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CABINET

MINISTERIAL STEERING COMMITTEE ON ECONOMIC STRATEGY SUB-COMMITTEE ON ECONOMIC AFFAIRS

NATIONALISED INDUSTRIES' 1983 INVESTMENT & FINANCING REVIEW (IFR)

Memorandum by the Chief Secretary, Treasury

1. The IFR report prepared by Treasury and sponsor Department officials sets out nationalised industry bids for external finance and for investment allocations during the period 1984-85 to 1986-87. Overall the industries are making substantial additional bids for 1984-85 and 1985-86. Decisions are now needed on the total amount of external finance that should be made available over the next 3 years.
2. Accepting industries' bids for external finance would mean that the baseline is increased by £511 million in 1984-85, £103 million in 1985-86, and decreased by £1,028 million in 1986-87. Including potential expenditure on the redundant mineworkers' payments scheme (RMPS) adds a further £58 million in 1984-85 and 1986-87 and £62 million in 1985-86. Unlike last year, none of this extra finance will increase investment in aggregate in 1984-85 and 1985-86. It either adds to industries' working capital or makes up for a deficiency in industries' own internal resources. The loss of financial discipline that would result from acceding to these bids is clearly unacceptable. Indeed there is no reason to do so. These figures represent opening bids by the industries. In a number of cases, as the Annexes to the report make clear, officials have identified areas where they believe savings can be achieved.

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3. Despite these bids there are more general signs that our policies towards the nationalised industries are beginning to take effect. External finance appears to be on a downward trend overall and the medium-term plans of some industries show increasing realism and moves towards greater efficiency. The spur of future privatisation is already causing some industries to improve their performance. However I do not believe that future improvements can be entrusted to the industries alone. Without continuing external pressure existing inefficiencies will not be eradicated and unacceptable practices, for example on pay and productivity, will continue to flourish.

4. Wider public expenditure considerations, both immediate and longer-term prospects, point strongly to reducing expenditure plans below the current baseline. Cabinet will be discussing the overall position shortly. But it is clear that the possibility of tax cuts ^{becoming} is increasingly remote unless present expenditure expectations can be considerably reduced. The overall position provides compelling reasons for driving nationalised industry expenditure, in aggregate well below the current baselines.

5. The existing provision published in Cmnd 8789 was settled last year in the light of industries' 1982-83 external financing limits (EFLs). These EFLs were undershot in total by over £1 billion. The signs are that this year's EFLs will again be undershot.

This clearly suggests that present baselines are too high, and insufficiently tight to ensure that the type of financial discipline commonplace in the private sector will be consistently applied to nationalised industries.

6. If we are to reduce the industries' bids substantially, how should this be achieved? Discussions with the industries have not yet reached the stage where I can make specific proposals industry-by-industry. Officials need to pursue further discussions with the industries over the summer so that we are in a position to come to firm decisions in the autumn, both about the EFLs for 1984-85 and

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about the levels of external finance for later years. We shall be discussing the Corporate Plans of a number of industries (NCB, BGC and BS) before the Recess. We need however to take broad decisions now, so that these can both inform the discussions that are to take place and also influence the updated forecasts the industries will be producing after the summer.

7. Some general guidelines for these discussions can, I believe, be put forward:

- (i) Reductions in current costs. As the report points out reductions in current costs where these can be achieved represent much the best way of reducing requirements for finance because this puts the emphasis on increasing efficiency rather than on cuts in capital investment or tariff increases, both easy and damaging ways out.
- (ii) Reductions in working capital. It is always a temptation for industries to exaggerate their working capital requirements in order to provide a financial cushion for the future.
- (iii) Sales of fixed assets. Industries are only proposing minimum sales of fixed assets over the next 3 years. The Boards of the industries should clearly be encouraged to maximise such sales as part of their normal business activities.
- (iv) 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 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, given the importance of the public trading sector in setting the tone for the pay round as a whole.

8. We clearly wish to encourage profitable investment by the industries. But it would be a mistake to regard their investment bids as sacrosanct. In 1981-82 and 1982-83 there were large and embarrassing shortfalls in their agreed programmes. It goes without

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saying that care needs to be exercised to ensure that the projects included within the bids are likely to yield an adequate return and that the programmes as a whole are realistic. We must ensure that inflated investment programmes do not provide a cushion which would allow a loss of control over current costs to be accommodated.

9. In summary our primary objective in considering industries' external finance bids must be to reduce them all to the maximum realistic extent so that in the absence of market pressures they will provide sustained pressure for efficiency. This holds for all industries, whether their proposals are above or below the current baseline. Annexes to the officials' report suggest a number of areas where reductions should be achievable. In the light of these analyses, it should be possible to reduce industries' external finance to £900 million below the baseline in 1985-86. For 1986-87 the industries themselves see no need for the levels of finance implied by the baseline and are proposing a cut of nearly £1 billion. I think we should aim to secure a further £1 billion reduction. I propose this as our targets.

10. 1984-85 presents greater problems. As a minimum requirement it is essential to get back to the baseline. But we need - and I think we can - do better than that if we are to accommodate some of the inescapable bids arising elsewhere in the public sector. I therefore propose that, while recognising that the scope for savings will vary industry-by-industry, we set ourselves the target of at least £500 million below the 1984-85 baseline. The net effect of these targets is to reduce industries' bids by around £1 billion in each of the 3 years.

Conclusion

11. I invite my colleagues:

- (i) To note the report prepared by officials and the substantial bids for extra finance being put forward by the industries in 1984-85 and 1985-86.
- (ii) To press their industries for the maximum possible savings in all years.

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(iii) To agree that for the industries in aggregate we should aim to achieve reductions below the baseline of at least £500 million in 1984-85, £900 million in 1985-86 and £2 billion in 1986-87.

(iv) To ask officials to pursue discussions intensively with the industries and to report back with firm proposals to achieve the targets in (iii) for Ministers to consider in the autumn.

[P.R.]

H M TREASURY
8th July 1983

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NATIONALISED INDUSTRIES'

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INVESTMENT AND FINANCING REVIEW

1983

July 1983

NATIONALISED INDUSTRIES' INVESTMENT AND FINANCING REVIEW 1983

Decisions Required

1. The Investment and Financing Review (IFR) is the annual forward look at nationalised industries' investment and financing requirements. This report which covers the years 1984-85 to 1986-87 has been prepared jointly by the Treasury and sponsor Departments on the basis of information provided by the industries. It sets out in individual industry Annexes:

- baseline figures which for 1984-85 and 1985-86 are as in the last Public Expenditure White Paper (Cmnd 8789) as adjusted for the Budget reductions in National Insurance Surcharge
- industries' bids for any additional finance
- a commentary on the industries' recent performance and an assessment of the bids.

Industries' bids will be updated, if necessary, in mid-September in order to take account of any forecast changes in trading circumstances, and revised as appropriate to reflect Ministerial decisions on overall totals.

2. The report, which forms part of the annual planning of public expenditure totals, provides a basis for Ministerial decisions on the aggregate external financing requirements for nationalised industries. These decisions lead to the setting of individual external financing limits (EFLs) for 1984-85 (announced in the Autumn), investment allocations for 1984-85 to 1986-87 (communicated to the industries in December) and external finance baseline figures for 1985-86 and 1986-87 (announced in aggregate in the next Public Expenditure White Paper).

3. Decisions on investment are normally taken on the basis of approving 100 per cent of the agreed investment programme for Year 1 (1984-85), approving 85 per cent of the programme for Year 2 (1985-86) and approving 70 per cent for Year 3 (1986-87). Early decisions help the industries to plan future years' investment sensibly.

4. The coverage of this year's IFR is unchanged from last year except that Department of Energy expenditure on the Redundant Mineworkers Payment Scheme (RMPS) is brought within the scope of the IFR for the first time, and the Welsh Water Authority is included in the section on the Water Industry. The Water Industry is now treated as a nationalised industry for all practical purposes and will be included in Part 3 of the next Public Expenditure White Paper.

5. Plans are being prepared to privatise certain industries during the period covered by the IFR; when this happens, any bids for finance will cease to be counted as public expenditure. There are many uncertainties about the exact timing of the future privatisation programme. Stylised assumptions on timing have therefore been made for the purposes of the IFR. The IFR assumes that all existing nationalised industries will remain within the public sector during the IFR period. Sales of BT equity are however assumed to take place in 1984-85 and 1985-86 with dividend income accruing to HMG and treated as negative public expenditure.

Nature of this year's IFR

6. The introduction of improved corporate planning procedures has led, in some instances, to better information flows and a greater Whitehall understanding of industries' business performance. The corporate planning cycle is intended to ensure that as far as possible all industries' plans and their prospects as businesses are discussed in advance of the IFR in order better to inform Ministerial decisions. The IFR remains the mechanism by which the industries' aggregate impact on public expenditure is assessed and controlled.

7. Detailed figures for individual industries are set out in the Annexes to this report. The text makes clear the status of the figures and sets out the current position on corporate plan discussions. In all cases, the figures are supplied by the industries themselves and are not necessarily accepted by sponsor Departments or the Treasury. An assessment by the Department and the Treasury is included in each Annex.

THE AGGREGATE POSITION

External Finance

8. Industries' aggregate additional bids over the baseline are set out in Table 1 (a positive figure implies an increase compared to the baseline; a negative figure a reduction below the baseline):

TABLE 1

Summary of aggregate bids

	<u>£ million cash</u>		
	<u>1984-85</u>	<u>1985-86</u>	<u>1986-87</u>
External finance baseline	2563	2092	2155
<u>Additional industry bids</u>			
Capital requirements	-184	+50	+102
Internal resources	+875	+314	-810
Assumed British Telecom dividends	-180	-260	-320
TOTAL EXTERNAL FINANCE ADDITIONAL BID	+511	+103	-1028
RMPS baseline (see para 4)	146	168	173
RMPS additional bid	+58	+62	+58
TOTAL IFR ADDITIONAL BID	+£569m	+£165m	-£970m

Overall, industries are bidding for an extra +£511 million in 1984-85, an extra +£103 million in 1985-86, and for -£1028 million less than the baseline in 1986-87. (Last year, for comparison, industries bid for increases over the baseline of +£1136 million, +£1130 million, and +£291 million over the three years of the 1982 IFR and were granted -£72 million, +£111 million, and -£433 million.) Table 2 shows the level of external finance that would be necessary over the years 1982-83 if industries bids were met in full (including offsets from assumed British Telecom dividends).

TABLE 2

External finance

	<u>£ million cash</u>				
	<u>1982-83</u> <u>outturn</u>	<u>1983-84</u> <u>forecast</u>	<u>1984-85</u> <u>proposal</u>	<u>1985-86</u> <u>proposal</u>	<u>1986-87</u> <u>proposal</u>
Total external finance	2098	3086	3074	2195	1127

9. Individual industry external finance bids are set out in detail in Table A (on page 11). The main bids for extra external finance arise from the National Coal Board, the British Steel Corporation, British Rail, and British Shipbuilders. In contrast, the Electricity Supply Industry and the British Gas Corporation expect to be at or substantially below baseline in all years of the IFR. Overall, officials' preliminary assessment is that substantial reductions in the aggregate bid should be possible in all years.

10. It should be noted that 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 £7½ billion in 1983-84, and internally-generated funds, of the order of nearly £4½ billion. Relatively small percentage changes in either of these flows can dramatically affect the need for external finance.

Investment

11. Industries are proposing the following investment in fixed assets over the next three years:

TABLE 3

Fixed asset investment

	<u>£ million cash</u>				
	<u>1982-83</u> <u>outturn</u>	<u>1983-84</u> <u>forecast</u>	<u>1984-85</u> <u>proposal</u>	<u>1985-86</u> <u>proposal</u>	<u>1986-87</u> <u>proposal</u>
Fixed asset investment	6678*	7427	8159	8376	8722
% change on previous year	-	+11.2%	+9.8%	+2.6%	+4.1%
Change compared to baseline			-7	-30	+61

(* excludes BNOC and BTDB)

Total investment compared to baseline decreases by -£7 million in 1984-85, -£30 million in 1985-86, and increases by +£61 million in 1986-87. Within these totals, the National Coal Board, the Electricity Supply Industry (England and Wales), and the British Airports Authority decrease their investment substantially compared to the baseline: the British Gas Corporation, British Telecom (in 1985-86 and 1986-87), British Rail, and the Water Industry, bid to increase their expenditure. Detailed figures for each industry are set out in Table B (on page 12).

12. The effect of these proposals is that investment would increase in real terms in 1984-85, decline slightly in 1985-86, and be relatively flat in 1986-87. Overall, the industries' expectations are modest compared to last year when industries bid for increases of +£514 million, +£620 million, +£841 million over the three years of the 1982 IFR. This may result from more realistic planning and a desire to avoid the large shortfalls in 1981-82 and 1982-83 rather than a change in substance. An analysis of industries' bids shows that industries' expect about 30 per cent of their investment will be devoted to new construction and about 60 per cent to plant and machinery.

Manpower

13. Table C (on page 13) sets out a breakdown of industries' expected manpower requirements over the IFR period. Table 5 shows the position in aggregate.

TABLE 5

Nationalised industries manpower

	<u>No. employed</u>			
	<u>1983-84</u>	<u>1984-85</u>	<u>1985-86</u>	<u>1986-87</u>
Total industries	1,403,676	1,355,771	1,324,465	1,298,129

Manpower is expected to drop by nearly 106,000 (about 8 per cent) from 1983-84 to 1986-87 with all industries showing a decrease other than the British National Oil Corporation, National Girobank, British Airports Authority, and the British Waterways Board. The National Coal Board accounts for the largest part of the decrease.

Turnover

14. The overall decreases in manpower are accompanied by an increase in turnover in real terms implying overall rises in productivity. Table D (on page 14) sets out turnover assumptions provided by the industries as deflated by the industries' own tariff assumptions. Over the period 1982-83 to 1986-87, the largest real increases in turnover are expected by British Telecom (+23.6%), National Girobank (+20.9%), the British Airports Authority (+20.1%), the British Gas Corporation (+14.9%), and British Airways (+10.7%). Decreases in real terms are expected by the Scottish Transport Group (-6.7%), the National Coal Board (-6.5%), the National Bus Company (-3.8%), and the Civil Aviation Authority (-3.0%) (figures for British Shipbuilders not available).

EXPLANATION OF BIDSAggregate position

15. A change in an industry's external financing requirement (EFR) can result from any of the following factors acting either singly or in combination:

- (i) Changes in expected expenditure on fixed asset investment
- (ii) Changes in working capital requirements (eg because of changes in stock-holding, work-in-progress, or the balance between debtors and creditors)
- (iii) Changes in expected internal resources which may result either from changes in costs (eg pay, interest rate changes, effect of inflation on purchases) or changes in expected income (eg because of changes in demand or tariffs).

The balance between these figures can vary greatly from industry to industry and from year to year.

