTAL CAPITAL REQUIREMENT ADDITIONAL BID		-7	-4	-68
INTERNAL RESOURCES ADDITIONAL (SHORTFALL)		(66)	(214)	55
Grants		-	-	-
Leasing		-	-	1
Short-term borrowing		62	213	-124
Long and medium term borrowing		-3	-3	-3
Foreign borrowing		-	-	3
TOTAL EXTERNAL FINANCE ADDITIONAL BID		59	210	-123

ASSUMPTIONS 1981-82 = 100, for indices	1982-83	1983-84	1984-85	1985-86
GDP (index number	102	105	106.5	107.5
% inflation	10%	8%	8%	8%
% change in industry tariff ⁽¹⁾	23%	8%	8%	10%
% change in industry average earnings/employee	8%	8%	8%	8%
Manpower (thousands)	102.9	102.4	101.7	101.0
Unit labour costs (index number)	106.5	110.0	114.4	118.1
Output (index number) (million therms of gas sold and used)	101.6	106	109.6	113.7

(1) increase in domestic tariffs. Comparable run for contract prices is 5½%, 8%, 8%, 8%.

5 British Gas Corporation

1. Status of Bids

The bids proposed by the industry are consistent with the Corporate Plan. Discussions of the Plan should shortly begin and will be completed by the Autumn.

2. Recent Performance

2. BGC have been set a financial target of a $3\frac{1}{2}$ per cent average rate of return on average net assets at current cost for the three years ending 31 March 1983, and a performance objective of a 5 per cent reduction in real terms in net trading costs for the same period. They are forecasting to meet both. A target for later years has not yet been set.

3. Assessment of economic assumptions

3. In their economic assumptions BGC's forecast of inflation is very much in line with that of independent forecasters. They are however more optimistic in their forecasts of GDP, forecasting a growth of 7.5 per cent in the period to 1985-86 against an average of 6.8 per cent forecast by independent sources. In 1982-83 domestic tariff and prices are assumed to rise by 23 per cent while contract prices show a $5\frac{1}{2}$ per cent increase. In later years contract prices are expected to rise at the rate of (BGC assumed) inflation, as are domestic tariffs except in 1985-86 when they are forecast to rise by 2 per cent real in order to maintain domestic profitability. Manpower shows a small decline of 1,900 over the period from 1982-83 to 1985-86 while average earnings are expected to increase ^{in line with} inflation. Given the small increase in output unit labour costs reach 118.1 by 1985-86 (1981 equals 100). The wage bill shows a reduction in real terms over the planning period.

4. Additional bids

4. BGC are forecasting minor savings in capital requirements in 1983-84 and 1984-85. There are however considerable changes in the composition of BGC's capital expenditure as a result of escalating costs on the Rough and Morecambe

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projects. The Department are currently probing this with the Corporation.

5. The baseline figures for 1983-84 and 1984-85 are those agreed by the Secretary of State and the Chief Secretary. BGC subsequently advised the Department that the agreed cuts in capital expenditure and operating costs in the 1981 IFR would result in additional taxation and a reduction of £52m and £65m in the level of repayments in 1983-84 and 1984-85 respectively. No account of these additional payments was taken in last year's White Paper and therefore part of the additional bid is represented by this higher forecast of taxation.

6. A deterioration in internal resources is forecast for 1983-84 and 1984-85 as a result of a considerable fall in estimated profits, partly offset by an increase in interest receivable. The change is analysed below:

Table 5.2

(+ = improvement)

	<u>1983-84</u>	<u>1984-85</u>
		<u>£m</u>
Profit	-73	-274
Interest	+39	+64
Taxation	+190	+263
Additional taxation after cuts	-52	-65
Depreciation	-117	-143
Other non-cash adjustments (accounting adjustments SSAP 16 and MWCA)	-55	-65
Sale of fixed assets	+5	+6
Other capital receipts	-3	0
	<u>-66</u>	<u>-214</u>

7. The fall in profits results from a large fall in turnover due largely to a lower estimated demand for gas coupled with lower prices forecast for gas sold.

Table 5.3

	<u>1983-84</u>	<u>1984-85</u>
		<u>£m</u>
Change in turnover - all activities	-570	-1176
Volume change in gas income	-92	-104
Revenue changes in gas income	-436	-881

8. BGC see little hope of making up the lost volume (221m therms in 1983-84, 226m in 1984-85) and are reluctant to lift their present marketing restrictions until gas supplies can be increased. In 1985 BGC are forecasting lower price increases in both the contract and tariff markets. Increases are projected at the rate of inflation they have assumed (8 per cent). Previously they were forecasting a 5 per cent real increase in domestic tariffs with contract prices tied to oil price increases which were above the rate of inflation.

9. The fall in turnover has been partly offset by savings in costs of £497m in 1983-84 and £902m in 1984-85. These savings have been ^{secured} largely in the cost of gas as a result of lower sales and less uncertainty over future prices coupled with an assumption that the gas levy will be 1p/therm lower at 4p/therm. The rate of levy for years after 1982-83 has not yet been decided by Government, although the Gas Levy Act provides for the levy to continue at the 1982-83 rate if it is not changed by Order.

Table 5.4

(+ = improvement)

<u>SAVINGS IN COST</u>		<u>£m</u>	
		<u>1983-84</u>	<u>1984-85</u>
Cost of gas		+102	+426
Gas levy		+154	+149
Trading costs		+70	+120
Other costs	- depreciation	+117	+143
	- current cost adjustments	<u>+54</u>	<u>+64</u>
		<u>+497</u>	<u>+902</u>

10. The Department are probing the question of trading costs with the Corporation.

6. BRITISH STEEL

ANNEX 6

TABLE 6.1

BASELINE	£m	1982-83	1983-84	1984-85	1985-86
Total capital requirements		301	316	335	348 (2)
Total internal resources		-64	116	325	338
Total external finance		365	200	10	10

ADDITIONAL INDUSTRY BIDS	£m	1983-84	1984-85	1985-86
Fixed assets in UK		7	25	
Working capital		0	10	
Other		0	0	
TOTAL CAPITAL REQUIREMENT ADDITIONAL BID		7	35	
INTERNAL RESOURCES ADDITIONAL (SHORTFALL)		7	(46)	
Grants		0	0	
Leasing		0	0	
Short-term borrowing		0	0	
Long and medium term borrowing		0	81	
TOTAL EXTERNAL FINANCE ADDITIONAL BID		0	81	

ASSUMPTIONS 1981-82 = 100, for indices	1982-83	1983-84	1984-85	1985-86
RPI (all items) index	110	121	133	
Short term interest rates (level)	15%	13%	13%	
% change in industry tariffs (Home)	13	9	9	
Manpower	92,400	88,300	87,800	
Average earnings per employee' (index no.)	112	123	132	

(1) Excluding central staff

(2) BSC's Corporate Plan does not extend to 1985-86, therefore this year will not be considered in this IFR.

6 BRITISH STEEL CORPORATION

1. Status of Industry Bids

1. The BSC bids are based directly on the Corporate Plan for 1982/85 which was considered by E(NI) on 9 June. BSC are undertaking a review of their 3 integrated strip mills, the outcome of which is likely to affect the projected figures for 1983/84 and 1984/85. The Secretary of State is to report further to E(NI) in the light of that review.

2. Recent Performance

2. BSC's performance in 1981/82 was close to target, and both EFL and loss targets would have been met, but for the effects of the severe weather and the ASLEF dispute. Performance so far in 1982/83 has however been adversely affected by a significant decline in UK steel order intake.

3. Assessment of Economic Assumptions

3. The economic assumptions underlying the IFR figures were analysed in the recent report on the BSC Corporate Plan for E(NI). They are considered to be reasonable, provided the international steel market does not collapse, bringing down prices to uneconomic levels.

4. Additional Bids

4. An increase in the EFL for 1982/83 from £350m to £365m was agreed by E(NI) on 9 June. There is an additional bid of £81 million for 1984/85, above the current PES provision for that year of £10 million. Until further decisions are taken in the light of the strip mills review referred to above, the case for the extra £81 million cannot be made in detail; the current provision of £10 million in 1984/85 may however prove unrealistic.

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ANNEX 7

7. BRITISH TELECOM

TABLE 7.1

BASELINE	£m	1982-83	1983-84	1984-85	1985-86
Total capital requirements		2472	2850	3120	3245
Total Internal Resources		2152	2535	2805	2917
Revised Baseline Capital Requirements ⁽¹⁾		2043	2415	2645	2751
Revised Baseline Internal Resources		1723	2100	2330	2423
Total external finance		320	315	315	328

(1) Revised baseline on accounting basis used in BT's plan

ADDITIONAL INDUSTRY BIDS over revised baseline (provisional) £m	1983-84	1984-85	1985-86
Fixed assets in UK	205	240	
Working capital	-79	-45	
Other	9	9	
TOTAL CAPITAL REQUIREMENT ADDITIONAL BID	135	204	197
INTERNAL RESOURCES ADDITIONAL (SHORTFALL)	(102)	(74)	26
Grants	-	-	
Leasing	-3	-4	
Short-term borrowing	-30	-	
Long and medium term borrowing	270	282	
TOTAL EXTERNAL FINANCE ADDITIONAL BID	237	278	171

ASSUMPTIONS 1981-82 =100, for indices	1982-83	1983-84	1984-85	1985-86
GDP (index number)	101.5	104.5	107.2	105.6
% inflation	11	10	10	10
% change in industry tariff	4.3	3.4	4.8	1.4
% change in industry average earnings/employee	11.9	10.9	11.9	9.7
Manpower	245,200	398,600	236,000	232,700
Unit labour costs %	-6.6	-6.1	-6.7	-7.7
Output (index number)	108.4	116.0	124.1	132.8

7 British Telecom

1. Status of Bids

1. The BT bids are those contained in their 1982 Medium Term Plan. The Plan has been discussed by officials and BT management and formed the basis of a presentation by the BT Board to the Secretary of State and the Chief Secretary on 20 May. As a result of these discussions BT have been asked to investigate ways in which their requirements could be brought back within the projected baseline figures for external finance, without cuts in desirable investment.
2. The Secretary of State discussed those issues with the Chairman of BT on 24 June and following the consideration of the Medium Term Plan at E(NI) in early June further discussion with BT will be necessary.

2. Recent Performance

3. In 1979-80 to 1981-82, BT's financial target was to make a return of 5% (before interest) on mean net assets at replacement cost. In 1979-80 and 1980-81 the business fell short of the target, earning returns of 4.6% and 4.4%. In 1981-82 the return was about 6.2% on the basis of old accounting policies - the equivalent of 6.8% using the (proposed) new accounting policies.
4. The main reason for this fluctuating performance has been the level of business growth and income. The recession reduced historic rates of traffic growth (of around 10%) to about 3% in 1980-81. In 1981-82 however the business was over-cautious in its traffic projections and income rose by a somewhat larger amount and above the figure projected, making the price rise in November 1981 appear, at least in part, unnecessary.
5. Real investment has increased in each of the last three years as BT have geared up for their modernisation programme. There has been a contrast between 1981-82 and the earlier years in that BT fell £150 million short of their capital budget last year. The increase in real investment in 1981-82 has therefore been notably more modest than in the recent past and than originally planned. The

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main reason for this has been the lower customer demand.

6. Corresponding to these changes in business performance, BT have suffered continual EFL difficulties. In 1979-80 the limit was held only by resort to expediency measures and in 1980-81 they overran the EFL which had been raised by £145 million in the course of the year. On the other hand BT were £130 million inside their 1981-82 EFL of £380 million which had been increased by £200 million early in the year. This confirmed the suggestion that in part the 1981 price rise had not in fact been needed.

7. The most significant conclusion from these contrasting histories was that BT's forecasting has not been accurate enough. This is bound to colour attitudes towards their current plans.

Assessment of Economic Assumptions

8. BT's 1982 Medium Term Plan is relatively optimistic about GDP (forecast to grow by 3% and 2.5% in 1983-84 and 1984-85) and relatively pessimistic about inflation (which is not forecast to fall below 10% in any year). BT's average tariff assumptions are well within their forecasts of the general movement in prices; they intend to carry out further tariff rebalancing measures to equalise returns on individual services which would entail domestic bills rising by more than business bills.

9. BT are assuming increases in average earnings per employee slightly above their inflation assumption. The estimated reductions of a little under 7% per annum in unit labour costs rely substantially on continued growth in output, although BT project a modest fall in manpower. There would appear therefore to be scope for greater improvements in productivity and possibly for a more rapid reduction in manpower.

Additional Bids

10. BT have proposed major changes in their accounting policy, the effect of which is to expense items which have in the past been charged to capital account. These proposals are acceptable to Ministers but discussions are continuing concerning some of them. The 1982 Medium Term Plan was framed on the assumption that BT's proposals would have been fully implemented and the baseline has been revised to a consistent basis. This will need to be revised further when final agreement has been reached on the accounting policies BT should now adopt.

11. Additional investment bids of £205 million and £240 million in 1983-84 and 1984-85 are the main reason why BT have submitted plans for higher external finance requirements. In these years lower projected internal resources (£102 million and £74 million below baseline respectively) have also contributed to additional finance bids of £237 million and £278 million. In 1985-86 increased capital expenditure is also the most important factor in a higher financing bid of £171 million. The projected investment figures are slightly below the level envisaged in BT's 1981 Medium Term Plan, but there remains a substantial gap between them and the baseline.

12. Officials are exploring ways of narrowing the financing gaps projected in the 1982 Plan. The most concrete means of closing them completely would appear to lie in:

(i) Tighter control of working capital. Officials are not satisfied that the needs projected are not excessive. Are BT over-stocking? Could other working capital requirements be controlled more commercially?

(ii) Higher rates of increase in productivity.

(iii) A more realistic appreciation of likely trends in input prices and average earnings. BT might also consider the scope for greater reductions in manpower.