16. The following overall picture emerges compared to the baseline:

1984-85

- . Fixed asset investment virtually unchanged
- . Stocks and work-in-progress decrease by £246 million
- . Other working capital increase by £70 million
- . Internal resources worsen by £875 million

1985-86

- Fixed asset investment virtually unchanged
- Stocks and work-in-progress decrease by £180 million
- Other working capital increase by £255 million
- Internal resources worsen by £314 million

1986-87

- Fixed asset investment increase by £61 million
- Stocks and work-in-progress decrease by £68 million
- Other working capital increase by £118 million
- Internal resources improve by £810 million

In aggregate, the major influence determining industries' external finance bids in this year's IFR appears to be changes in the expected level of internal resources. Table E (on page 15) summarises for each industry internal resources changes as compared to the baseline. Reasons for the changes are discussed in the individual Annexes.

Economic Assumptions

17. In accordance with past practice, industries have made their own assumptions about the economy. These are summarised in the Annexes and in Tables F-G (on pages 16-17). The industries' working assumptions on economic growth are not out of line with outside forecasters and the Treasury's own forecast. The relative decline in respect of 1985-86 is caused by British Telecom's swing from relative optimism to a 1½% fall in GDP that year.

18. The industries' inflation assumptions are more pessimistic than the Treasury's and towards the upper end of the range of outside forecasters. The industries have reduced their forecasts from last year, as have most outsiders, but do not see the current low rates of inflation being sustained. Their forecasts for the medium term are in the 7-8% per annum range (last year figures 9-10%).

19. The average of the industries' projections for real earnings in their own industries is towards the bottom of the range of outsiders' forecasts for real earnings in the whole economy, but because the industries are more pessimistic on inflation their figures for their own nominal earnings are reasonably in line with outsiders' figures for the whole economy. Those industries which have also submitted projections

for whole economy average earnings show on average substantially lower real increases for their own industries than for the economy as a whole. If this relative performance is not achieved, EFL's must be at risk. Each 1 per cent change in nationalised industries' earnings changes the aggregate external finance requirement by some £150 million in 1984-85.

20. The industries' tariff assumptions have been revised since last year, mainly reflecting their view of inflation. For electricity, the reduction in real terms which occurred in April 1983 means that it is now cheaper throughout the period than would have been expected last year. Table I (on page 19) shows the assumptions for the domestic tariffs of number of industries both in nominal terms and after deflating by their RPI assumptions. Most of the changes in real terms are relatively small. Only British Rail, National Bus Company and the Water Industry are projecting real increases in each year of the IFR period. The National Coal Board (albeit provisionally), British Telecom and the Post Office are projecting real falls for each year. Taken together the industries' domestic tariffs are projected to decline relative to the RPI in each year (see Table J on page 20). Every 1 per cent change in tariff changes in aggregate external finance requirement by some £450 million in 1984-85.

21. Officials will continue to scrutinise and evaluate the industries' IFR submissions either in the context of considering Corporate Plan and Performance Reviews or in bilateral IFR discussions. Updated trading forecasts will be incorporated if and when they become available.

Options available to Ministers

22. If Ministers wish to reduce the aggregate external financing requirements proposed by the industries, the following main options are available:

- (i) Reducing current costs. This is attractive because it does not simply transfer the burden to the consumer or the Government. It acts directly on industries internal resources. The scope for reductions varies considerably between industries; in some, substantial economies could be achieved, particularly for industries insulated from competitive pressures, in other considerable headway has been made in recent years 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.

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- (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 closed recently, after the very rapid increases in the industries' prices during 1980 and 1981, and nationalised industry prices in 1983-84 are expected to rise less rapidly than the RPI for the first time for several years. If Ministers did wish tariffs to rise, early implementation would allow stabilisation in the later years of the Administration. Most prices are at, or close to, economic levels. The main exception is gas where a further real increase in prices particularly for domestic consumers would be justifiable. For water and buses, the financial targets are already likely to bring some real increases.
- (iii) Squeezing working capital. There is always a temptation for industries to build up levels of working capital in order to provide a cushion against future financial pressures. This is highly undesirable if overall financial discipline is to be maintained and levels can sometimes be reduced without adverse effects on creditors, consumers, or the industries themselves.
- (iv) Cutting investment. As mentioned earlier, industries have already had approval for up to 85 per cent of the investment programmes set out in Cmnd 8789 for 1984-85 and for 70 per cent of the programme for 1985-86, but, in principle, investment could be held at or near this level. Investment shortfall is normally common and there was a substantial shortfall below plans in 1981-82 and 1982-83. Where the profitability of industries' investment programmes are doubtful, there may be scope for reductions 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 in any event the different circumstances of individual industries make it unsuitable to seek uniform reductions from all the industries at this stage.

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Conclusion

23. Ministers are invited:

- (i) To note the additional bids for external finance submitted by the nationalised industries.
- (ii) To determine 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 as a basis for subsequent discussions with the industries on how any reductions in aggregate figures should preferably be made.

Total External Finance

£ million cash (1)

	1983-84	1984-85	1985-86	1986-87	
	forecast outturn	baseline	bid	change	baseline
NATIONAL COAL BOARD	1430	921	1202	+281	988
ELECTRICITY (ENGLAND AND WALES)	-406	-278	-350	-72	-484
NORTH OF SCOTLAND HYDRO-ELECTRIC BOARD	-2	16	2	-14	23
SOUTH OF SCOTLAND ELECTRICITY BOARD	275	279	279	-	230
BRITISH GAS CORPORATION	-34	-31	-31	-	-216
BRITISH NATIONAL OIL CORPORATION	3	-1	-4	-3	-1
BRITISH STEEL CORPORATION	325	93	313	+220	80
BRITISH TELECOM	-108	82	112	+30	-12
POST OFFICE	-47	-47	-	+47	-44
NATIONAL GIROBANK	2	-1	-	+1	-1
BRITISH AIRWAYS BOARD	5	-90	-79	+11	-97
BRITISH AIRPORTS AUTHORITY	33	16	22	+6	18
BRITISH RAILWAYS BOARD	909	1013	1043	+30	1087
BRITISH WATERWAYS BOARD	42	45	48	+3	48
NATIONAL BUS COMPANY	66	67	67	-	72
SCOTTISH TRANSPORT GROUP	18	19	21	+2	26
BRITISH SHIPBUILDERS	210	89	173	+84	71
CIVIL AVIATION AUTHORITY	9	18	25	+7	19
Total Nationalised Industries (excl water)	2730	2211	2842	+631	1805
WATER (ENGLAND AND WALES)	356	352	412	+60	350
Total Industries (incl water)	3086	2563	3254	+691	2155
RMPS	167	146	204	+58	173
(2)				+62	231

Notes

- (1.) All figures to nearest £ million. Totals may differ due to rounding.
 (2.) Redundant Mineworkers Payments Scheme (RMPS) included in this IFR (see Annex 1 for details).
 (3.) BT figures assume payment of dividends to HMG and others throughout IFR.
 Payment to HMG assumed as:

	-£260m	-£320m
Total IFR public expenditure bld incl RMPS is therefore:	+£165m	-£970m
	=====	=====

TABLE A

Expenditure on fixed assets investment

£ million cash (1)

	1983-84	1984-85		1985-86		1986-87				
forecast	baseline	bfd	change	baseline	bfd	change	baseline	bfd	change	
outturn										
NATIONAL COAL BOARD	800	986	849	-137	1025	904	-121	1056	868	-188
ELECTRICITY (ENGLAND AND WALES)	1458	1475	1400	-75	1534	1302	-232	1580	1375	-205
NORTH OF SCOTLAND HYDRO-ELECTRIC BOARD	44	44	46	+2	51	52	+1	53	59	+7
SOUTH OF SCOTLAND ELECTRICITY BOARD	419	335	390	+55	290	335	+45	298	275	-23
BRITISH GAS CORPORATION	891	876	903	+27	791	833	+42	815	840	+25
BRITISH NATIONAL OIL CORPORATION	1	-	-	-	-	-	-	-	1	+1
BRITISH STEEL CORPORATION	224	240	227	-13	260	214	-46	268	268	-
BRITISH TELECOM	1730	2230	2192	-38	2259	2419	+160	2327	2710	+383
POST OFFICE	130	128	170	+42	140	128	-12	147	118	-29
NATIONAL GYROBANK	10	7	12	+4	8	6	-2	8	7	-2
BRITISH AIRWAYS BOARD	264	198	195	-3	200	241	+41	206	168	-38
BRITISH AIRPORTS AUTHORITY	130	156	146	-10	185	141	-44	191	135	-56
BRITISH RAILWAYS BOARD	335	373	446	+73	461	543	+82	475	578	+103
BRITISH WATERWAYS BOARD	3	4	6	+3	4	7	+3	4	7	+3
NATIONAL BUS COMPANY	63	72	72	-	88	79	-9	90	88	-2
SCOTTISH TRANSPORT GROUP	17	17	22	+5	19	20	+1	19	20	-
BRITISH SHIPBUILDERS	90	128	146	+18	118	125	+7	122	95	-27
CIVIL AVIATION AUTHORITY	27	30	29	-1	34	33	-1	35	35	-
Total Nationalised Industries (excl water)	6636	7298	7251	-47	7465	7382	-83	7691	7645	-46
WATER (ENGLAND AND WALES)	791	869	908	+40	941	994	+53	969	1076	+107
Total Industries (incl water)	7427	8166	8159	-7	8406	8376	-30	8660	8722	+61

Notes

(1.) All figures in £ million cash

TABLE B

Mandpower

	1983-84	1984-85	1985-86	1986-87
NATIONAL COAL BOARD	234,100	215,500	200,500	185,500
ELECTRICITY (ENGLAND AND WALES)	136,100	132,800	130,400	127,700
NORTH OF SCOTLAND HYDRO-ELECTRIC BOARD	3,900	3,860	3,860	3,860
SOUTH OF SCOTLAND ELECTRICITY BOARD	12,465	12,390	12,395	12,355
BRITISH GAS CORPORATION	100,000	99,000	98,000	97,000
BRITISH NATIONAL OIL CORPORATION	150	150	150	150
BRITISH STEEL CORPORATION	75,500	71,000	68,000	67,000
BRITISH TELECOM	237,000	229,000	222,000	218,000
POST OFFICE	178,000	176,800	177,900	177,200
NATIONAL GIROBANK	5,050	5,050	5,350	5,600
BRITISH AIRWAYS BOARD	35,856	34,200	34,030	33,760
BRITISH AIRPORTS AUTHORITY	7,251	7,251	7,645	7,800
BRITISH RAILWAYS BOARD	188,000	184,500	181,100	179,850
BRITISH WATERWAYS BOARD	3,150	3,150	3,150	3,150
NATIONAL BUS COMPANY	51,694	51,010	50,386	50,055
SCOTTISH TRANSPORT GROUP	10,241	9,940	9,890	9,840
BRITISH SHIPBUILDERS	60,000	55,692	55,692	55,692
CIVIL AVIATION AUTHORITY	7,370	7,233	7,117	7,017
Total Nationalised Industries (excl water)	1,345,827	1,298,526	1,267,565	1,241,529
WATER (ENGLAND AND WALES)	57,849	57,245	56,900	56,600
Total Industries (incl water)	1,403,676	1,355,771	1,324,465	1,298,129

Notes

1. Figures for BSC in 1986-87 and BS in 1985-86 and 1986-87 are notional.

NATIONALISED INDUSTRIES FINANCIAL INFORMATION SYSTEM
INVESTMENT AND FINANCING REVIEW 1983
Turnover (deflated by industries tariff assumptions)

TABLE D

£ million	1982-83	1983-84	1984-85	1985-86	1986-87	1982-83 to 1986-87
NATIONAL COAL BOARD	4,797	4,720	4,516	4,513	4,484	-6.5%
ELECTRICITY (ENGLAND AND WALES)	8,723	9,034	9,134	9,219	9,313	+6.8%
SOUTH OF SCOTLAND HYDRO-ELECTRIC BOARD	266	269	271	273	276	+3.8%
NORTH OF SCOTLAND ELECTRICITY BOARD	755	768	774	783	793	+5.0%
BRITISH GAS CORPORATION	5,958	6,070	6,288	6,582	6,847	+14.9%
BRITISH STEEL CORPORATION	2,974	3,071	3,252	3,201	3,200	+7.6%
BRITISH TELECOM	6,388	6,802	7,170	7,446	7,897	+23.6%
POST OFFICE	2,636	2,689	2,702	2,731	2,770	+5.1%
NATIONAL GIROBANK	206	213	222	235	249	+20.9%
BRITISH AIRWAYS BOARD	2,030	2,110	2,049	2,144	2,248	+10.7%
BRITISH AIRPORTS AUTHORITY	283	290	305	320	340	+20.1%
BRITISH RAILWAYS BOARD	2,114	2,187	2,096	2,115	2,156	+2.0%
BRITISH WATERWAYS BOARD	18	18	18	17	18	-
NATIONAL BUS COMPANY	657	651	648	642	632	-3.8%
SCOTTISH TRANSPORT GROUP	150	147	144	141	140	-6.7%
CIVIL AVIATION AUTHORITY	236	224	223	227	229	-3.0%
Total Nationalised Industries (excl water)	38,191	39,263	39,812	40,589	41,592	+8.9%
WATER (ENGLAND AND WALES)	2,018	2,034	2,040	2,048	2,061	+2.1%
Total Industries (incl water)	40,209	41,297	41,852	42,637	43,653	+8.6%

Notes

1. The great bulk of BNOCs turnover represents trading in participation oil, on which BNOC is not permitted to make a profit. Accordingly it is not meaningful to show BNOCs turnover here.
2. No figures for British Shipbuilders are included because no appropriate information is available.