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8 POST OFFICE

ANNEX 8

TABLE 8.1

BASELINE	£m	1982-83	1983-84	1984-85	1985-86
Total capital requirements		105	124	137	142
Total internal resources		143	162	175	182
Total external finance		-38	-38	-38	-40

ADDITIONAL INDUSTRY BIDS	£m	1983-84	1984-85	1985-86
Fixed assets in UK		72.8	61	40
Working capital		0	0	-2
Other		0	0	0
TOTAL CAPITAL REQUIREMENT ADDITIONAL BID		72.8	61	38
INTERNAL RESOURCES ADDITIONAL (SHORTFALL)		(31.1)	(20.8)	(7.1)
Grants		0	0	0
Leasing		-3.9	-4.2	-2.2
Short-term borrowing		107.6	86	47.5
Long and medium term borrowing		0.2	0	-0.2
TOTAL EXTERNAL FINANCE ADDITIONAL BID		103.9	81.8	45.1

ASSUMPTIONS 1981-82 =100, for indices	1982-83	1983-84	1984-85	1985-86
GDP (index number)	101.4	103.9	106.0	106.5
% inflation (RPI)	109.5	119.4	130.1	141.8
% change in industry tariff	107	115	126	138
% change in industry average earnings/employee	107	121	133	148
Manpower	174,000	173,800	173,700	172,500
Unit labour costs	106	113	122	133
Output (index number)	100	103	105	106

8 Post Office (Postal)

1. Status of Bids

The Postal Business investment and strategic review was received in late May.

2. The Department of Industry and the Treasury have discussed the plan with the Post Office on 16 June and as a result of the discussions the Post Office has been asked to provide additional information on a number of points, including:

- (a) a note on sensitivities and the effects on the central strategy of changes in certain basic assumptions, such as volume, productivity, and pay;
- (b) the pay assumption for 1 April 1983-84, which appears excessive;
- (c) a note on the investment appraisal of letter mechanisation;
- (d) a breakdown of the additional investment in this year's plan compared to last year's White Paper;
- (e) to show wherever possible that any bid for increases investment has been properly appraised.

2. Recent Performance

3. The financial objective for 1980-81 to 1982-83 is for a return after historic and supplementary depreciation and interest of 2% on turnover. A similar target for 1978-79 and 1979-80 was met but performance fell short in 1980-81 with an achievement of only 1.1 per cent ⁽¹⁾ on turnover due to the effect of the recession on revenue from certain services, particularly parcels and overseas mail. Performance in 1981-82 has seen a substantial improvement with an estimated return after interest of 3.6 per cent on turnover. The major contributory factors were improvements in productivity together with success in containing the anticipated fall in postal traffic. These have resulted in improved revenue and cash flow with consequently increased profit and a higher contribution from interest on cash balances held. Real unit costs were held

(1) before other gains

steady in 1981-82, as against 1980-81 levels. This performance was better than the Post Office has recently managed against the current performance target - to hold costs steady in the quinquennium ending 1982-83, and provides the Post Office with a good base from which to address the new, more testing target set for 1982-83 to 1984-85 which taking 1981-82 as a baseline requires a 5 per cent reduction on real unit costs.

3. Assessment of Industry's Economic Assumptions

4. The Post Office's assumptions on inflation are relatively pessimistic at 9 $\frac{1}{2}$ per cent in 1982-83 and 9 per cent thereafter. Earnings per man are forecast to be rather above inflation based on an assumption of basic wage increases of about 10% plus some locally-negotiated productivity addition. Tariffs, reflecting assumed continuation of the existing financial target (which expires in 1982-83), will be somewhat below inflation.

4. Additional Bids

5. The main changes in the postal business compared to the White Paper base are an increased bid for investment in fixed assets, and internal resources some 10-15 per cent lower than in 1983-84 and 1984-85. The external financing bids are for £103.9 million in 1983-84, £81.8 million in 1984-85 and £45.1 million in 1985-86. It should be noted that, while the baseline assumes that the NIS reduction will be clawed back, the Post Office plan assumed that the benefits of the reduction would be passed on to customers in 1983-84 and subsequent years in the form of lower tariffs than would otherwise be necessary. This differing treatment accounts for £13 million of the Post Office's bids for external finance in each year.

6. In the light of the further information requested and on the basis of the discussion of the Corporate Plan DOI and Treasury officials are now considering how the gap can be closed. Some possibilities are an examination of the effects of reducing the scale of the investment programme proposed (for the later years in particular some of the Post Office's figures are broad estimates of cost), the scope for reduced expenditure through further increased efficiency, a new and more testing financial target (the present one expires in 1982-83) and the effect of lower planning assumptions, particularly for inflation and earnings.

9. NATI

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ANNEX 9

9. NATIONAL GIROBANK

TABLE 9.1

BASELINE	£m	1982-83	1983-84	1984-85	1985-86
Total capital requirements		8.3	7.5	10.5	11.0
Total internal resources		8.3	7.5	10.5	11.0
Total external finance		0	0	0	0

ADDITIONAL INDUSTRY BIDS	£m	1983-84	1984-85	1985-86
Fixed assets in UK		1.3	1.3	na
Working capital		0	0	na
Other		1.5	-0.4	na
TOTAL CAPITAL REQUIREMENT ADDITIONAL BID		2.8	0.9	2.9
INTERNAL RESOURCES ADDITIONAL (SHORTFALL)		2.8	0.9	2.9
Grants		0	0	0
Leasing		0	0	0
Short-term borrowing		0	0	0
Long and medium term borrowing		0	0	0
TOTAL EXTERNAL FINANCE ADDITIONAL BID		0	0	0

ASSUMPTIONS 1981-82 = 100, for indices	1982-83	1983-84	1984-85	1985-86
GDP (index number)	101.3	103.8	105.9	106.4
% inflation (RPI)	110.5	121.6	133.7	147.1
% change in industry tariff	108.0	112.0	119.0	125.0
% change in industry average earnings/employee	113.1	125.6	144.9	155.3
Manpower numbers	5,200	5,100	5,000	5,300
Unit labour costs	na	na	na	na
Output (index number)	114.3	134.7	153.1	159.2

9. National Girobank

1. Status of Bids

The National Girobank Business Plan and IFR were received in mid April.

2. The Department of Industry, Treasury and the Bank of England have met the Girobank to discuss the plan.

3. The National Girobank plan needs refinement in certain respects, particularly in the introduction of a sensitivity analysis indicating the effect on the plan of different assumptions in key areas such as interest rates; real wages; growth of bank accounts.

4. The National Girobank has accordingly been asked to provide the relevant information.

2. Recent Performance

5. Over the past years the National Girobank helped to some extent by high interest rates has normally more than met its financial target and has more than stayed within its external financing limits.

3. Assessment of Economic Assumptions

6. The key economic assumptions affecting the National Girobank are on interest rates and real earnings (see para 3 above). The bank has been asked to look at the effect on its Corporate Plan of different assumptions in these areas.

4. Additional Bids

7. The National Girobank's bids are generally in line with those in last year's White Paper; the implied external financing requirement is unchanged over the period and the changes relate mainly to increased need for working capital which is balanced by increased internal resources.

10. BRITISH AIRWAYS

TABLE 10.1

BASELINE	£m	1982-83	1983-84	1984-85	1985-86
Total capital requirements		257	338	395	411
Total internal resources		265	246	305	317
Total external finance		-8	92	90	94

ADDITIONAL INDUSTRY BIDS	£m	1983-84	1984-85	1985-86
Fixed assets in UK		-123	-193	-194
Working capital		10	-	-
Other		-6	-7	-4
TOTAL CAPITAL REQUIREMENT ADDITIONAL BID		-119	-200	-198
INTERNAL RESOURCES ADDITIONAL (SHORTFALL)		(119)	(102)	(73)
Grants		-3	-3	-4
Leasing				
Short-term borrowing		3	-95	-121
Long and medium term borrowing				
TOTAL EXTERNAL FINANCE ADDITIONAL BID		-	-98	-125

ASSUMPTIONS 1981-82 = 100, for indices	1982-83	1983-84	1984-85	1985-86
GDP (index number)	100.5	102	104	105.6
% inflation (RPI)	11.0	11.5	12.0	11.5
% change in industry average earnings/employee	6.7	12.9	12.1	11.4
Manpower	40,805	38,870	36,935	34,000
Unit labour costs (index)	94.6	100	104.1	105.4
Output (index number) for TKs	96.2	98	100.6	102.9

10 BRITISH AIRWAYS BOARD

1. Status of Bid

1. British Airways' IFR submission is drawn largely from the recommended strategy (option C) in GP10, the airline's latest corporate plan. This strategy has not yet been endorsed by the British Airways Board pending further consideration of the scope for cuts in capital expenditure and operations. The Board has approved the figures, though, for the purposes of the IFR.

2. Officials are currently discussing GP10 with BA. The intention is to submit a paper for a Performance and Corporate Plan Review discussion by E(NI) before the end of July. Dependent on these discussions, and the Board's further consideration of their future strategy, BA's external financing bids may be altered.

2. Recent performance

3. British Airways' current cost return on net assets for the three years ending 31 March averaged -6.8% pa compared to the Government's financial target of +6% pa. This reflects the substantial losses made by the airline in the last two financial years. Although the downturn in demand in the air transport sector was largely to blame for BA's performance in these years, the airline also suffered from accumulated inefficiencies and overmanning, and from the over-optimistic expansion programme that it embarked on at the beginning of the period.

4. BA's management started to remedy these problems in September 1981 when they announced a series of economy measures - including a cut of 8,000 staff by June 1982 - aimed at cutting costs and increasing competitiveness. The short term costs of these measures added to British Airways' losses and financing requirements in 1981-82, but the measures had been largely completed by the end of the year, and they can be expected to contribute to an improvement in the airline's underlying trading position in the period covered by the IFR.

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3. Assessment of Economic assumptions

5. British Airways has made relatively pessimistic assumptions for GDP and inflation. BA's pay assumption is broadly in line with their assumption on inflation. Manpower is forecast to continue to decline with the implementation of a further staff severance scheme, and it is this that will be primarily responsible, together with increased productivity, for the low rise in BA's unit labour costs. BA's total output will not increase much over the period, partly as a result of the restraint in capital investment proposed in BA's corporate plan, but also due to sluggish market recovery, and in the later years increasing competition.

4. Additional bids

6. BA's bids (which include contingency allowances) significantly undershoot the EFR for 1984-85 set out in the 1982 Public Expenditure White Paper and the implied EFR for 1985-86. This reflects the substantially lower levels of capital expenditure proposed in option C of GP10 compared to the White Paper. BA plans to accommodate this by increasing its fleet utilisation, and by reducing the size of the airline's operating network (by withdrawing from unprofitable routes); BA also plans to improve efficiency through further reductions in manpower. Such are the poor market prospects and mounting competitive pressures on the airline business, however, that these improvements are not expected to bring internal resources to the (now clearly over-optimistic) levels forecast by BA last year. Officials are probing with BA the realism of their current forecasts.

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11 BRITISH AIRPORTS AUTHORITY

ANNEX 11.1

TABLE 11.1

BASELINE	£m	1982-83	1983-84	1984-85	1985-86
Total capital requirements		148	204	193	201
Total internal resources		101	168	174	181
Total external finance		47	36	19	20

ADDITIONAL INDUSTRY BIDS	£m	1983-84	1984-85	1985-86
Fixed assets in UK		-29	4	-14
Working capital			-1	-3
Other			1	-4
TOTAL CAPITAL REQUIREMENT ADDITIONAL BID		-30	4	-21
INTERNAL RESOURCES ADDITIONAL (SHORTFALL)		(41)	(21)	(35)
Grants				
Leasing				
Short-term borrowing				
Long and medium term borrowing		11	25	14
TOTAL EXTERNAL FINANCE ADDITIONAL BID		11	25	14

ASSUMPTIONS 1981-82 = 100, for indices	1982-83	1983-84	1984-85	1985-86
GDP (index number)	101.9	103.8	105.9	107.9
% inflation	10	10	7.5	7.5
% change in traffic charges	NIL	10	10	7.5
% change in industry average/earnings employee	7	10	10	7.5
Manpower	7,221	7,275	7,372	7,938
Unit labour costs, £/passenger	2.02	2.11	2.19	2.33
Output (index number) : traffic	104.7	111.4	118.5	125.6

11 British Airports Authority

1. Status of Bids

The Authority's Corporate Plan, its Five Year Budget and fixed capital investment programme, and the business assumptions on which these are based, have been discussed in detail. The timing of investment on the three major projects, Terminal 4 at Heathrow, the second terminal at Gatwick and the development of Stansted, has also been considered; together these account for 62% of the proposed expenditure over the review period. The Authority's fixed capital expenditure bid for the three future years has been reduced by 20% overall from the Corporate Plan levels to allow for possible slippage.

2. Recent Performance

The Authority achieved a 5.6% CCA return on average net assets in 1981-82 compared with 5.9% the previous year and its target of an average of 6% over the three year period 1980-81 to 1982-83. This achievement results from success in controlling costs, higher than forecast commercial revenue, and higher interest receivable from cash on deposit because of slippage in the capital expenditure programme resulting from planning delays. Overall performance against target has been adversely affected by the Scottish airports which have seen a substantial downturn in traffic.

3. The recession has affected progress on the Authority's two performance aims which are, an increase in passengers handled per employee of an average of 3% per annum, and a reduction in operating costs per passenger of an average of 2½% per annum, both over the 3 year period 1980-81 to 1982-83. In the first year the results were disappointing being -1.1% and +1.3%; but in 1981-82 the results were much improved being +4.9% and -0.7% reflecting the gains in productivity which the Authority has made. The outturn over the 3 year period is expected to be +3.6%, better than target, and -1.3% somewhat below target, though the Authority expect to achieve this in 1983-84.