Summary

£ million cash (1)

Total Internal Resources

	1983-84	1984-85	1985-86	1986-87	
	forecast outturn	baseline	bld	change	baseline
NATIONAL COAL BOARD	-476	65	-450	-515	66
ELECTRICITY (ENGLAND AND WALES)	1672	1738	1814	+76	1970
NORTH OF SCOTLAND HYDRO-ELECTRIC BOARD	54	32	50	+18	25
SOUTH OF SCOTLAND ELECTRICITY BOARD	89	32	77	+45	27
BRITISH GAS CORPORATION	990	1105	1115	+10	1192
BRITISH NATIONAL OIL CORPORATION	1	1	5	+4	1
BRITISH STEEL CORPORATION	-119	273	77	-196	247
BRITISH TELECOM	2009	2283	2093	-190	2372
POST OFFICE	157	144	143	-1	157
NATIONAL GYROBANK	8	12	15	+3	15
BRITISH AIRWAYS BOARD	314	295	272	-23	305
BRITISH AIRPORTS AUTHORITY	96	147	132	-15	168
BRITISH RAILWAYS BOARD	-669	-825	-794	+31	-811
BRITISH WATERWAYS BOARD	-38	-41	-41	-	-43
NATIONAL BUS COMPANY	-6	10	7	-3	22
SCOTTISH TRANSPORT GROUP	-1	-2	1	+3	-5
BRITISH SHIPBUILDERS	-115	28	-63	-91	70
CIVIL AVIATION AUTHORITY	11	14	4	-10	16
Total Nationalised Industries (excl water)	3978	5310	4455	-855	5793
WATER (ENGLAND AND WALES)	425	511	490	-21	596
Total Industries (incl water)	4403	5820	4945	-875	6389
				-314	6583
				-305	5969
				-9	614
				-19	17
				-2	15
				-10	13
				-2	17
				-55	72
				-2	15
				-742	6711
				+67	681
				+810	7392

Notes

(1.) All figures in £ million cash

TABLE E

TABLE F

GROSS DOMESTIC PRODUCT	Assumptions				% CHANGE
	1983-84	1984-85	1985-86	1986-87	
NATIONAL COAL BOARD	-	-	-	-	1.3
ELECTRICITY (ENGLAND AND WALES)	2.0	2.0	1.3	1.0	1.0
NORTH OF SCOTLAND HYDRO-ELECTRIC BOARD	1.0	1.0	1.0	1.5	1.5
SOUTH OF SCOTLAND ELECTRICITY BOARD	2.2	1.9	1.5	1.0	1.0
BRITISH GAS CORPORATION	2.5	2.5	-	-	-
BRITISH NATIONAL OIL CORPORATION	-	-	-	-	-
BRITISH STEEL CORPORATION	2.0	3.0	1.5	1.0	1.0
BRITISH TELECOM	2.0	2.5	-1.5	1.5	1.5
POST OFFICE	2.5	1.5	1.5	1.5	1.5
NATIONAL GYROBANK	2.2	1.5	1.0	1.0	1.0
BRITISH AIRWAYS BOARD	1.0	-	-	-	-
BRITISH AIRPORTS AUTHORITY	-	-	-	-	-
BRITISH RAILWAYS BOARD	1.7	2.1	2.3	1.1	1.1
BRITISH WATERWAYS BOARD	1.5	2.0	1.5	2.0	2.0
NATIONAL BUS COMPANY	1.0	1.0	1.0	1.0	1.0
SCOTTISH TRANSPORT GROUP	-	-	-	-	-
BRITISH SHIPBUILDERS	3.5	3.0	2.3	1.8	1.8
CIVIL AVIATION AUTHORITY	1.1	2.4	1.5	1.8	1.8
WATER (ENGLAND AND WALES)	1.8	1.9	1.6	2.1	2.1
Average (weighted by turnover)	2.1	2.2	0.9	1.2	1.2
Range of outside forecasters (calendar years)	1.7/2.6	1.2/3.0	1.6/2.3	-	-

TABLE G

RETAIL PRICE INDEX	1983-84	1984-85	1985-86	1986-87	% CHANGE
	Assumptions				
NATIONAL COAL BOARD	6.0	7.5	7.5	7.5	7.5
ELECTRICITY (ENGLAND AND WALES)	6.0	7.0	7.0	7.0	7.0
NORTH OF SCOTLAND HYDRO-ELECTRIC BOARD	6.0	7.0	7.0	7.0	7.0
SOUTH OF SCOTLAND ELECTRICITY BOARD	7.0	8.0	8.0	8.0	8.0
BRITISH GAS CORPORATION	6.0	6.0	6.0	6.0	6.0
BRITISH NATIONAL OIL CORPORATION	6.0	6.7	8.0	8.5	8.5
BRITISH STEEL CORPORATION	6.0	8.5	8.5	7.0	7.0
BRITISH TELECOM	5.6	7.0	7.0	7.0	7.0
POST OFFICE	5.6	7.0	7.0	7.0	7.0
NATIONAL GIROBANK	7.5	7.5	8.0	7.5	7.5
BRITISH AIRWAYS BOARD	7.5	7.5	7.5	7.5	7.5
BRITISH AIRPORTS AUTHORITY	6.5	8.3	8.6	9.0	9.0
BRITISH RAILWAYS BOARD	7.0	7.0	7.0	7.0	7.0
BRITISH WATERWAYS BOARD	7.0	7.0	7.0	7.0	7.0
NATIONAL BUS COMPANY	6.0	7.0	8.0	8.0	8.0
SCOTTISH TRANSPORT GROUP	6.0	8.0	8.0	8.0	8.0
BRITISH SHIPBUILDERS	6.0	5.0	5.0	5.0	5.0
CIVIL AVIATION AUTHORITY	6.0	7.5	7.5	7.5	7.5
WATER (ENGLAND AND WALES)	6.0	7.5	7.5	7.5	7.5
Average (weighted by turnover)	6.3	7.6	7.7	7.6	7.6
Range of outside forecasters (calendar years)	4.7/6.7	5.4/8.0	5.7/7.9	-	-

% change

	Nominal earnings				Real earnings			
	1983-84	1984-85	1985-86	1986-87	1983-84	1984-85	1985-86	1986-87
NATIONAL COAL BOARD	6.0%	5.0%	6.0%	6.0%	0.0%	-2.3%	-1.4%	-1.4%
ELECTRICITY (ENGLAND AND WALES)	6.0%	8.0%	8.0%	8.0%	1.9%	.9%	.9%	.9%
NORTH OF SCOTLAND HYDRO-ELECTRIC BOARD	6.0%	7.0%	7.0%	7.0%	0.0%	0.0%	0.0%	0.0%
SOUTH OF SCOTLAND ELECTRICITY BOARD	5.0%	7.0%	7.0%	7.0%	-1.9%	0.0%	0.0%	0.0%
BRITISH GAS CORPORATION	5.0%	5.0%	5.0%	5.0%	-9.0%	-1.6%	-2.8%	-9.0%
BRITISH STEEL CORPORATION	8.3%	9.1%	8.6%	9.2%	2.2%	.6%	.1%	.6%
BRITISH TELECOM	5.5%	6.4%	6.4%	6.7%	1.4%	1.2%	.6%	.9%
POST OFFICE	7.1%	8.3%	6.0%	8.0%	.9%	.9%	.9%	.9%
NATIONAL GYROBANK	8.5%	8.5%	9.0%	8.0%	0.0%	0.0%	0.0%	0.0%
BRITISH AIRWAYS BOARD	7.5%	7.5%	7.5%	7.5%	-	2.1%	.6%	.0%
BRITISH AIRPORTS AUTHORITY	-	10.6%	9.3%	9.0%	-1.9%	-1.9%	-1.9%	-1.9%
BRITISH RAILWAYS BOARD	5.0%	5.0%	5.0%	5.0%	.9%	0.0%	0.0%	.9%
BRITISH WATERWAYS BOARD	6.0%	7.0%	7.0%	8.0%	.9%	.9%	.9%	.9%
NATIONAL BUS COMPANY	-	8.0%	9.0%	7.0%	-3.7%	-9.0%	-9.0%	-9.0%
SCOTTISH TRANSPORT GROUP	4.0%	7.0%	7.0%	7.0%	-1.4%	-1.1%	-3.0%	-1.1%
BRITISH SHIPBUILDERS	4.5%	5.0%	5.0%	5.0%	0.0%	-5.0%	0.0%	0.0%
CIVIL AVIATION AUTHORITY	6.0%	7.0%	7.5%	7.5%	0.0%	-5.0%	0.0%	0.0%
WATER (ENGLAND AND WALES)	6.6%	7.4%	7.4%	7.7%	0.3%	-0.1%	-0.3%	0.1%
Average (weighted by turnover)	6.6%	7.4%	7.4%	7.7%	0.3%	-0.1%	-0.3%	0.1%

Notes

1. Deflated by industries own RPI assumptions

Range of outside forecasters (%) 7.0/7.9 7.3/7.9 7.0/8.3 - 0.6/3.1 -0.6/1.7 -0.8/1.0 -

TABLE H

TABLE I

	RPI weights	Nominal										Real	
		1983-84	1984-85	1985-86	1986-87	1983-84	1984-85	1985-86	1986-87	1983-84	1984-85	1985-86	1986-87
National Coal Board	9	5.0	6.0	6.0	6.0	-0.9	-1.4	-1.4	-1.4	-0.9	-1.4	-1.4	-1.4
Electricity (England & Wales)		-	5.5	6.7	7.2	-6.0	-1.4	-0.3	+0.2	-6.0	-0.3	+0.2	+0.2
North of Scotland HEB		-	7.0	7.0	7.0	-6.0	0	0	0	-6.0	0	0	0
South of Scotland EB		-	7.0	7.0	7.0	-6.0	0	0	0	-6.0	0	0	0
Electricity (weighted sum) ⁽²⁾	32	-	5.7	6.7	7.2	-6.0	-1.3	-0.3	+0.2	-6.0	-0.3	+0.2	+0.2
British Gas Corporation	24	6.0	8.0	9.0	9.0	-0.9	0	+0.9	+0.9	-0.9	+0.9	+0.9	+0.9
British Telecom ⁽³⁾	16	4.0	6.0	6.0	6.0	-1.9	-2.3	-2.3	-2.3	-1.9	-2.3	-2.3	-2.3
Post Office ⁽⁴⁾	2	1.7	4.8	6.2	6.2	-3.7	-2.0	-0.7	-0.7	-3.7	-0.7	-0.7	-0.7
British Rail	6	3.2	10.5	9.6	9.6	-3.1	+2.0	+0.9	+0.6	-3.1	+0.9	+0.6	+0.6
National Bus Company	4	7.3	7.8	7.7	7.8	+0.3	+0.7	+0.7	+0.7	+0.3	+0.7	+0.7	+0.7
Regional Water Authorities ⁽⁵⁾	9	7.4	9.7	9.4	8.3	+1.3	+2.0	+1.8	+1.2	+1.3	+2.0	+1.8	+1.2

Notes:

- (1) Based on IFR information
- (2) Weighted together by turnover figures for 1983-84:

ESI(E&W)	9049
NSHEB	269
SSEB	768
	10068

- (3) Tariff assumptions available only for BT as a whole. Figures here are based on those for BT as a whole, reflecting relative increase in domestic tariffs which BT wants.

- (4) Figures are for all PO sales.

- (5) Reflects last stages of tariff realignments to remove cross-subsidisation of domestic consumers by industrial consumers.

TABLE J

CONTRIBUTION BY INDIVIDUAL INDUSTRIES TO THE REAL CHANGE
IN NI DOMESTIC PRICES

	Weight in RPI (total RPI=1000)	1983-84	1984-85	1985-86	1986-87
National Coal Board	9	-0.1	-0.1	-0.1	-0.1
Electricity	32	-2.0	-0.4	-0.1	+0.1
British Gas Corporation	24	-0.2	0	+0.2	+0.2
British Telecom	16	-0.3	-0.4	-0.4	-0.4
Post Office	2	-0.1	0	0	0
British Railways	6	-0.2	+0.1	+0.1	0
National Bus Company	4	0	0	0	0
Water	9	+0.1	+0.2	+0.2	+0.1
Weighted real increase in NI prices	102	-2.6	-0.6	-0.2	-0.1

- Notes
- (1) The weighted total does not include London Transport which figures in the normal NI price series.
 - (2) The weighted total in the sum of the real increases in individual industry tariffs shown in Table I.
 - (3) Figures may not sum because of rounding.

CONFIDENTIAL

INDIVIDUAL INDUSTRY ANNEXES

Index

Annex 1	-	National Coal Board
Annex 2	-	Electricity Supply Industry (England and Wales)
Annex 3	-	Scottish Electricity Boards
Annex 4	-	British Gas Corporation
Annex 5	-	British National Oil Corporation
Annex 6	-	British Steel Corporation
Annex 7	-	British Telecom
Annex 8	-	Post Office (Postal)
Annex 9	-	National Girobank
Annex 10	-	British Airways Board
Annex 11	-	British Airports Authority
Annex 12	-	British Rail Board
Annex 13	-	British Waterways Board
Annex 14	-	National Bus Company
Annex 15	-	Scottish Transport Group
Annex 16	-	British Shipbuilders
Annex 17	-	Civil Aviation Authority
Annex 18	-	Water (England and Wales)

TABLE 1-1

NATIONAL COAL BOARD

BASELINE £m	1983-84 forecast outturn	1984-85	1985-86	1986-87
Fixed asset investment	800	986	1025	1056
TOTAL CAPITAL REQUIREMENTS	954	986	1025	1056
TOTAL INTERNAL RESOURCES	-476	65	66	68
TOTAL EXTERNAL FINANCE	1430	921	959	988

ADDITIONAL INDUSTRY BIDS £m	1984-85	1985-86	1986-87
Fixed assets in UK	-137	-121	-188
Working capital	- 99	-146	-146
Other	+ 2	+ 2	+ 3
TOTAL CAPITAL REQUIREMENT ADDITIONAL BID	-234	-265	-331
EXPECTED CHANGE IN INTERNAL RESOURCES	-515	-307	- 68
Grants	+630	+445	+296
EDC	-	-	-
Net temporary borrowing	+ 34	+ 34	+ 34
Net long and medium term borrowing	-388	-442	-596
Leasing	+ 5	+ 5	+ 3
TOTAL EXTERNAL FINANCE ADDITIONAL BID	+281	+ 42	-263

(1) In addition to the external finance + 58 + 62 + 58
bid, the following additional requirements
are sought for payments to redundant mineworkers (see paragraph 16)

ASSUMPTIONS % CHANGE	1983-84	1984-85	1985-86	1986-87
GDP	-	-	-	-
Retail Price Index	6.0	7.5	7.5	7.5
Average earnings (whole economy)	-	-	-	-
Average earnings (own industry)	6.0	5.0	6.0	6.0
Tariffs (overall)	2.5	6.0	6.0	6.0
Tariffs (domestic)	5.0	6.0	6.0	6.0
Tariffs (industrial)	2.5	6.0	6.0	6.0
Manpower (no)	234,100	215,500	200,500	185,500

NATIONAL COAL BOARD (NCB)

Status of Bids

The financing needs of the NCB are based on the Board's latest estimates. The baseline figures are those included in the 1982 IFR as adjusted for subsequent NIS changes. In the absence of long-term plans for the industry it has been recognised in the past two IFR rounds that figures included for years 2 and 3 were for aggregate public expenditure planning purposes only and had no basis in industry plans.

Recent Performance1982-83

2. The NCB's external financing requirement (EFR) for 1982-83 was £951 million. The Board kept within their EFL of £962 million, however, only by rolling over to 1983-84 payments of about £130 million. Within their EFR the Board received deficit/operating grants of £386 million and social grants of some £130 million. The Board reported a loss after deficit grant of £110 million, of which £70 million was estimated to result from industrial action during the year, both in the coal industry itself and on the railways. Capital expenditure of £862 million in 1982-83 was within the Board's £872 million capital approval.

1983-84

3. The Board's present forecast financing needs, compared with the limits set initially in Autumn 1982, are as follows:-

		£m	
	Limit	Latest forecast	Excess
EFR	1,201	1,430	229
Deficit Grant	407	607	200
Capital Investment	800	800	-

The increases arise from lower than expected sales and prices, offset to some extent by better than expected control of operating costs. (After several years in which real unit deep-mined operating costs rose on average by 4 per cent per annum, 1983-84 should be the third year in which the Board have kept wages costs and other operating cost increases at or near the level of general inflation.)

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4. The Board have significantly reduced their investment bids from previous levels. £800 million is being sought for investment in 1984-85. This is the lowest level in real terms for several years, but should be sufficient for the continued development of new mine facilities at Selby, and a modest start at Asfordby, and to contribute towards improvements in efficiency.

5. The Department of Energy are discussing with the Board what action they can take to reduce their forecast additional financing needs.

Outlook

6. Although there are some differences in underlying assumptions, neither the Board nor the Department of Energy in their short term energy demand forecasts expect increased coal demand in the inland or export markets over the next 3 years. The Board expect their total sales, inland and export, to average about 113 mtpa over the IFR period, compared with 125.1 mt in 1979-80. NCB coal prices are also expected to meet continuing pressure from consumers, including the ESI, for some form of alignment with international coal prices which are low at present. The Board expect average proceeds over the next 5 years to fall by nearly 10 per cent in real terms, concentrated in the early years. These pressures on NCB coal sales and prices are reflected in the Board's forecast financing needs.

Assessment of Economic Assumptions

7. The Department of Energy have discussed the assumptions underlying their 3 year financial projections with the Board.

8. The Board's assumptions on unit operating costs and productivity imply keeping real unit cost increases below inflation throughout the period, and are ambitious. They imply substantial real reductions in the Board's labour and other input costs. They also reflect the effects on average costs (a) of highly efficient and low-cost new capacity (notably Selby which begins production in 1983-84 and builds up to full output of 10 mtpa 1987-88), and (b) of reduction in the massive losses at present associated with inefficient capacity.

9. The Board's assumed manpower levels are those embodied in the real cost reduction outlined above.

10. On coal demand and prices the Board's assumptions are prudent. The Department of Energy's Short Term Forecasts show similar prospects in total for coal sales to the Board's estimates (see also section 3 above). The Department agrees with the Board about the climate of pressure on coal prices arising from the recession, from efforts to keep down gas and electricity prices, and in particular from low international coal prices. The precise

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effect on NCB coal prices, and on their financial forecasts, will depend on the outcome of coal sales (1 per cent higher gdp leading to higher electricity sales and industrial activity could increase coal sales by up to 1 mtpa, and revenues by £20-40 mpa), and coal prices (1 per cent on coal prices is worth £40 million in a full year).

11. The biggest factor in coal sales and prices, and in the NCB's financial position, is the electricity supply industry which consumes about 80 mt coal per annum. Ministers will need to consider the financial assumptions of the two industries together.

12. The NCB and ESI have used different planning assumptions about coal prices in their IFR returns, the ESI assuming higher coal price increases. The Department of Energy is discussing with both Boards the possible implications of international coal price levels on their coal pricing arrangements. In order not to prejudice the position of either Board in their coming negotiations, no common coal price assumption has been imposed. The difference between the Boards' pricing assumptions could represent additional revenue to NCB or lower costs to ESI (or some combination) of some £100, £200 and £300 million in the three years. If the outcome of a negotiation is a coal price increase at or above inflation (as assumed by ESI) this would result in a lower EFR for the NCB. If, however the outcome is a small price increase then the ESI's costs would be lower. This would be reflected in lower electricity prices, and would tend to worsen the ESI's EFR.

Treasury/Departmental Preliminary Assessment of External Finance Proposals and Scope for Savings

13. The Board's financial forecasts reflect their market prospects. Higher coal sales and prices would increase the Board's internal resources, but this will depend on performance in the economy in general, and on the developing commercial relationship between the NCB and ESI.

14. The achievement of the Board's financial prospectus, and any prospect of improvement, depend however, on their attaining the cost objectives implied, and this in turn depends above all on the rate of closure of high-cost and inefficient capacity which the Board achieve. Failure to achieve these would generate even higher external financing requirements.

15. Ministers are reviewing their strategy for the coal industry.

Redundant Mineworkers Payments Scheme (RMPS)

16. Although not included within the Board's EFL, expenditure under the RMPS is part of the total cost of public support for the industry and can conveniently be judged in the

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context of the IFR. The rundown in manpower assumed in the IFR will lead to increased requirements as follows:

	1983-84	1984-85	1985-86	£ million 1986-87
Baseline	167	146	168	173
Additional bids	-	+58	+62	+58

ELECTRICITY
BASELINE
Fixed a
TOTAL C
TOTAL I
TOTAL E
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Fixed a
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ANNEX 2

ELECTRICITY (ENGLAND AND WALES)

TABLE 2-1

BASELINE £m	1983-84 forecast outturn	1984-85	1985-86	1986-87
Fixed asset investment	1458	1475	1534	1580
TOTAL CAPITAL REQUIREMENTS	1266	1460	1500	1545
TOTAL INTERNAL RESOURCES	1672	1738	1970	2029
TOTAL EXTERNAL FINANCE	-406	-278	-470	-484

ADDITIONAL INDUSTRY BIDS £m	1984-85	1985-86	1986-87
Fixed assets in UK	-75	-232	-205
Working capital	+84	+212	+156
Other	-5	-	-
TOTAL CAPITAL REQUIREMENT ADDITIONAL BID	+4	-20	-49
EXPECTED CHANGE IN INTERNAL RESOURCES	+76	+90	+317
Grants	-	-	-
EDC	-	-	-
Net temporary borrowing	-50	-233	-234
Net long and medium term borrowing	-25	+125	-129
Leasing	+3	-2	-3
TOTAL EXTERNAL FINANCE ADDITIONAL BID	-72	-110	-366

ASSUMPTIONS % CHANGE	1983-84	1984-85	1985-86	1986-87
GDP				
Retail Price Index	2.0	2.0	1.3	1.3
Average earnings (whole economy)	6.0	7.0	7.0	7.0
Average earnings (own industry)	7.0	8.0	8.0	8.0
Tariffs (overall)	8.0	8.0	8.0	8.0
Tariffs (domestic)	0.1	5.5	6.7	7.2
Tariffs (industrial)	-	5.5	6.7	7.2
Manpower (no)	0.5	5.5	6.7	7.2
	136,100	132,800	130,400	127,700

ELECTRICITY SUPPLY INDUSTRY (ENGLAND AND WALES) (ESI)

Status of Bid

ESI's figures are consistent with its new financial target of 1.4 per cent CCA return on net assets (including CEGB capital work in progress) over 1983-84 to 1984-85. ESI has also been set a demanding performance aim of reducing its controllable real unit costs by 4.25 per cent over the financial target period, and if the industry achieves this in full, it will be reflected in slightly improved financial results.

Recent Performance

2. The ESI provisionally estimates a net return on average net assets of 3.2 per cent for 1982-83. This will produce an average return of 2.3 per cent on net assets valued at current cost (excluding CEGB capital work in progress) over the period 1980-81 to 1982-83 compared with its financial target of 1.7 per cent. This over-achievement is primarily due to the effect of a lower than anticipated rate of inflation on costs after tariffs had been set.

3. Provisional outturn against the 1982-83 EFL of -£148 million was -£152 million.

4. In the industry as a whole, capital investment in 1982-83 was £96 million below the planned level of £1,370 million. This was due to a revision of the incidence of expenditure on Heysham II, the lower rate of inflation, and some slight general slippage: the major capital projects are currently proceeding according to budget.

Assessment of Assumptions

5. Though similar to those of other nationalised industries, ESI's assumptions for GDP growth are slightly below Government forecasts and those for the rate of inflation slightly above (though changes in GDP growth have some relevance for load forecasts these are more sensitive to other variables, such as the index of manufacturing production).

6. The forecast increase in average earnings in the ESI is above that expected in the economy as a whole and above the expected level of inflation. This arises mainly because manpower reductions are falling more heavily on lower paid technical and clerical staff. The ESI's total manpower is forecast to reduce by 6 per cent between 31 March 1984 and 31 March 1987.

7. The ESI's tariff assumptions reflect the new financial target and are based on the zero average electricity price increase for the current year, followed by an increase below the

rate of inflation in 1984-85. Thereafter prices are forecast to rise broadly in line with inflation.

8. The ESI's financial results are sensitive to variances in load forecasts. The Council is currently forecasting a load of 217.0 TWh in 1983-84, with loads of 220.0 TWh, 222.2 TWh and 224.5 TWh in the following three years. This compares with a provisional outturn figure of 210.4 TWh (212.4 TWh after weather correction) in 1982-83, and the Industry's forecasts may prove to be slightly optimistic. A 1 per cent change in the estimate of unit requirements on the CEGB would alter operating profit by some £40 million, worth just over 0.1 per cent on the industry's rate of return.

9. The industry's forecasts are based on the assumption that coal and oil deliveries and burn will be virtually constant during the Review period, with, consequently, nil growth in stocks compared with their level at the end of 1982-83. After remaining constant in real terms in 1983-84 and 1984-85, coal prices are assumed to rise by 2-3 per cent a year in real terms thereafter.

Outlook and Treasury/Departmental Preliminary Assessment of Proposals

1984-85

10. Despite reduced fixed asset expenditure, total capital requirements are £4 million higher due to a need for a further £84 million working capital (other than stock). This is due mainly to a projected deterioration in the debtor/creditor's balance. An improvement in internal resources of £76 million is expected, which arises mainly from an increase in CCA profit as a result of the application of the new financial target, which is slightly higher than that which the industry had previously anticipated. This results overall in an increase in net repayments of external finance of £72 million.

1985-86

11. Fixed assets show a reduction of £232 million. This is in part due to lower inflation assumptions, but a major factor is the later assumed start date for the construction of the Sizewell B power station. However, this is offset by a substantial increase in working capital requirements of £212 million. For the same reasons as apply in 1983-84, internal resources are forecast to improve by £90 million, and this is reflected in overall external finance repayments, which are higher by £110 million.

1986-87

12. Lower capital expenditure and greater revenue produce increased repayments of external finance of £366m, giving an EFL of -£850m.

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NORTH OF SCOTLAND HYDRO-ELECTRIC BOARD

ANNEX 3

TABLE 3-1

BASELINE £m	1983-84 forecast outturn	1984-85	1985-86	1986-87
Fixed asset investment	44.4	43.9	51.0	52.5
TOTAL CAPITAL REQUIREMENTS	52.5	47.6	47.5	48.9
TOTAL INTERNAL RESOURCES	54.0	31.8	24.7	25.4
TOTAL EXTERNAL FINANCE	-1.5	15.8	22.8	23.5

ADDITIONAL INDUSTRY BIDS £m	1984-85	1985-86	1986-87
Fixed assets in UK	+1.8	+1.1	+6.9
Working capital	+2.0	+4.5	+8.1
Other	+0.1	+0.1	-
TOTAL CAPITAL REQUIREMENT ADDITIONAL BID	+3.9	+5.7	+15.0
EXPECTED CHANGE IN INTERNAL RESOURCES	+18.1	+23.8	+24.5
Grants	-	-	-
FC	-	-	-
Net temporary borrowing	+0.2	+0.2	+0.2
Net long and medium term borrowing	-14.7	-18.6	-12.7
Leasing	+0.3	+0.3	+0.3
TOTAL EXTERNAL FINANCE ADDITIONAL BID	-14.2	-18.1	-9.5

ASSUMPTIONS % CHANGE	1983-84	1984-85	1985-86	1986-87
GDP	1.0	1.0	1.0	1.0
Retail Price Index	6.0	7.0	7.0	7.0
Average earnings (whole economy)	-	-	-	-
Average earnings (own industry)	6.0	7.0	7.0	7.0
Grants (overall)	-	5.0	-	-
Grants (domestic)	-	5.0	-	-
Grants (industrial)	-	5.0	-	-
Power (no)	3,900	3,860	3,860	3,860

TABLE 3-2

SOUTH OF SCOTLAND ELECTRICITY BOARD

BASELINE £m	1983-84 forecast outturn	1984-85	1985-86	1986-87
Fixed asset investment	419	335	290	298
TOTAL CAPITAL REQUIREMENTS	364	310	250	258
TOTAL INTERNAL RESOURCES	89	32	27	28
TOTAL EXTERNAL FINANCE	275	279	223	230

ADDITIONAL INDUSTRY BIDS £m	1984-85	1985-86	1986-87
Fixed assets in UK	+ 55	+ 45	- 23
Working capital	- 10	+ 1	- 7
Other	-	-	-
TOTAL CAPITAL REQUIREMENT ADDITIONAL BID	+ 45	+ 47	- 30
EXPECTED CHANGE IN INTERNAL RESOURCES	+ 45	+ 47	+ 52
Grants	-	-	-
PDC	-	-	-
Net temporary borrowing	+1	+1	+1
Net long and medium term borrowing	-1	-1	-82
Leasing	-	-	-
TOTAL EXTERNAL FINANCE ADDITIONAL BID	-	-	-82

ASSUMPTIONS % CHANGE	1983-84	1984-85	1985-86	1986-87
GDP	2.2	1.9	1.5	1.5
Retail Price Index	6.0	7.0	7.0	7.0
Average earnings (whole economy)	-	-	-	-
Average earnings (own industry)	6.0	7.0	7.0	7.0
Tariffs (overall)	-	7.0	7.0	7.0
Tariffs (domestic)	-	7.0	7.0	7.0
Tariffs (industrial)	-	7.0	7.0	7.0
Manpower (no)	12,465	12,390	12,395	12,355

3. SCOTTISH ELECTRICITY BOARDS (NSHEB AND SSEB)

Status of Bids

The IFR submissions of the two Scottish Electricity Boards again form the basis of their assessment of prospects and plans.

2. Over the last year there have been discussions on the need to produce for Ministers, in advance of the IFR submission, a paper outlining the various options open to the Boards in considering strategic issues. This paper is to be submitted by December and the outcome of the IFR will be notified to the Board for incorporation in the preparation of the review.

3. The Boards will continue to produce their existing Corporate Plans which are basically for internal use as an outline of operational plans.

Recent Performance

4. Units of electricity sold in 1982-83 by the South of Scotland Electricity Board (SSEB) were down 2.3 per cent on the previous year due to the milder winter and the continuing recession. Sales by the North of Scotland Hydro-Electric Board (NSHEB) after adjustment for the loss of Invergordon smelter load were virtually unchanged from the 1981-82 load. The tariffs of both Boards were around 8 per cent higher than in the previous year. Increases in generating costs however were much lower at around 4-5 per cent principally due to excellent performance from the Hunterstone nuclear stations, high output from Peterhead and the above average output from hydro stations. Some £29 million of the increase in generating costs is attributable to a revision of the method of estimating the charge to revenue in respect of the eventual treatment of irradiated fuel. Consideration of the accumulated amount of fuel awaiting reprocessing and the feasibility and economic advantage of long term storage in dry conditions resulted in a cumulative adjustment to the accounting estimates made in previous years' accounts.

5. As a result of the above factors there was a significant improvement in the operating profit of the SSEB from £105 million to £134 million and a modest increase from £75 million to £79 million for the NSHEB.