4. Economic Assumptions

After the slowdown over the last two years in the growth of air traffic the Authority expects the upward trend experienced in each of the last 10 months

to continue with an overall growth in terminal passengers of about 6% per annum reaching 54 million in 1985-86. This forecast is lower than that made in its 1981 plan by the equivalent of about one year's growth. The Authority has also revised downwards its longer term planning forecasts in a similar way and these are now in line with the Department of Trade's forecasts.

5. These forecasts suggest that capacity at Heathrow (30 mppa) will be reached in 1984-85, about two years before Terminal 4 is ready, and since growth at Gatwick (which has grown at over 1 million passengers per annum through the recession) is forecast to continue at the present rate, capacity there (16 mppa) may be reached before 1987, the earliest date that the first phase of the planned second terminal could be ready even if planning consent were now given. Both airports are likely to suffer increasing congestion over the next few years.

6. The Authority's inflation assumptions are somewhat more pessimistic than the Government's. Its revenue forecasts assume that traffic charges will increase in line with inflation after 1982-83 (subject to the outcome of the present litigation on charges) though commercial revenue is expected to show some real increase as a result of increased promotional and retailing activities. Tariffs and average earnings per employee are projected to rise broadly in line with inflation but the paybill and unit labour costs are expected to increase in real terms as the number of employees increases in the latter part of the period in preparation for the opening of new terminal facilities, particularly Terminal 4 at Heathrow and later the second terminal at Gatwick.

7. Additional Bids

The Authority's bid for fixed capital expenditure over the 3 year period is in total £46 million lower than the baseline. The principal reason is the delay in timing of expenditure on all three major projects as a result of planning delays, and the Authority has realistically allowed a significant amount of slippage to allow for this, but some savings will result from construction costs being lower than previously estimated. Changes in other capital requirements are small. The Authority forecasts a total shortfall in its internal resources of £96 million over the 3 years, and its bid for external finance is therefore increased by £50 million over the period despite an anticipated undershoot of £12 million in 1982-83.

8. The reduction in internal resources arises principally from the Authority's decision, taken in the light of the current litigation over its airport charges and threats of retaliatory action by the United States, to maintain its traffic charges at the May 1981 level through 1982-83 thus foregoing recovery of increase in costs. Since the Authority plans to increase its traffic charges in future years only in line with inflation, this loss of revenue will persist in each of the future years of the review period. In total this is expected to account for about £51 million of the shortfall on internal resources. A further £10 million of the shortfall is accounted for by lower tax benefits from building allowances resulting from lower than previously forecast capital expenditure in the years 1980-81 to 1982-83.

9. The scope for reducing external financing requirements by increasing internal resources is limited first by the extent to which the Authority is inhibited from making real increases in traffic charges (already among the highest in the world) by the current legal action by the airlines, the constant pressure by the United States Government to have them reduced, and the increasing contingent liability arising from any damages awarded by the Courts; and secondly because the Authority has already made substantial savings in its controllable costs. On the Authority's traffic growth assumptions, there is not much scope for cutting the investment programme significantly, particularly in 1984-85 and 1985-86, since the Authority has already allowed a substantial amount of slippage in anticipation that major projects may have to be deferred if planning consents are not obtained in due time. These issues are still being scrutinised and will be reported on by the Secretary of State to E(NI) in the Corporate Plan review in early July.

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ANNEX 12

12 CIVIL AVIATION AUTHORITY

TABLE 12.1

BASELINE	£m	1982-83	1983-84	1984-85	1985-86
Total capital requirements		36.5	36.1	36.8	38.6
Total internal resources		5.6	17.6	22.1	23.2
Total external finance		30.9	18.5	14.7	15.4

ADDITIONAL INDUSTRY BIDS	£m	1983-84	1984-85	1985-86
Fixed assets in UK		-0.4	-2.0	-
Working capital		-4.4	-1.2	-2.4
Other		-	-	-
TOTAL CAPITAL REQUIREMENT ADDITIONAL BID		-4.8	-3.2	-2.4
INTERNAL RESOURCES ADDITIONAL (SHORTFALL)		(4.8)	(3.2)	(1.8)
Grants				
Leasing				
Short-term borrowing				
Long and medium term borrowing				
TOTAL EXTERNAL FINANCE ADDITIONAL BID		-	-	-0.6

ASSUMPTIONS 1981-82 = 100, for indices	1982-83	1983-84	1984-85	1985-86
GDP (index number)	100.5	102.5	105.1	107.2
% inflation	107.0	113.4	119.1	125.0
% change in industry tariff ⁽¹⁾	100.0	103.3	107.5	111.6
% change in industry average earnings/employee	105.0	108.3	111.3	116.1
Manpower	7,505	7,421	7,304	7,239
Unit labour costs	100.4	106.1	112.1	118.6
Output (index number)	-	-	-	-

(1) 1982-83 = 100

12 CIVIL AVIATION AUTHORITY

Status of Industry Bids

There are no additional bids.

2. Discussions have been held on the 1982 Corporate Plan and as a result the Authority is to issue a revised version/supplementary notes incorporating specific Department of Trade and Treasury comments. DOT and Treasury views on the general Corporate Plan format have been sent to the CAA and are being considered. The Authority's IFR bids, which have been agreed with the DOT and the Treasury, will be reflected in the revised Corporate Plan.

Recent Performance

3. A financial target has not yet been agreed between the CAA and Central Government but work is in progress on this issue. The Authority's self-imposed target is to achieve a 5% return after interest on capital employed on a historic cost basis with the exception of the operation of its highlands and islands aerodromes and on operations where charges are fixed internationally (Eurocontrol). In the last 5 years the average rate of return has been 7.7 per cent.

Economic Assumptions

4. The GDP assumptions reflect the view that the world economic recession is virtually over but that emergence from the recession in the UK may be delayed until later in 1982.

5. The Treasury's general inflation assumptions have been adopted. The tariff index shown on the table is a weighted average based on the forecast price changes for each of the CAA's controllable activities in the IFR period. Manpower is expected to decline with the introduction of more modern telecommunications equipment which will give rise to greater traffic-handling capability and hence productivity improvements.

6. The Authority has not produced an output index but its traffic assumptions

are as follows: passenger volume is expected to increase by an average 5.4% per annum over the period 1981-2-1986-7 whilst Air Transport Movements, which declined by about 3% in 1981-2, will increase at an average annual rate of 1.0% until 1986-87.