6. Interest charges for the NSHEB remained at a similar level to 1981-82 whereas the SSEB's interest bill rose by £27 million to £114 million reflecting the increased cost of financing construction of the Torness project. Net profits after interest for the SSEB were £20 million (1981-82: £17 million) and £18 million (1981-82: £13 million) for the NSHEB.

7. Continuing the trend of the previous two years the Boards' investment again fell short of their investment approval allocation (by 24.2 per cent for SSEB and 13.6 per cent for NSHEB). Borrowing requirements for 1982-83 stayed well within the external financing limits with an underspend of £83.7 million and £11 million respectively. The main reason for the reduced financing requirements were a lower incidence of cash spending on the Torness project, improved plant performance coupled with cost savings and economies.

Outlook

8. A joint financial target of a 1.4 per cent return on average net current cost assets has been agreed for the three years 1983-84 to 1985-86. Performance aims have also been set. On generation and transmission there is a joint aim of reducing controllable costs by 4 per cent in real terms by 1984-85 (compared with 1982-83). The Boards are to endeavour to maintain controllable costs at this level in 1985-86 despite the termination of gas supplies to Peterhead power station which will result in increased generating costs. There are separate performance aims for distribution which seek a reduction in controllable costs of 8 per cent for the SSEB and 4½ per cent for the NSHEB by 1985-86.

Trading Performance over Next 3 Years

9.(i) SSEB - The average rate of sales growth is now expected to be 1.6 per cent per annum compared with 2 per cent per annum for the same period in the previous load estimates. The main factor which accounts for the reduction is the expectation that the economy will grow at a slightly lower rate than was assumed previously. Tariffs are expected to increase by around 5 per cent in 1984-85 and thereafter are expected to be kept in line with inflation. Actual tariff increases will be assessed in the light of load growth, success in reducing costs in real terms, prices of competing fuels, financing targets and other factors.

Construction of the AGR nuclear power station at Torness is generally on programme and the Board are aware of the importance of commissioning by 1987 if the full potential for cost savings is to be achieved.

(ii) NSHEB - The North Board is now predicting an average rate of sales growth of around 1.3 per cent - compared with the 1.8 per cent estimated in 1982. Recovery in load growth is considered most likely to come from light engineering and other small industries, but in view of the depth of the recession any recovery is now expected to be slower than was anticipated in 1982-83.

NSHEB are anxious to limit future tariff increases as far as possible and increases in prices are currently planned so as not to exceed the general rate of inflation assumed.

Assessment of Economic Assumptions

10. In line with other nationalised industries, the SSEB assumption for GDP is for 2 per cent growth in 1984-85 falling to 1½ per cent for the next two years; NSHEB have assumed only 1 per cent throughout. For inflation both Boards are forecasting a steady 7 per cent which is not inconsistent with the outlook of independent forecasting bodies although higher than the Government's forecasts. On future coal prices, both Boards project that these will rise in line with inflation in 1984-85 and by 2 per cent in real terms in subsequent years. Following the 5 per cent increase in oil prices from 1 January 1984, both Boards have assumed increases in real terms thereafter of 2 per cent per annum in 1984-85 and 1985-86 and 3 per cent the following year.

11. The Boards' assumptions appear to be on the cautious side but this does not appear to result in their costs, revenue, or their EFRs being significantly mis-stated.

Treasury/Department Preliminary Assessment of External Finance proposals and Scope for Savings

12. Following agreement to the setting of a financial target, SSEB have agreed to withdraw their additional bids for 1984-85 and 1985-86. This has in effect brought about reductions in the financing requirements sought by the Board for these years and there seems little scope for other capital savings by either Board.

13. Although there has been a considerable shortfall on capital expenditure for the construction of Torness due mainly to difficulties in estimating the phasing of expenditure, extra expenditure is expected in 1983-84 in order to catch up. The Board has stressed there is no identifiable item which would delay commissioning of the station. Torness accounts for about 70 per cent of the Boards' combined capital expenditure programme in the IFR period.

TABLE 4-1

BASILINE £m	1983-84 forecast outturn	1984-85	1985-86	1986-87
Fixed asset investment	891	876	791	815
TOTAL CAPITAL REQUIREMENTS	956	1074	982	1012
TOTAL INTERNAL RESOURCES	990	1105	1192	1228
TOTAL EXTERNAL FINANCE	-34	-31	-210	-216

ADDITIONAL INDUSTRY BIDS £m	1984-85	1985-86	1986-87
Fixed assets in UK	+27	+42	+25
Working capital	-17	+80	+38
Other	-	-	-
TOTAL CAPITAL REQUIREMENT ADDITIONAL BID	+10	+122	+63
EXPECTED CHANGE IN INTERNAL RESOURCES	+10	+306	+317
Grants	-	-	-
FDC	-	-	-
Net temporary borrowing	-	-184	-262
Net long and medium term borrowing	-	-	+8
Leasing	-	-	-
TOTAL EXTERNAL FINANCE ADDITIONAL BID	-	-184	-254

ASSUMPTIONS % CHANGE	1983-84	1984-85	1985-86	1986-87
GDP	2.5	2.5	1.5	1.0
Retail Price Index	7.0	8.0	8.0	8.0
Average earnings (whole economy)	9.0	10.0	10.0	10.0
Average earnings (own industry)	5.0	7.0	7.0	7.0
Tariffs (overall)	7.0	8.0	9.0	9.0
Tariffs (domestic)	6.0	8.0	9.0	9.0
Tariffs (industrial)	3.0	7.0	7.0	8.0
Manpower (no)	100,000	99,000	98,000	97,000

4. BRITISH GAS CORPORATION (BGC)

Status of Bid

The bid proposed by the Corporation is consistent with the 1983 Corporate Plan. Further information on the Plan has been requested and will be discussed with the Corporation, with a view to submitting the Corporate Plan review to E(NI) at the end of July.

Recent Performance

2. BGC were 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 years 1980-81 to 1982-83. The expected averaged return over this 3 year period is estimated at 4.1 per cent. The Corporation, pending agreement on a new target for the next three year period, are currently working towards a $3\frac{1}{2}$ per cent minimum return. Agreement of a specific figure is expected later in the year once the 1983 Corporate Plan and the Efficiency Study by Deloitte, jointly commissioned by BGC and the Department of Energy have been considered in depth.

3. A performance objective of a 5 per cent reduction, in real terms, in net trading costs per therm at Seasonal Normal Temperatures (SNT) in 1982-83 compared with 1980-81 was also agreed. The Corporation expect to better this target with a reduction of more than 6 per cent, as illustrated below.

	1980-81	1982-83	% Change
Gas sold and used at SNT (in therms)	16,664	16,937	+1.6%
Net trading costs £m (1980-81 prices)	1,560	1,487	-4.7%
p/therm (1980-81 prices)	9.36	8.78	-6.2%

Prior to agreement on a further target with Government, the Corporation are continuing efforts to reduce costs and improve efficiency. Corporate Plan forecasts envisage an improvement in net trading costs per therm (at 1982-83 prices) over the 4 years to 1986-87 of 11 per cent provided that forecast sales materialise. As with the financial target, a formal performance objective should be agreed in the autumn.

4. Performance against EFLs in recent years has been satisfactory, despite difficult trading conditions, as the table below illustrates:

Year	EFL	£m Actual Net External Finance
1980-81	-400	-409
1981-82	49	39
1982-83	-87	-230

The large positive variance in this year's EFL arises from improvements in the level of working capital as estimated debtors decreased, and a reduction in capital expenditure levels, most of which is attributable to slippage on the Rough and Morecambe projects. At year end, capital expenditure was £70 million below budget: stringent efforts have been made to improve project management on the Rough and Morecambe projects to restrict further slippage from the critical path.

Outlook

5. The Corporation expect to remain self financing over the next 3 years, and to achieve a 3.9 per cent average return on net current cost assets. The industry, however, is vulnerable to external uncertainties and their future estimates are subject to economic recovery, the performance of oil prices, exchange rates, inflation and the weather. Forecasts also assume that the rate of gas levy remains constant at 4p per therm and that domestic tariffs will increase by 5 per cent, 9 per cent, 9 per cent and 10 per cent in October of each year up to 1986-87.

6. These increases, which given the Corporation's inflation assumptions would hold domestic prices constant in real terms over the period taken as a whole, are not enough to eliminate substantial and increasing losses on the 25 per cent of BGC's gas supplies imported from Norway.

Assessment of Economic Assumptions

7. BGC's forecast of inflation, 7 per cent in 1983-84 and 8 per cent in each subsequent year of the period, is higher than Government forecasts, and is at, or very slightly above, the top of the range of external

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forecasts. Most of the other key economic assumptions are consistent with those put forward by the Working Group on Energy Strategy (WGES). Projections are set out below:

1981 = 100 ((1)-(4) only)

1985	BGC	WGES
(1) GDP	107	106
(2) Consumer Expenditure	107	107
(3) Industrial Output	105	111
(4) Service Output	107	104
(5) Oil Prices \$/bbl	30	27

The first four assumptions affect demand projections. The differences between BGC and D.En on demand forecasts is slight and using BGC's assumptions would make little difference to D.En's forecasts. The difference on industrial output is less than it appears as BGC's index refers to manufacturing production rather than industrial production.

8. The one significant difference is on oil prices. Here BGC foresee a faster recovery in prices than the Department. This is being probed with the Corporation.

Treasury/Departmental Preliminary Assessment of External Finance Proposals and Scope for Savings

(i) Fixed Asset Expenditure

9. BGC have made additional bids of £27 million and £42 million in 1984-85 and 1985-86 respectively. This increase is due to rephasing of expenditure in Rough and Morecambe from earlier years, total slippage on these two projects in 1982-83 being £94 million. Nevertheless, overall capital expenditure from 1982-83 to 1985-86 is still in real terms within previous forecasts. The rate of project slippage has declined considerably in the latter half of 1982-83 and the Corporation are anxious to maintain this performance. Little scope for savings, beyond productivity improvements, exists as both projects are crucial elements in the Corporation's strategy of meeting peak day demand. Certain regional expenditure is demand-related and would be deferred if industrial demand fails to pick up this year. The extent of any possible savings here is difficult to identify, but is being discussed with the Corporation.

(ii) Working Capital

10. Working capital levels in 1984-85 are down £17 million, the effects of depressed sales nearly balancing the position of debtors and creditors. Slippage on Rough however has reduced the cost of stocks to the benefit of working capital levels. In 1985-86, the Corporation forecast an extra requirement of £80 million as the cost of the loss of creditors

exceeds the benefits obtained by the reduction in debtors. The further reduction in stocks is also insufficient to offset the cost of fewer creditors. Initial appraisal of the forecasts indicates that there may be some scope for improvement especially in creditors. The extent has not yet been assessed but is being probed as part of the discussions of the Corporate Plan.

(iii) Changes in Expected Internal Resources

11. Internal resources are expected to be up by £10 million in 1984-85 and £306 million in 1985-86 mainly as a result of increased profitability, arising principally from lower gas costs and reductions in trading costs which outweigh reductions in turnover reflecting lower gas demand.

12. The changes in profitability from the baseline are summarised below:

		1983-84	1984-85	£m 1985-86
Turnover		-188	-259	-180
Costs	- Gas	+112	+142	+184
	- Gas levy	+10	+26	+14
	- Net trading costs	+80	+94	+200
	- Other costs	+26	+16	+27
	- Depreciation	+29	+33	+30
TOTAL		+257	+311	+455
Operating profit		+69	+52	+275
CC adjustments		+10	+11	+11
CC Operating profit		+79	+63	+286
(+ = improve profitability)				

The reasons for changes from baseline and the scope for improvements are being probed with the Corporation. At this stage it is probable that lower inflation, manpower and oil price forecasts are the main causes of increased profits, but changes in fixed asset phasing and lower gas throughput also tend to increase profits by reducing depreciation.

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13. The only other significant changes in other internal resource elements are shown below:

	1984-85	£M 1985-86
Change from baseline:		
Interest	-12	-40
Taxation	+31	+140
Other Adjustments	-33	-40

Interest levels are down owing to a reduction in forecast interest rates; reductions in taxation arise from elimination of the tax charge in 1985-86 relating to offshore oil assets and from the changes in oil taxation announced in the Chancellor's last budget; while reductions in other adjustments reflect changes in fixed asset phasing, lower gas throughput and inflation.

14. There is scope for faster increases in gas prices in order to eliminate the losses on imported gas supplies. If at the same time the levy were increased, the increase in BGC's revenue from higher prices would be offset and would not necessarily be reflected in lower external financing. The Exchequer would however receive the whole benefit.

(iv) Overall External Finance Position

15. The forecast reductions in gas costs and trading costs will have a significant effect on profitability and together with lower taxation payments, are sufficient, particularly in 1985-86, to offset the extra bids for fixed asset expenditure and working capital and also the decline in certain internal resources. The overall effect therefore on EFL is an unchanged figure for 1984-85, -£31 million, and an improvement in 1985-86 of £184 million, to -£394 million.

(v) Treasury/Departmental Assessment

16. BGC's forecasts are an improvement on baseline, and the forecasts are being studied thoroughly in the context of the Corporate Plan and in discussions on the financial target and performance aim. Initial indications are that some small additional savings may be possible but that significant further improvements would require higher prices than those proposed in the Corporate Plan. Ministers will be invited as part of the Corporate Plan Review to consider the extent they wish BGC to eliminate losses on imported gas supplies by raising prices, ie in effect to move to a regime of long run marginal cost pricing.

TABLE 5-1

BRITISH NATIONAL OIL CORPORATION

BASELINE £m	1983-84 forecast outturn	1984-85	1985-86	1986-87
Fixed asset investment	0.5	-	-	-
TOTAL CAPITAL REQUIREMENTS	4.1	-	-	-
TOTAL INTERNAL RESOURCES	0.8	1.0	1.0	1.0
TOTAL EXTERNAL FINANCE	3.3	-1.0	-1.0	-1.0

ADDITIONAL INDUSTRY BIDS £m	1984-85	1985-86	1986-87
Fixed assets in UK	+0.4	+0.4	+0.5
Working capital	-	-	-
Other	-	-	-
TOTAL CAPITAL REQUIREMENT ADDITIONAL BID	+0.4	+0.4	+0.5
EXPECTED CHANGE IN INTERNAL RESOURCES	+3.5	+2.8	+2.8
Grants	-	-	-
FDC	-	-	-
Net temporary borrowing	-3.1	-2.4	-2.3
Net long and medium term borrowing	-	-	-
Leasing	-	-	-
TOTAL EXTERNAL FINANCE ADDITIONAL BID	-3.1	-2.4	-2.3

ASSUMPTIONS % CHANGE	1983-84	1984-85	1985-86	1986-87
GDP	-	-	-	-
Retail Price Index	6.0	6.0	6.0	6.0
Average earnings (whole economy)	-	-	-	-
Average earnings (own industry)	6.0	6.0	6.0	6.0
Tariffs (overall)	-	-	-	-
Tariffs (domestic)	-	-	-	-
Tariffs (industrial)	-	-	-	-
Manpower (no)	150	150	150	150

BRITISH NATIONAL OIL CORPORATION (BNOC)

Status of bid

The IFR figures drawn up by the Corporation assume that its business continues without major change, and in particular that it is able to continue trading participation oil neither at profit nor at loss. This assumption is the least that can be made prior to the completion of the present review of the Corporation's future role but may need to be revised in due course. Finalisation of the Corporation's draft corporate plan also depends on the outcome of the review.

2. The IFR figures also assume that volumes of liquid petroleum gas (LPG) traded by the Corporation are maintained. This has not been agreed and indeed it is Government policy that new LPG participation options should not be exercised. If the LPG volumes traded are allowed to decline the Corporation's pre-tax profit would be reduced by about £0.1m in 1985-86 and £0.2m in 1986-87. The effect in later years would be more marked.

Recent performance

3. In the first five months of its existence as a separate trading organisation, BNOC achieved an operating profit of £1.9m. However, unprecedented uncertainty in the oil market and the need for the Corporation, in setting its prices, to avoid destabilising the oil market have resulted in it making a loss of over £8 million on participation oil trading earlier this calendar year (£4 million of the loss falls in the current financial year, 1983-84.) A loss of this size will make it difficult for the Corporation to meet its financial target of a pre-tax profit of £10m over the four years from 1 January 1983.

Outlook

4. The Corporation is forecasting that it will be able to return to the position of breaking even on its participation oil trading for the next three years. However, the oil market is likely to remain weak during this period, so there remains a risk that the Corporation could be exposed to further losses.

5. The Corporation also forecasts that, in accordance with its objectives, it is able to continue to make profits on its other trading activities. Such forecasts are largely speculative and whilst the Corporation's figures are not unreasonable, actual performance could fluctuate fairly widely in either direction.

Assessment of Economic Assumptions

6. There is no reason to object to BNOC's assumption that its staff's average earnings will rise in line with the RPI (6 per cent pa). However, the main determinant of the Corporation's financial performance is its success in achieving trading margins; this is very sensitive to conditions in the oil market, and difficult to predict.

Treasury/Departmental Preliminary Assessment of External Finance Proposals and Scope for Savings

(i) Fixed asset expenditure

7. Although the Corporation's expenditure is under £1m pa, the figure seems high in relation to the size of the Corporation. The Department is pursuing this with the Corporation.

(ii) Working Capital

8. Back-to-back trading enables the Corporation to maintain working capital at minimal levels in normal circumstances, but there were net creditors outstanding at the beginning of 1983-84 as a consequence of losses made on oil delivered in March 1983. The change shown for 1983-84 is simply the result of a return to normal circumstances.

(iii) Changes in internal resource expectation and external finance position

9. BNOC forecasts an improvement in internal resources compared to baseline with the exception of 1983-84, leading to a corresponding improvement in its EFR. This is due to the replacement of the somewhat stylised figures in the White Paper, in view of the Corporation's belief that there will be opportunities in its trading activities to earn higher profits.

(iv) Treasury/Departmental assessment

10. The Corporation's financial performance depends critically on the state of the oil market and its freedom of action is limited at the behest of Government by the need, in periods of market instability, to avoid contributing to that instability. The IFR forecasts assume no major upsets in the oil market; actual performance could be liable to wide fluctuation as a result of factors outside the Corporation's control. There appears to be no scope for savings beyond the possibility of some small reduction in the already low level of forecast capital expenditure.

TABLE 6-1

BRITISH STEEL CORPORATION

BASELINE £m	1983-84 forecast outturn	1984-85	1985-86	1986-87
Fixed asset investment	224	240	260	268
TOTAL CAPITAL REQUIREMENTS	206	366	325	335
TOTAL INTERNAL RESOURCES	-119	273	247	254
TOTAL EXTERNAL FINANCE	325	93	78	80

ADDITIONAL INDUSTRY BIDS £m	1984-85	1985-86	1986-87
Fixed assets in UK	-13	-46	-
Working capital	+32	-55	-
Other	+5	+5	-
TOTAL CAPITAL REQUIREMENT ADDITIONAL BID	+24	-96	-
EXPECTED CHANGE IN INTERNAL RESOURCES	-196	-168	-
Grants	-	-	-
EDC	-	-	-
Net temporary borrowing	+247	+98	-
Net long and medium term borrowing	+2	+2	-
Leasing	-29	-28	-
	-	-	-
TOTAL EXTERNAL FINANCE ADDITIONAL BID	+220	+72	-

ASSUMPTIONS % CHANGE	1983-84	1984-85	1985-86	1986-87
GDP	2.0	3.0	1.5	-
Retail Price Index	6.0	6.7	8.0	-
Average earnings (whole economy)	-	-	-	-
Average earnings (own industry)	5.0	5.0	5.0	-
Tariffs (overall)	-2.3	7.0	7.6	-
Tariffs (domestic)	-1.0	7.0	7.0	-
Tariffs (industrial)	-	-	-	-
Manpower (no)	75,500	71,000	68,000	67,000

BRITISH STEEL CORPORATION (BSC)

Status of Bids

The BSC bids are based on the Corporate Plan for 1983-1986, presented in February and approved by Ministers in May. An EFL of £235 million for 1983-84 was announced on 19 May 1983. Adjustments have been made to BSC's bids for later years to take account of those decisions and other developments since the preparation of the Plan. As in the Plan itself, no allowance is made for costs that may arise if BSC's discussions with US Steel lead to a proposal to supply slab to the US.

Recent Performance

2. BSC broke even in the month of March 1982 but a severe drop in orders during the Spring and Summer of 1982-83 led to mounting losses. BSC acted to cut losses and stem the cash drain by first cutting production and then later initiating a programme of accelerated redundancies and closures, the latter with the objective of reducing the number of operating sites. However the target of break-even in 1982-83 had to be abandoned and the loss in that year was eventually £387 million. The Government instructed BSC to prepare its Corporate Plan for 1983-86 on the basis that steelmaking would continue at all five integrated sites and with the objective of breaking even before interest in 1984-85. Recent performance shows a gradual recovery in trading conditions from the low point of December 1982 with higher demand overall and some recovery of prices but also offsetting weaknesses in some areas eg tubes.

Outlook

3. In examining the 1983-86 Corporate Plan, the Department of Industry stressed the market uncertainty which made forward assessments of the trading performance in 1984-85 very difficult. BSC drew up the Plan on the basis that there would be no further substantial disruption of trading conditions in Europe ie that despite the overhang of excess capacity, and the willingness of Governments to subsidise production at a loss, the Community regime would succeed in preserving general stability. BSC's performance over the last few months is consistent with their operating plan for 1983-84 and achievement of their EFL for the current year. Performance in the remainder of the year will be affected by decisions shortly to be taken on the European steel regime, market developments and exchange rate movements.

Assessment of Economic Assumptions

4. The key external determinants for BSC are sales volume, prices and exchange rates. On sales volume, it appears that BSC have adopted a approach which, if their assumption of no major market disruption is accepted, tends towards caution but there is no basis for challenging their view until the future of the European steel regime becomes clearer in the wake of the Steel Council now adjourned to 25 July. On prices, it seems BSC have been unduly cautious in respect of 1983-84, and this led directly to the decision to reduce the contingency margin suggested by BSC for 1983-84 by £100m when the EFL for the current year was set. For the later years, most of the contingency margin has been taken out of the IFR figures on the grounds that, while the events which would lead to that margin being needed remain a very real possibility (and past experience is that BSC has always needed a generous contingency margin), they are not in fact being predicted at the moment. The IFR figures do, however, contain a positive allowance in 1984-85 and 1985-86 made for exchange rate assumptions more favourable to BSC than those on which the plan was originally drawn up. (The key element of the BSC assumptions underlying the IFR figures is that the pound will fall to around 2.9 Deutschmark in 1984-85 and 1985-86; a pattern in which the pound remained above 3.6 Dm would cost BSC an additional £75m/£100m a year.) The 1984-85 figures also include the cash effects of adverse profit variances arising in 1983-84 and allowance is made in both 1984-85 and 1985-86 for some further losses now likely to arise on the stainless steel and tubes businesses. On internal factors, BSC's record has been good and given the desired volume levels to which the Plan is geared, that their targets on capacity utilisation manpower, and energy usage seem realistic and achievable. An element of contingency has been included however to allow for the effect of local labour disputes.

Treasury/Departmental Preliminary Assessment of External Finance Proposals and Scope for Savings

5. Assessment of later years and in particular prospects for 1984-85 depend, as already mentioned, on the continued effectiveness of the European steel cartel. The scope for savings is difficult to judge until the likely future course of the European steel regime becomes clearer. At this stage attention might focus on some of the following:-

Fixed asset expenditure

There has been a slight history of underspending in recent years, but BSC has now cut back to projects which are essential for efficiency and competitiveness. The pattern and level of expenditure will be affected by the European Commission's decision on the Port Talbot hot strip mill project.

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Working capital

Tight control is being maintained over stocks and debtors, but the overall figure is sensitive to movements in output.

Internal resources

As noted above, the figures already exclude the contingency provision proposed by BSC, but some improvement might be achievable if the market permits sterling price levels above those assumed.

TABLE 7-1

BRITISH TELECOM

BASELINE £m	1983-84 forecast outturn	1984-85	1985-86	1986-87
Fixed asset investment	1730	2230	2259	2327
TOTAL CAPITAL REQUIREMENTS	1901	2365	2360	2431
TOTAL INTERNAL RESOURCES	2009	2283	2372	2443
TOTAL EXTERNAL FINANCE	-108	82	-12	-12

ADDITIONAL INDUSTRY BIDS £m	1984-85	1985-86	1986-87
Fixed assets in UK	-38	+160	+383
Working capital	-123	-42	-18
Other	+1	-3	-14
TOTAL CAPITAL REQUIREMENT ADDITIONAL BID	-160	+115	+351
EXPECTED CHANGE IN INTERNAL RESOURCES	-190	-194	+ 66
Grants	-	-	-
EDC	-	-	-
Net temporary borrowing	+170	+360	+474
Net long and medium term borrowing	-168	+12	+12
Leasing	+28	-83	-204
TOTAL EXTERNAL FINANCE ADDITIONAL BID	+30	+20	+3

ASSUMPTIONS % CHANGE	1983-84	1984-85	1985-86	1986-87
GDP	2.0	2.5	-1.5	1.0
Retail Price Index	6.0	8.5	8.5	8.5
Average earnings (whole economy)	8.0	9.1	8.6	9.2
Average earnings (own industry)	8.3	9.1	8.6	9.2
Tariffs (overall)	3.0	5.0	5.0	5.0
Tariffs (domestic)	-	-	-	-
Tariffs (industrial)	-	-	-	-
Manpower (no)	237,000	229,000	222,000	218,000

BRITISH TELECOM (BT)

Status of Bids

1. The bid is based on BT's 'first draft outline' for a period in which they expect to be a plc, adjusted for BT retaining their £1,250m liability to POSSF. Preliminary discussions on the outline have been held between the Government and BT at both Ministerial and official level, but much further information is still required from BT.

2. Privatisation is assumed to follow a sale in 1984 but as it is uncertain when transfer to the private sector will be achieved BT's external financing needs are shown for the entire period of the IFR. The receipt by Government of dividends on its shares in BT reduce the impact on the PSBR and planning totals which will be smaller than the EFL/EFR by the amount of the dividends paid.

£ million

<u>Baseline</u>	1984-85	1985-86	1986-87
Fixed assets in UK	2230	2259	2327
Total capital requirements	2365	2360	2431
Total internal resources	2283	2372	2443
EFRs (Baseline)	<u>82</u>	<u>(12)</u>	<u>(12)</u>

3. Bids over baseline amount to £30m, £309m and £285m. If 50 per cent of BT equity is disposed of in autumn 1984, the interim dividend in that year payable to the Government in respect of a half year in which BT plc was wholly owned and dividends on the Government's remaining holding, which would be treated as negative public expenditure for as long as BT remains within the public sector would amount to £180m, £260m and £320m. These figures would need adjustment if less than 50 per cent were sold in October 1984, if the dividends for 1984-85 were at a lower level than for a full year, or if BT's debt obligations were altered.

Recent Performance

4. The main feature of BT's performance against EFLs and target was last year's massive £633m undershoot:

Year	1978-79	1979-80	1980-81	1981-82	1982-83
EFL £m	(40)	315	(122)	380	310
Actual EFR £m	(67)	270	(109)	250	(323)*
Target RRA %	6.0	5.0	5.0	5.0	5.5
Actual RRA %	6.9	4.6	4.4	6.5	5.9*
RUC target %	-5	-5	-5	-5	-5
RUC %	-10.5	-3.8	+5.5	+1.7	-0.7*

*provisional

5. BT's capital investment has recently failed to meet their projections:

Year	78-79	79-80	80-81	81-82	82-83
Planned fixed asset expenditure in UK	986	1,076	1,489	1,930	1,969†
Shortfall (excess)	(7)	(139)	(56)	413	300*

*estimated

†on changed accounting policies

6. Business volume has grown at about 7 per cent per annum over the last five years, while prices have been level in real terms. Employment (staff in post) rose from 233,000 in 1978-79 to 246,000 in 1982; it is now about 240,000. BT average earnings have risen faster than average earnings over the last five years (4 per cent over the period).

Outlook

7. As shown below most of BT's future projections show a fairly sharp break with the trends of the past four years, most notably in respect of the improved cost control they now envisage.

78-89 to 82-83	Overall change	84-85 to 87-88
-2%	GDP	+3.5%
+1%	RUC	-36%
+8k	Manpower	-20k
+23%	Volume	+30%
level	Real tariffs	-13%
+4%	BT; national average earnings	level

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8. The main features of the projected trading position are:

Year	1984-85	1985-86	1986-87
Income £ billion	7.5	8.2	9.1
Expenditure £ billion	6.2	6.6	7.1
Operating Profit £ billion	1.3	1.6	2.0

BT have not so far supplied market share data which would be necessary to evaluate these projections properly.

Assessment of Economic Assumptions

9. BT's assumptions on inflation and average earnings are high, the GDP assumption acceptable. The accuracy of the tariff assumptions depends in part upon the outcome of discussions on the "RPI minus X" formula relating to BT's monopoly services (on which decisions cannot be made until the autumn) and in part upon the effects of competition, but BT are clearly aiming to hold tariff increases well below the RPI.

Treasury/Departmental Preliminary Assessment of External Finance Proposals and Scope for Savings

Fixed Assets

10. BT's proposals are:

£m	83-84	84-85	85-86	86-87
£m at 83-84 prices	1,730	2,192	2,419	2,710
% increase in volume on previous year	1,730	2,068	2,103	2,171
	-3%	20%	2%	3%

They show a large increase in the first IFR year (1984-85) and a flat profile after that (with indeed a small real decrease in investment for 1987-88). BT say that the hump in expenditure is largely due to projected needs for analogue/digital conversion equipment in the first stages of digitalisation of the network. However, BT have not provided sufficiently disaggregated figures to enable this to be assessed. They also have not provided any assurance the programme meets the RRR; BT say they cannot do so while RPI-X is not settled.