Additional Bids

7. There are no additional bids.

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BRITISH RAIL

ANNEX 13

to nearest £1m

TABLE 13.1

BASELINE	£m	1982-83	1983-84	1984-85	1985-86
Total capital requirements		193	221	221	230
Total internal resources		-744	-772	-821	-854
Total external finance		897	993	1042	1084
ADDITIONAL INDUSTRY BIDS	£m	1983-84	1984-85	1985-86	
Fixed assets in UK		40	49	134	
Working capital		-43	-12	-2	
Other		-29	-51	-91	
TOTAL CAPITAL REQUIREMENT					
ADDITIONAL BID		-32	-14	41	
INTERNAL RESOURCES ADDITIONAL (SHORTFALL)		(29)	(10)	(142)	
Grants		41	93	164	
Leasing		)			
Short-term borrowing		) -44	-97	19	
Long and medium term borrowing		)			
TOTAL EXTERNAL FINANCE ADDITIONAL BID		-3	-4	183	
ASSUMPTIONS	1981-82 = 100, for indices	1982-83	1983-84	1984-85	1985-86
GDP (index number)		101.0	102.7	104.4	106.0
% inflation		10.9	10.2	9.6	9.6
% change in industry tariff: freight		5.2	6.8	10.4	7.9
passenger		9.9	11.6	11.2	11.5
% change in industry average earnings		11.2	9.4	11.3	12.8
earnings/employee		205,963	198,203	194,076	191,492
Manpower (1)		100.0	119.7	131.0	147.9
Unit labour costs (index)		107.1	100.1	96.8	94.9
Output (index number) (2)					

- (1) consolidated businesses only, ie excluding businesses to be privatised
 (2) loaded train miles

13 BRITISH RAIL

1. Status of bids

1. The figures are not derived from a corporate plan but from planning data based on performance in 1981 and early 1982, with future requirements tailored to match the financial resources available in the baseline. They do not amount to a formal bid from the industry. The future of the railways is under review by the Committee chaired by Sir David Serpell. Substantive Ministerial discussions will follow the report of that committee due in the autumn. It has been agreed that there will be no separate Corporate Plan and Performance Review this year.

2. Recent performance

2. Since 1979 the Board's trading position has deteriorated substantially with revenue losses in all parts of the business not matched by cost reductions. This has been despite large reductions in manpower (over 20,000 men since end-1979) and in investment (from £388m in 1979-80 to £329m in 1982-83, which is £133m below ceiling). In 1981 the freight business showed significant improvement reducing a 1980 loss of £53m to £14m, but the passenger business results deteriorated markedly, requiring an exceptional increase in the ceiling on Government grant of £80m. Grant payments in 1982 continue at a level marginally below the 1981 level. Performance in 1982 has been strongly affected by the ASLEF disputes but the underlying trading position appears not to be deteriorating further and the programme of manpower reductions continues to be achieved.

3. Inter-City's financial target is to achieve a contribution to Group costs of £178 million by 1982. It will not be achieved. The contribution in 1981 was £58.5m. The financial target for the freight business is to achieve, by 1982, two thirds cca depreciation after meeting all relevant costs. It will not be achieved. In 1981, the business covered 30% of its depreciation. The Board has produced new business plans in response to the Government's request for plans showing how both businesses could meet a fully commercial remit by 1985. The plans are being considered by officials. New financial targets will be considered following the Serpell Committee report.

3. Assessment of economic assumptions

4. The increases in price inflation and average earnings in the economy assumed by Board may be too high. The Board forecast that the average earnings of their employees will rise significantly faster than the rest of the economy, especially in 1985-86; this seems unduly pessimistic.

4. Additional bids

5. Compared to the very low capital expenditure figures assumed in the baseline, Board are bidding for increased investment especially in 1985-86. This is largely infrastructure investment. After taking account of this, the internal resources performance is maintained in 1983-84 and improves in 1984-85, but deteriorates in 1985-86. The Board also plans improvements in working capital, especially in 1983-84. Overall these plans enable the Board to remain within the planning figures for external finance for 1983-84 and 1984-85. Within total external finance, however, the Board's projections show a level of central Government grant (carried on Programme 6) considerably above the working assumption contained in the baseline of a broadly constant level of grant. The Board stress that it has not been possible to include within these figures an investment programme sufficient to keep pace with the need for renewals, let alone provision for major new projects such as main line electrification and the Victoria-Gatwick link.

14 BRITISH WATERWAYS BOARD

TABLE 14.1

BASELINE	£m	1982-83	1983-84	1984-85	1985-86
Total capital requirements		5.3	4.4	4.6	5.0
Total internal resources		(34.1)	(37.9)	(41.4)	(43.0)
Total external finance		39.4	42.3	46.0	48.0

ADDITIONAL INDUSTRY BIDS	£m	1983-84	1984-85	1985-86
Fixed assets in UK		0.1	0.2	0.1
Working capital		0.0	0.0	0.1
Other				
TOTAL CAPITAL REQUIREMENT ADDITIONAL BID		0.1	0.2	0.2
INTERNAL RESOURCES ADDITIONAL (SHORTFALL)		(1.1)	(2.6)	(5.8)
Grants		1.2	3.0	6.0
Leasing		0.0	0.0	0.0
Short-term borrowing		0.0	0.0	0.0
Long and medium term borrowing		0.0	0.0	0.0
TOTAL EXTERNAL FINANCE ADDITIONAL BID		1.2	3.0	6.0

ASSUMPTIONS 1981-82 = 100, for indices	1982-83	1983-84	1984-85	1985-86
GDP (index number)	101.5	103	104.6	106.1
% inflation	10%	10%	10%	10%
% change in industry tariff				
% change in industry average earnings/employee	7½%	9%	9%	9%
Manpower	3200	3200	3200	3200
Unit labour costs				
Output (index number)				

14 BRITISH WATERWAYS BOARD

1. Status of Bids

1. BWB derives 90% of its total external finance from grant aid and its expenditure plans depend primarily upon annual decisions about levels of grant carried on Programme 8. Additional bids received from BWB exceed the baseline to cover inflation rates of 10% per annum and to provide for increased wage costs of 9% per annum from 1983-84. Discussions with the Board about corporate planning for 1983-84 onwards are expected to commence in early July, while discussions on their IFR bids have begun.

2. Recent Performance

2. BWB has no financial targets or agreed performance indicators. A recent study by management consultants has indicated scope for improving efficiency and productivity and identified opportunities for increased income from leisure activity but has shown that certain unprofitable trading activities are never likely to pay their way. Accounts for 1981 (to be published on 24 June) show deficits on warehouses, docks and the freight fleet although this is more than balanced by a £1.17m surplus from property operations.

3/4 Assessment of Bids and Assumptions

3. BWB have provided no appraisal of projected additional expenditure. The additions over the baseline reflect existing grant levels increased by 10% for inflation. This is unacceptable within the constraints of cash limits notified to the Board and further discussions are taking place. Projection of static manpower levels throughout the period fails to reflect the opportunities for reductions and increased productivity identified by the consultants and DOE will be seeking improvements through corporate planning procedures and within a general programme of implementation of the consultants' recommendations. Proposals for rationalisation of BWB commercial activities, which could affect the IFR figures, are being prepared for Ministerial consideration. We anticipate the final IFR figures to be at the baseline level.