11. BT's figures are open to two criticisms:

- (a) they are prepared on the basis of inflation assumptions which are too high. This same fault in 1982-83 led to their overestimating external financing by some £120m;

- (b) BT may again fail to achieve the leap in investment now forecast for 1984-85. A similar leap was predicted for 1982-83 and did not take place. The leap depends critically upon the maintenance of spending at a high level on TXE 4 equipment, the successful installation of System X equipment and certain other capital items. A flatter profile would be more prudent.

For example, it would be possible to substitute a 10 per cent increase in fixed asset spending in 1984-85 and a 4 per cent increase in each year thereafter all in real terms, and take an inflation assumption 1.5 per cent lower than BT project for 1984-85 and 2 per cent lower thereafter. The savings achieved would be £156m, £164m and £212m.

Working Capital

12. BT's projections of working capital requirements are modest compared with previous experience but in the last two years BT's working capital position has strengthened considerably and, after the shortfalls in recent years, BT's projections are probably acceptable.

Changes in internal resources expectation

13. The major concerns are volume, prices and costs:

- (a) BT have experienced steady volume growth averaging 7 per cent over the last ten years. They are projecting this to continue for the future. This assumption depends partly on GDP and partly upon growth specific to telecommunications; there seems little reason to doubt the projection of growth in the total telecommunications market, though this may be a little on the low side. The main question mark is the impact of competition. If for example BT lost 1 per cent more of their business to competition than they expect in 1986-87, then their internal resources would be decreased by nearly £100m.
- (b) On prices BT have assumed tariffs rising at RPI-3.5 per cent over the whole of their business. It will be easier to assess this assumption in the light of the work of the RPI-X working party in the autumn.
- (c) BT's assumptions on costs assume both that they will be able to hold BT wages in line with their assumption of the national average (which they have not done before) and that they will improve operational efficiency to the extent that they can reduce manpower beginning in 1984-85. Both assumptions, while desirable, are ambitious. They are in marked contrast to past performance, which has seen BT's wages rising ahead of the average, and cost reductions falling well short of reasonable expectations (see RUC performance in para 3 above).

14. Taken together these considerations imply a real risk that BT's internal resources will be considerably lower than they expect - although the acceptance by BT of ambitious targets on costs must be welcomed.

Overall external finance position and assessment

15. On the assumption that expected dividends are treated at negative public expenditure, the effect of BT's bid is an overall decrease in public expenditure. Equally, if no dividends were to be paid and BT were treated as a nationalised industry throughout the review period, the internal resources position then projected would be reflected in a bid well below baseline.

16. There are, as noted above, two main weaknesses within the planned projections:

- (a) capital expenditure may fall below the levels projected;
- (b) cost savings may not be achieved on the scale forecast.

These risks point in opposition directions. While the Government wishes BT to make as rapid progress as possible with its investment plans, subject to these meetings the RRR, any shortfall will ease the pressures on internal resources: pressures which Sir George Jefferson needs to continue in place in order to drive the business to attain the substantial cost reductions he is seeking. It might help him to achieve these desirable savings if the Government agree to treat capital expenditure somewhat differently from current. This could be done if, following practice adopted for 1983-84, Ministers approve a shortfall or negative contingency provision to the capital programme. BT could continue to plan for their bid level of investment but for EFL/EFR purposes a lower set of figures would be adopted on the understanding that BT was free to come back with a bid for additional finance if in the event a higher level of capital investment proved attainable.

Illustrative figures are:

	1984-85	1985-86	1986-87
BT fixed assets in UK (target)	2192	2419	2710
Less shortfall allowance	156	164	212
BT fixed assets in UK (estimate)	2036	2255	2498
Total capital requirements	2049	2311	2570
Total internal resources	2093	2178	2509
EFR	(44)	133	61
Excess bid over baseline	(126)	145	73
Overall public expenditure impact	(306)	(115)	(247)

POST OFFICE

TABLE 8-1

BASELINE £m	1983-84 forecast outturn	1984-85	1985-86	1986-87
Fixed asset investment	130	128	140	147
TOTAL CAPITAL REQUIREMENTS	110	98	114	119
TOTAL INTERNAL RESOURCES	157	144	157	164
TOTAL EXTERNAL FINANCE	-47	-47	-43	-44

ADDITIONAL INDUSTRY BIDS £m	1984-85	1985-86	1986-87
Fixed assets in UK	+ 42	- 12	- 29
Working capital	+ 3	+ 20	+ 21
Other	-	-	-
TOTAL CAPITAL REQUIREMENT ADDITIONAL BID	+ 45	+ 8	- 8
EXPECTED CHANGE IN INTERNAL RESOURCES	- 1	- 8	- 8
Grants	-	-	-
PDC	+ 10	+ 7	+ 7
Net temporary borrowing	+ 47	+ 20	- 14
Net long and medium term borrowing	-	- 1	+ 12
Leasing	- 10	- 10	- 6
TOTAL EXTERNAL FINANCE ADDITIONAL BID	+ 47	+ 16	-

ASSUMPTIONS % CHANGE	1983-84	1984-85	1985-86	1986-87
GDP	2.5	1.5	1.5	1.5
Retail Price Index	5.6	7.0	7.0	7.0
Average earnings (whole economy)	7.3	7.5	7.0	7.5
Average earnings (own industry)	5.5	6.4	6.4	8.0
Tariffs (overall)	1.7	4.8	6.2	6.2
Tariffs (domestic)	-	-	-	-
Tariffs (industrial)	-	-	-	-
Manpower (no)	178,000	176,800	177,900	177,200

THE POST OFFICE: POSTAL BUSINESS

Status of Bid

The bids for fixed asset investment derive from the objectives described in the Post Office Corporate Plan 1983-84 to 1987-88. The figures in the attached annex have been amended from those submitted, to reflect accounting policy changes, tax, exclusion of counter mechanisation from the two later years following preliminary discussions with the Post Office.

2. The strategic aims of the Plan are to:-

- secure a growth in mails volume at declining real prices;
- accelerate completion of the Letter Mechanisation programme;
- arrest an expected decline in Post Office counter business, by marketing, cost reduction and investment in automation;
- improve productivity;
- modernise the Postal Estate, and introduce new technology into the mails sector;
- review the balance between road and rail transport and the potential for contracting out, which may have implications for British Rail.

Recent Trading Performance

3. The Post Office has been profitable since the ending of the period of statutory price restraint in 1976. With the exception of 1980-81 it has also met its financial objective of making a profit after interest of 2 per cent on turnover, adjusted for the effects of National Insurance Surcharge reductions. In 1981-82 and 1982-83 the Post Office exceeded its objective, achieving a return on turnover, respectively, of 3.6 per cent (against a target of 2.5 per cent) and an estimated 4.9 per cent (target 3 per cent). Following an upward trend in the 1970's, real postal tariffs have declined in each of the past three years and are now at the level of five years ago.

Other Performance Indicators

4. Real Unit Costs - In the four year period of its earlier Real Unit Cost (RUC) performance target which was to keep unit costs constant in real terms, Post Office real unit costs rose by 4.7 per cent. Since the introduction of a new RUC target, the Post Office has met the first year aim of reducing real unit costs by 2 per

cent and expects to meet the further target of a 3 per cent reduction in the next 2 years.

5. Capital Spend - Following a period from the late 70's when its capital investment allocation was more often underspent, in 1982-83 a small capital overspend arose.
6. Productivity - A downward drift in productivity throughout the last decade has been reversed in the last 2-3 years, due primarily to the introduction of the Improved Working Methods (IWM) mails bonus scheme at the time of the Monopolies and Mergers Commission investigation into the Inner London Letter Post. Although concentrated in the Inner London area, where improvements of over 20 per cent in the 3 years have been achieved, productivity nationally has increased by 8 per cent, growing by over 3 per cent per annum in the last 2 years.
7. Pay - Average earnings over the last few years have remained slightly below the rate of inflation and are estimated to stay roughly in line in the future. Productivity improvements in the last two years have seen a decline in real unit labour costs which are expected to fall by a further 5 per cent in the plan period.

Outlook

8. It seems likely that the Post Office will continue to meet its financial objective and EFL. Recent experience indicates a higher probability that its investment allocation will be spent in full.

Assessment of Assumptions

9. The economic assumptions on which the Corporate Plan and IFR are based do not diverge significantly from the general outlook.
10. The business assumptions of a growth, over the 5 years, in inland letters (+6 per cent), parcels (+20 per cent) and overseas mail (+3 per cent) are reinforced by the performance over the last year which saw a growth of 2 per cent in inland letters and 5 per cent in parcels. Some impact is expected from competition with the growth in Information Technology but Post office estimates of volume have in the past proved to be conservative.
11. Operationally, the mails productivity improvement of 8 per cent in the next 5 years appears low in the light of recent performance (+3 per cent per annum) and little better than

1/14
productivity through volume growth. Subject to expected increases in traffic a greater improvement will be sought.

12. Postal tariffs are forecast to fall by 6 per cent in real terms by 1987-88, but will be sensitive to volume changes.

Treasury/Department Preliminary Assessment of External Financing Proposals

Fixed Assets

13. The fixed asset totals have effectively been reduced by amounts of £14.7 million, £12 million and £10.4 million in the 3 years to incorporate the effect of revising accounting policies on the de-capitalisation of minor fixed assets. The intention of ensuring consistency of treatment is to be welcomed but the level below which assets are de-capitalised may be too high. Discussions are being held with the Post Office to identify a more appropriate level although the effect of this adjustment is not likely to be major. There would, in any event, be no effect on EFL due to compensating changes on depreciation.

14. The bids for fixed asset investment are more modest than in the previous year, itself representing a substantial reduction on the year before that and reflecting a growing realism from the Post Office in its demands for capital investment. The capital investment bid for 1984-85 still represents, after taking account of de-capitalisation proposals incorporated in the figures, an increase of some £40 million on the approved investment level for that year and of some 7 per cent in volume over 1983-84.

15. The main elements contributing to the higher investment bid in 1984-85 are the acceleration of the Letter Mechanisation programme to complete all the main building work by 1985, and the start of Counter automation expenditure. Capital requirements for other accommodation have in this, as in earlier plans, been forecast to peak in 1984-85. Restraints on public expenditure in the past have caused cut-backs in this element of the approved Post office capital programme, which the Post office is again seeking to redress.

16. On the letter mechanisation programme, although it is doubtful if the benefits arising would, in retrospect, justify the overall expenditure, there is a strong case for an acceleration of future investment as proposed to complete the programme at the earliest opportunity so as to secure the fullest possible benefits which arise only when the full network is in operation. In the past year the Post Office has shown some signs of being more likely to manage and sustain a building programme on the scale envisaged.

17. The intention to introduce counter automation on a wide scale, subject to current trials and evaluation, is seen as a highly desirable aim. Detailed proposals have yet to be formulated and, until seen and appraised by Government, it is thought sensible to exclude the main investment bids presently included for this area (£21 million in each of 1985-86 and 1986-87 at 1983-84 prices). An amount of £10 million is retained in 1984-85 for the evaluation and initial prototype stage. However, this programme may lead later to substantial additional investment bids in 1985-86 and 1986-87, the amounts depending on the phasing of the programme.

Working Capital

18. It has been established that the very high reductions anticipated in the plan for working capital are unrealistic, and to achieve them would require deliberate manipulation of the working capital at the year end. More realistic amounts have been incorporated in the figures.

Internal Resources

19. The proposed change in policy on de-capitalising fixed assets has had an effect on depreciation, reducing this figure by similar amounts to those quoted for the reduction in fixed asset spend.

20. The profit figure submitted has been based on a target of 2½ per cent on turnover. As a financial objective for 1984-85 onwards remains to be set, it is more sensible to calculate the profit figure on the 3 per cent target agreed with Post Office for 1983-84 only.

21. No allowance has been made for taxation in the original bid but Post Office estimates have now been included.

Overall External Finance Position

22. Additional bids of £46.5 million in 1984-85; £15.7 million in 1985-86 and a reduction of £0.4 million in 1986-87.

Scope for Further Savings

23. The overall investment programme is thought to represent a realistic assessment by the Post Office of its fixed asset requirements. Last year's overspend gives no reason to expect slippage in 1984-85. Any further reduction would therefore have to come from a conscious decision to delay certain programmes. There appears to be little scope for acceptable further savings in working capital, especially in 1984-85.

24. There appears to be no scope for increasing internal resources unless it is decided to increase the profit assumptions. This would almost certainly require increases in postal tariffs or performance aims. The present financial target ends in March 1984 and officials are currently considering a revised set of targets for subsequent years with the objective of putting proposals to Ministers which strike a balance between internal financing needs, efficiency incentives and tariff constraint. The case for a more testing performance aim in the light of 1982-83's achievement would also be examined. It is intended that Ministers should have the opportunity to set targets for the forward years before the Autumn.

TABLE 9-1

BASELINE £m	1983-84 forecast outturn	1984-85	1985-86	1986-87
Fixed asset investment	10.0	7.4	7.9	8.1
TOTAL CAPITAL REQUIREMENTS	9.5	11.4	13.9	14.3
TOTAL INTERNAL RESOURCES	9.9	12.0	14.5	14.9
TOTAL EXTERNAL FINANCE	-0.4	-0.6	-0.6	-0.6

ADDITIONAL INDUSTRY BIDS £m	1984-85	1985-86	1986-87
Fixed assets in UK	+4.1	-1.7	-1.6
Working capital	-1.0	+3.7	+5.8
Other	-	-	-
TOTAL CAPITAL REQUIREMENT ADDITIONAL BID	+3.1	+2.0	+4.2
EXPECTED CHANGE IN INTERNAL RESOURCES	+2.5	+1.4	+3.6
Grants	-	-	-
PDC	-	-	-
Net temporary borrowing	-	-	-
Net long and medium term borrowing	-	-	-
Leasing	+0.6	+0.6	+0.6
TOTAL EXTERNAL FINANCE ADDITIONAL BID	+0.6	+0.6	+0.6

ASSUMPTIONS % CHANGE	1983-84	1984-85	1985-86	1986-87
GDP	2.2	1.5	1.5	1.5
Retail Price Index	5.6	7.0	7.0	7.0
Average earnings (whole economy)	7.3	7.5	7.0	7.7
Average earnings (own industry)	7.1	8.3	6.0	6.7
Tariffs (overall)	3.7	6.0	5.2	5.1
Tariffs (domestic)	-	-	-	-
Tariffs (industrial)	-	-	-	-
Manpower (no)	5,050	5,050	5,350	5,600

NATIONAL GIROBANK

Status of bids - relationship to business plan

The National Girobank Business Plan was received in March and the IFR submission in mid-April. The Department of Industry, the Treasury and the Bank of England have met Girobank for a general discussion on the Plan. There are however numerous areas and aspects of the Plan which require more detailed consideration with Girobank. Current discussions have identified the need for additional information and clarification on the Plan assumptions and sensitivities.