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15 NATIONAL BUS COMPANY

ANNEX 15

TABLE 15.1

to nearest £0.1m

BASELINE	£m	1982-83	1983-84	1984-85	1985-86
Total capital requirements		55.0	70.0	84.0	87.4
Total internal resources		-14.1	-1.3	12.9	13.4
Total external finance		69.1	71.3	71.1	74.0

ADDITIONAL INDUSTRY BIDS	£m	1983-84	1984-85	1985-86
Fixed assets in UK		-6.0	-5.0	11.9
Working capital		) -1.0	) -1.0	) -0.3
Other				
TOTAL CAPITAL REQUIREMENT ADDITIONAL BID		-7.0	-6.0	11.6
INTERNAL RESOURCES ADDITIONAL (SHORTFALL)		(9.9)	(9.0)	2.1
Grants		7.5	8.0	13.4
Leasing		-6.2	-7.9	-6.9
Short-term borrowing		-	-	-
Long and medium term borrowing		1.6	2.9	3.0
TOTAL EXTERNAL FINANCE ADDITIONAL BID		2.9	3.0	9.5

ASSUMPTIONS 1981-82 = 100, for indices	1982-83	1983-84	1984-85	1985-86
GDP (index number)	100.6	101.9	104.1	105.6
% inflation	10.0	10.0	10.0	10.0
% change in industry tariff	10.0	10.4	14.3	15.0
% change in industry average earnings/ employee	7.7	10.3	10.0	10.0
Manpower	51,500	50,800	49,900	49,300
Unit labour costs (index)	105.8	116.5	128.8	142.4
Output (index number) (1)	96.9	95.8	94.7	93.9

(1) vehicle miles

15 NATIONAL BUS COMPANY

1. Status of industry bids

The IFR is based on the draft corporate plan which has not yet been discussed with the Company. The Final Plan will be submitted very shortly; discussions will take place during the summer months.

2. Recent performance

2. After a disastrous year in 1980, NBC made substantial progress in 1981 towards restoring its financial position, turning a pre-interest current cost loss of £17m in 1980 into a loss of only £0.7m. This involved service reductions of 5%, a cut-back in the vehicle fleet of 6% and a reduction in staff of 10%. The Company bettered its performance aim of 3% reduction in real operating costs per vehicle mile by achieving a reduction of 4.4%. Only a slight further improvement in profitability will be required in 1982 to achieve the required pre-interest current cost break-even, the first milestone towards the 1985 financial target of a pre-interest operating surplus by that date of £18.5 million in 1980 prices.

3. Assessment of industry's economic assumption

3. NBC's forecasts of national employment may be too optimistic in the early years affecting assumptions about bus patronage. Their forecasts of RPI and average earnings may be too high.

4. Additional bids

4. There are shown in Annex B. There is no significant additional bid until 1985-86. Projected shortfalls in internal resources are stated to be compatible with the annual financial target milestones for 1982 to 1985 (although this has yet to be verified). Substantial real price increases are assumed in the later years and these will need to be discussed with the Company. Investment figures reflect a dip in vehicle requirements in 1983-84 and 1984-85 following recent service reductions with a substantial increase over baseline in 1985-86 required to maintain fleet size, and a continuing 4% annual real increase in the cost of buses. This and the Company's overall investment requirements in all Review years will be examined in the Corporate Plan discussions.

TABLE 16.1

BASELINE	£m	1982-83	1983-84	1984-85	1985-86
Total capital requirements		14.4	14.9	15.6	16.0
Total internal resources		-5.9	-8.5	-9.3	-10.0
Total external finance		20.3	23.4	24.9	26.0

ADDITIONAL INDUSTRY BIDS	£m	1983-84	1984-85	1985-86
Fixed assets in UK		1.2	1.6	9.4
Working capital		-	-	-0.3
Other		-	-	-
TOTAL CAPITAL REQUIREMENT ADDITIONAL BID		1.2	1.6	9.1
INTERNAL RESOURCES ADDITIONAL (SHORTFALL)		3.5	3.8	0.3
Grants		0.1	0.4	5.4
Leasing		-	-	-
Short-term borrowing		-2.4	-3.6	-4.6
Long and medium term borrowing		-	1.0	8.0
TOTAL EXTERNAL FINANCE ADDITIONAL BID		-2.3	-2.2	8.8

ASSUMPTIONS 1981-82 = 100, for indices	1982-83	1983-84	1984-85	1985-86
GDP (index number)	-	-	-	-
% inflation	10	10	10	10
% change in industry tariff (scottish bus group)	1	9.4	9	8.7
% change in industry tariff (caledonian macbrayne)	0	0	0	0
% change on industry average earnings/employee	6	10.5	10.3	9.4
Manpower	9,900	9,800	9,700	9,700

16 SCOTTISH TRANSPORT GROUP

1. Status of Industry Bids

The Scottish Transport Group's (STG) financing requirements for 1983-84 and 1984-85 are below baseline levels. The additional bid of £9.0m in 1985-86 reflects the Group's forecast of replacement ship tonnage. The Group's financing projections are based on its corporate plan 1982-85, produced in late Spring, on which preliminary discussions with the Group have started. Further discussions will be held over the summer.

2. Recent Performance

2. The Group's financial target is threefold:

- (a) Road Passenger Service - to earn an average rate of return of 4½% per annum on net fixed assets at current cost over the four year period to 31 December 1983.
- (b) Shipping Services - to break even after receipt of Central Government grants.
- (c) Other Activities - to make a surplus of 8% on turnover after replacement cost depreciation.

The Group achieved all three parts of the target in 1981.

3. In the face of a steady decline in traffic over the last five years STG have secured significant cost economies principally through their bus services market analysis. In that five year period staffing has been reduced by 26%, bus fleet by 16%, and the shipping fleet by 5 vessels. This programme of economies is due for completion in 1983 when an end to further rapid cost reductions is foreseen.

3. Assessment of Industry's Economic Assumptions

4. The Group assume that their recent productivity gains will level out after 1983 leading to a greater need for revenue support. But fares are planned to

increase slightly ahead of inflation which is assumed to be 10% per annum and may be too high. Wages are forecast to rise at a slightly faster rate - about 10¹/₂% per annum. Wages are a high proportion of operating expenditure and a change here would have significant effects. On the shipping side, tariffs are not predicted to increase at all. This assumption and its implications for levels of grant aid to the shipping services, will also need to be discussed further.

4. Additional Bids

5. A sustained programme of cost reductions has enabled the Group to project a significantly reduced requirement for external finance. The effect on external finance is augmented by interest on short term deposits and savings in interest on cancellation of earlier proposals to seek NLF finance. The overall effect is offset in part by relatively small additional bids for extra bus replacement in 1983-84 and 1984-85; and offset altogether in 1985-86 by a large additional bid for new shipping tonnage. This is reflected in a sharp increase in external finance in that year, and an additional requirement of £8.8m. Detailed proposals have yet to be received and will need to be discussed with the Group. Discussion will also have to cover what steps should be taken to deal with the Group's clearly excessive liquidity.

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BRITISH SHIPBUILDERS

TABLE 17.1

BASELINE	£m	1982-83	1983-84	1984-85	1985-86
Total capital requirements		94	100	98	102
Total internal resources		-29	2	41	43
Total external finance		123	98	57	59

ADDITIONAL INDUSTRY BIDS	£m	1983-84	1984-85	1985-86
Fixed assets in UK		na (1)	na	na
Working capital		na	na	na
Other		na	na	na
TOTAL CAPITAL REQUIREMENT ADDITIONAL BID		10	25	18
INTERNAL RESOURCES ADDITIONAL (SHORTFALL)		0	4	13
Grants		5	7	-8
Leasing		0	0	0
Short-term borrowing		0	0	0
Long and medium term borrowing		5	14	13
TOTAL EXTERNAL FINANCE ADDITIONAL BID		10	21	5

(1) The baseline figures are not broken down into the elements of capital requirements

ASSUMPTIONS 1981-82 = 100, for indices	1982-83	1983-84	1984-85	1985-86
Growth of World Trade	105.0	110.0	113.9	116.0
Wholesale Price Index	108.0	116.6	125.9	136.0
% change in industry average earnings/employee	105.0	113.5	123.4	na
Manpower	66,173	66,359	68,681	na
Production assumptions				
- Merchant (throughput '000 cgrt)	290-340	370-420	420-510	na
- Warship (deliveries '000 SD)	18.6	10.5	15.1	na
- Engineering (deliveries '000 BHP)	230-280	270-330	330-400	na
- Offshore (turnover £m)	95	99	103	na
- Shiprepair (turnover £m) (at constant prices)	61	63	69	na

17 BRITISH SHIPBUILDERS

1. Status of Bid

1. BS's IFR reflects last year's Corporate Plan, and is provisional pending submission of their next Corporate Plan in August. Last year's Corporate Plan was regarded as too optimistic, and Ministers approved in February only the first year of the Plan ie 1982-83 subject to limits being placed on merchant shipbuilding employment.

2. Recent Performance

2. For the year 1981-82 BS were within their EFL of £150m and expect to be within the loss target of £25m after Intervention Fund assistance. While BS have at present a reasonably healthy order book, indications are that the market has now become stagnate and competition will intensify. Demand in the offshore market has weakened. BS's shiprepair activities are losing heavily and the Corporation is planning further restructuring.

3. Assessment of Economic Assumptions

3. The economic assumptions provided by BS for the IFR are those on which last year's Corporate Plan and IFR were based. BS are currently working on new economic assumptions to be adopted for the August Corporate Plan. BS has been informed about Ministerial concern at the level of this year's pay settlement (6.5%) and the need to secure a lower settlement next year.

4. Additional Bids

4. The baseline was agreed between Ministers last year at less than BS's IFR bid, subject to examination of BS's 1981 Corporate Plan. Because Ministers were unable to endorse BS's plans for merchant shipbuilding for the later years, the baseline was left unchanged. In following last year's IFR, BS figures exceed the baseline. It should also be noted that BS figures assume the more expensive strategy for modernising Vickers submarine facilities which Ministers are current considering.

5. A comparison of the baseline, the IFR bid and the Departmental estimates made last year is as follows:

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Table 17.2

External Finance	1982/83	1983/84	£M outturn prices
			£1984/85
Baseline	123	98	57
BS IFR	123	108	78
Departmental			
Estimates	123	113	112

These figures will need to be reassessed in the light of BS's next Corporate Plan.

18 REGIONAL WATER AUTHORITIES

TABLE 18.1

BASELINE	£m	1982-83	1983-84	1984-85	1985-86
Total capital requirements		717.9	730.0	766.5	796.7
Total internal resources		324.9	345.0	381.5	411.7
Total external finance		393.0	385.0	385.0	385.0

ADDITIONAL INDUSTRY BIDS	£m	1983-84	1984-85	1985-86
Fixed assets in UK		37.1	85.5	124.7
Working capital		-12.1	-10.5	-13.7
Other				
TOTAL CAPITAL REQUIREMENT ADDITIONAL BID		25	75	111
INTERNAL RESOURCES ADDITIONAL (SHORTFALL)		8	39	103
Grants		-	-	-
Leasing		-	-	-
Short-term borrowing		-	-	-
Long and medium term borrowing		17	36	8
TOTAL EXTERNAL FINANCE ADDITIONAL BID		17	36	8

ASSUMPTIONS 1981-82 = 100, for indices	1982-83	1983-84	1984-85	1985-86
GDP (index number) (1)	na	na	na	na
% inflation	9.5	8.5	8.5	8.0
% change in industry tariff (2)	9.0	7.0	9.5	11.0
% change in industry average earnings/employee (3)	8.5	8.5	8.5	8.0
Manpower	55,500	54,200	53,500	53,100
Unit labour costs (4)	na	na	na	na
Output (index number) (4)	na	na	na	na
Relevant Construction Index	4.8	9.5	9.2	7.5

- (1) assumes economic growth broadly in line with MTFs. But the Water Industry's demand and investment levels are not very sensitive to different assumptions about GDP.
- (2) the forecasts for later years are very uncertain.
- (3) assumed rate of pay settlements consistent with RPI.
- (4) no single output measure available for the industry and so no unit labour costs.

18 REGIONAL WATER AUTHORITIES*

1. Status of Bids

1. The investment and financial proposals are based on full corporate plans submitted by the industry, modified by the Department after full scrutiny, and detailed discussions with each of the 9 authorities concerned. The Department's scrutiny concentrated on the need for and realism of the investment plan and the consequences for charges.

2. Recent Performance

2. The authorities have over-achieved the financial targets set for 1981-82; and it now seems likely that they will over-achieve those for 1982-83. The main reason is that construction prices have been lower than assumed when charges were set, reducing CCA depreciation charges. Metered income has also held up better than expected.

3. Performance aims are about to be announced for the authorities for 1983-84. These show a reduction in real operating costs of over 5 per cent compared with the industry original proposals, and will bring these costs down below the 1979-80 base.

3. Assessment of Economic Assumptions

4. For the water industry, forecasts of external financing requirements are not particularly sensitive to variations in inflation assumptions, nor, in a short term, to the general level of activity in the economy. The industry is very capital intensive and the main determinant of charges, and hence of internal resources, is the interaction of the financial target and the CCA asset base. Increased revenue requirements can be readily passed on to the consumer, because charges are not generally related to demand.

5. The assumptions shown in the table are based on the common assumption used by the industry to draw up their corporate plans, adjusted by the Department after discussion with the industry. The assumption on wage settlements is that they will broadly follow movements in RPI. However the department intend to put increasing pressure on the level of settlements by setting tight performance aims.

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Additional Bids

6. The bid for additional investment is almost £100 million less for 1985-86 than the investment proposals in the industry's corporate plan. But the department consider the bid realistic and are satisfied that significant additional investment is needed to deal with underground dereliction, the needs of new residential and industrial development, and to remedy unacceptably low standards of service in some areas. (ie. unacceptably low in terms of drinking water quality and reliability of supply, foul flooding and pollution of rivers and estuaries). The provision for new development is very small and would be required to be increased if there should be any sustained recovery in building activity.

7. The additional investment will be largely financed by additional internal resources.

* This annex and the figures in the table relate only to the nine English water authorities. When the provision for the English authorities has been settled, a corresponding adjustment will be made to the provision for the Welsh authority.