2. The IFR has been considered with Girobank particularly with respect to forecast expenditure on fixed assets. Developments since the IFR was prepared have meant some reassessment of the data and this is being pursued with Girobank.

Recent performance

3. Girobank has performed satisfactorily in recent years. It has continued to expand, has been consistently profitable and has on the whole provided effective competition to the UK private banking sector. It is expected to meet fairly comfortably its financial target for the three year period 1982-83 to 1984-85 and has met its EFL each year since 1978/79. There has been continuing concern over the level of pay settlements in past years but substantial productivity improvements have led to reductions in unit labour costs in real terms and often in cash terms. However Girobank has a history of underspending its investment allocation both because of slippage of spending and reassessment of needs.

Outlook

4. Girobank may be expected to continue to be profitable and meets its financial and EFL targets although continued rapid growth and productivity and efficiency improvements may be expected to become progressively more difficult to achieve.

Assessment of Economic Assumptions

5. Business Plan and IFR macro-economic assumptions appear to be reasonable but assessment of business assumptions on among other things growth needs to be considered in the light of the additional information referred to above.

Treasury/Departmental Preliminary Assessment of External Finance Proposals and Scope for Savings

Fixed Asset Expenditure

6. Following discussion with Girobank in the light of developments since the IFR was prepared, the original IFR figures for fixed assets have been reduced. The bid for 1984-85 remains higher than baseline because of slippage of operationally committed spending from 1983-84 but the addition has been reduced compared to the original IFR bid submitted by Girobank. Bids for 1985-86 and 1986-87 have also been reduced and as a consequence are further below the baseline figure than the original IFR bids.

7. External finance proposals are reduced to the extent of the changes on fixed assets.

Changes in internal resources

8. Following discussion with Girobank, it was agreed that it would be prudent to provide for the possibility of corporation tax liability in the IFR years and an estimate of £1.1 million has been included for each year compared to Girobank's original assumption of zero.

9. IFR forecasts of internal resources have also been adjusted to reflect the effect of leasing. The net affect of the changes is an increase in the IFR forecast of internal resources.

Overall external Finance position

10. The adjusted IFR figures indicate a zero EFL in each of the IFR years although some further adjustment may be necessary following further clarification from Girobank on a number of matters particularly on leasing. These compare with the EFL baseline of -£0.6 million for each of three years of the survey.

11. The Treasury's assessment is that at the least, Girobank should be driven back to the EFL baseline although it has to be borne in mind that the latest adjusted IFR figures are tentative and may well be adjusted again in the light of the additional information which Girobank has been asked to provide.

TABLE 10-1

BRITISH AIRWAYS BOARD

BASELINE £m	1983-84 forecast outturn	1984-85	1985-86	1986-87
Fixed asset investment	264	198	200	206
TOTAL CAPITAL REQUIREMENTS	319	205	210	216
TOTAL INTERNAL RESOURCES	314	295	305	314
TOTAL EXTERNAL FINANCE	5	-90	-95	-97

ADDITIONAL INDUSTRY BIDS £m	1984-85	1985-86	1986-87
Fixed assets in UK	- 3	+41	-38
Working capital	-10	-14	-21
Other	+ 1	- 6	- 5
TOTAL CAPITAL REQUIREMENT ADDITIONAL BID	-12	+21	-64
EXPECTED CHANGE IN INTERNAL RESOURCES	-23	+35	+95
Grants	-	-	-
PDC	-10	-10	-10
Net temporary borrowing	-13	+ 2	+ 2
Net long and medium term borrowing	+36	- 2	-148
Leasing	- 3	- 3	- 3
TOTAL EXTERNAL FINANCE ADDITIONAL BID	+11	-14	-160

ASSUMPTIONS % CHANGE	1983-84	1984-85	1985-86	1986-87
GDP	1.0	1.5	1.0	0.5
Retail Price Index	7.5	7.5	8.0	7.0
Average earnings (whole economy)	-	-	-	-
Average earnings (own industry)	8.5	8.5	9.0	8.0
Tariffs (overall)	5.0	6.0	6.0	5.0
Tariffs (domestic)	6.0	7.0	7.0	6.0
Tariffs (industrial)	-	-	-	-
Manpower (no)	35,856	34,200	34,030	33,760

BRITISH AIRWAYS (BAB)

Status of bid

British Airways' financial plan for the period until 1987-88 is still the subject of discussion between the Department of Transport, the Treasury and British Airways. The original financial plan that BAB submitted is currently being revised following consultations with the Department.

2. British Airways' immediate bid is to replace Trident aircraft with quieter and more fuel efficient aircraft. The IFR assumes that the replacements will all be new aircraft. Consideration is presently being given by BAB to operational leasing of aircraft as well as purchasing secondhand versions which would reduce capital expenditure.

Recent performance

3(a) Profit and loss

In 1982-83 BAB made a profit after interest but before taxation of £62m compared with a loss of £114m in the previous year. After including taxation and extraordinary items there was a credit balance, for transfer to reserves, of £77m. This improvement results from cuts in both manpower and routes which taken together resulted in a 15 per cent improvement in productivity over the year.

(b) Recent years' EFL/investment behaviour

The Board's strategy for the past year has included a continuation of reduced capital expenditure and disposal of surplus assets. The EFL for 1982-83 required a net repayment of debt of £9m. The actual net repayment achieved was £35m.

Outlook

4. BAB's profits can be expected to increase in the immediate future mainly because of the continued reduction in manpower. There is also likely to be an increase in revenue per passenger. British Airways' manpower productivity is now comparable with that of its main competitors. The outlook for BAB is now more promising than for some time, but it is still exposed to unforeseen additional competition particularly on the North Atlantic routes.

Assessment of Economic Assumptions

5. The economic assumptions adopted by BAB are a reasonable basis for planning. The assumptions for GDP (1 per cent per annum growth over the next four years) and tariffs (increasing by 2 per cent less than RPI) are if anything somewhat conservative.

Treasury/Departmental Preliminary Assessment of external finance proposals and scope for savings

6. The increases in capital expenditure, from that predicted in the last IFR, are almost wholly due to bringing forward capital expenditure on shorthaul aircraft to replace the remaining Tridents from 1986-87 to 1984-85 and 1985-86. A year ago, BAB's projections which were the basis of the previous IFR, assumed that the ban on the generation of noisy aircraft that is due to come into effect at the beginning of 1986 would be deferred by a year. In the Department's view this was not a realistic assumption and BAB have now matched their investment to the earlier date. Increases in aircraft expenditure are partly offset by reductions in assumed spend on non-aircraft assets and by subsidiaries.

7. Although BAB's capital expenditure programme is still undecided and no final proposals have yet been received, any further revision is expected to reduce their external finance bid.

8. The IFR figures apply to British Airways as a nationalised industry. Once BAB is privatised - perhaps by 1985 - they will be outside the public sector and outside the scope of annual IFRs. Firm proposals on capital expenditure, when they arrive, will be scrutinised for their implications for BAB's future profitability, for BAB's future indebtedness and for the timing of privatisation.

TABLE 11-1

BASELINE £m	1983-84 forecast outturn	1984-85	1985-86	1986-87
Fixed asset investment	130	156	185	191
TOTAL CAPITAL REQUIREMENTS	129	163	185	191
TOTAL INTERNAL RESOURCES	96	147	168	173
TOTAL EXTERNAL FINANCE	33	16	17	18

ADDITIONAL INDUSTRY BIDS £m	1984-85	1985-86	1986-87
Fixed assets in UK	-10	-44	-56
Working capital	+3	+10	+13
Other	-2	-1	-4
TOTAL CAPITAL REQUIREMENT ADDITIONAL BID	-9	-35	-47
EXPECTED CHANGE IN INTERNAL RESOURCES	-15	-18	-1
Grants	-	-	-
FDC	-	-	-
Net temporary borrowing	-	-	-15
Net long and medium term borrowing	+6	-17	-30
Leasing	-	-	-
TOTAL EXTERNAL FINANCE ADDITIONAL BID	+6	-17	-46

ASSUMPTIONS % CHANGE	1983-84	1984-85	1985-86	1986-87
GDP	-	-	-	-
Retail Price Index	7.5	7.5	7.5	7.5
Average earnings (whole economy)	7.5	7.5	7.5	7.5
Average earnings (own industry)	7.5	7.5	7.5	7.5
Tariffs (overall)	-	-	-	-
Tariffs (domestic)	5.0	9.5	10.6	9.9
Tariffs (industrial)	7.5	7.5	7.5	7.5
Manpower (no)	7,251	7,251	7,645	7,800

BRITISH AIRPORTS AUTHORITY (BAA)Status of Bid

The bid reflects the broad strategy for development of the London area airports endorsed as the Government airports policy. The Authority's Corporate Plan (which incorporates objectives agreed with Ministers in 1982), contained forecast budgets and fixed capital investment programme which have been discussed. As a result, the timing of investment on the proposed new terminal at Stansted has been deferred by two years so as to reflect recent changes in the forecast growth of passenger traffic.

Recent Performance

2. The Authority achieved an average annual rate of return of 5 per cent (CCA) over the last three years against its financial target of an average of 6 per cent. Over the period of the target, the growth in passenger traffic has been only 0.5 per cent against a forecast when the target was established of over 5 per cent per annum. The outturn in 1982-83 was 3.8 per cent compared with the two previous years results of 5.9 per cent and 5.6 per cent. The main factors were the Authority's decision, taken in the light of litigation over its airport charges and threats of retaliatory actions by the United States, to freeze landing charges in 1982-83, and the recession in the air transport industry.

3. The recession also affected the outturn on the Authority's two performance aims both of which were affected by lower passenger throughput ie an increase in passengers handled per employee and a decrease in costs per passenger. The Authority achieved an improvement over the three years of 7 per cent against the first target of 9.3 per cent. This result was achieved by a reduction of 6 per cent in the number of employees. The Authority failed to meet its target of a 7.3 per cent reduction in real cost per passenger - the reduction was only 0.7 per cent. Controllable costs were reduced by 3.8 per cent but this benefit was largely offset by a substantial increase in uncontrollable costs (eg rent and rates rose by 25 per cent in real terms).

4. The Authority's expenditure on fixed assets in 1982-83 was £100 million, considerably below the base line figure of £152 million and its own budget of £135 million. As a result the Authority's requirement for external finance against an EFL of £47 million was negligible. Contributory factors were a later than anticipated start on the second terminal at Gatwick, a reduction in construction industry prices of about 10 per cent, and the re-timing of a number of traffic growth related projects. A lower outturn is also forecast in 1983-84 with fixed asset expenditure down by £22 million on base line.

Outlook

5. The Authority expect to remain profitable over the next three years and to be able to finance the greater part of its capital expenditure from internal resources. A new financial target and performance aims are under consideration for this period. On the Authority's own budget forecasts, based on a fairly modest upturn in growth of traffic in 1983-84, the average rate of return on net assets is expected to be 4.7 per cent per annum. Unit costs are expected to decrease in real terms over the period by 8.5 per cent.

Assessment of Economic Assumptions

6. The air traffic forecasts used by the Authority for budget purposes have been revised downwards since 1982 and are broadly consistent with the current official forecasts.

7. The Authority's inflation assumptions are more pessimistic than the Government's but its revenue forecasts assume that traffic charges will increase in real terms in each year mainly because of a planned increase in prices at Gatwick airport to reflect the costs of new investment in increased capacity. Commercial revenue per passenger is expected to rise in real terms, though prices will only rise in line with inflation. This reflects the Authority's policy of maximising revenue from non-aviation sources.

Treasury/Departmental Preliminary Assessment of External Finance Proposals

8. The Authority's initial bid for fixed assets expenditure was £47 million below the base line reflecting mainly re-timing of the investment programme (though further benefits from lower construction prices are expected to persist through to 1984-85). Following discussion, a delay in expenditure on the Stansted development has been included and this has brought the level of expenditure on fixed assets to £110 million below the base line.

9. Internal resources are lower than the baseline in the first two years by £15 million and £18 million. The main reason for this is that the increased tax liability forecast by the Authority in the September revisions of the IFR were not taken into account in establishing baseline figure because of uncertainty as to their effect. Revenue and profit in 1984-85 are also lower due to lower forecast traffic though this is largely offset by lower interest payments.

10. After allowance for changes in working capital the overall external financing requirement is £57 million below the baseline: this includes an additional bid of £6 million in 1984-85. In 1986-87 a negative EFR, of £28 million is forecast.

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11. The Authority's budget has been subjected to close examination in the context of the determination of a new financial target. This is still to be considered by Ministers. The Department take the view that there may be some further scope for re-phasing the development of the second terminal at Gatwick but the extent of this may be more accurately determined after further experience of traffic growth. The Authority's bid for £26 million higher working capital over the period requires further scrutiny. The Department does not support the additional bid of £6 million in 1984-85.

TABLE 12-1

BASELINE £m	1983-84 forecast outturn	1984-85	1985-86	1986-87
Fixed asset investment	335	373	461	475
TOTAL CAPITAL REQUIREMENTS	240	188	244	251
TOTAL INTERNAL RESOURCES	-669	-825	-811	-835
TOTAL EXTERNAL FINANCE	909	1013	1055	1087

ADDITIONAL INDUSTRY BIDS £m	1984-85	1985-86	1986-87
Fixed assets in UK	+73	+82	+103
Working capital	-5	+8	+7
Other	-7	+3	+5
TOTAL CAPITAL REQUIREMENT ADDITIONAL BID	+61	+93	+116
EXPECTED CHANGE IN INTERNAL RESOURCES	+31	-15	+5
Grants	-8	+3	-19
FDC	-	-	-
Net temporary borrowing	+41	+138	+128
Net long and medium term borrowing	-8	-39	-40
Leasing	+5	+6	+3
TOTAL EXTERNAL FINANCE ADDITIONAL BID	+30	+108	+110

ASSUMPTIONS % CHANGE	1983-84	1984-85	1985-86	1986-87
GDP	1.7	2.1	2.3	1.1
Retail Price Index	6.5	8.3	8.6	9.0
Average earnings (whole economy)	7.8	9.1	10.0	10.0
Average earnings (own industry)	-	10.6	9.3	9.0
Tariffs (overall)	-	-	-	-
Tariffs (domestic)	3.2	10.5	9.6	9.6
Tariffs (industrial)	1.2	6.4	5.6	8.5
Manpower (no)	188,000	184,500	181,100	179,850

BRITISH RAIL (BRB)

Status of Bid

The figures, which represent an initial bid, are derived by BRB from the working papers being used in the preparation of the 1983 Rail Plan, covering the period to 1988. This is expected to be finalised and agreed by the Board during August, and that version should take account of the objective suggested by the Government in April for the PSO grant and its comments on the strategies for the individual business sectors. It will then be possible to take better informed decisions about the IFR. This exercise will take the place of the Corporate Plan and Performance Review this year. Strategic issues are being dealt with separately in the follow up to the Serpell report.

Recent Performance

2. During 1982 BRB's financial position was seriously affected by industrial disputes. The Board estimate that the net cost to corporate activities as a whole was some £170 million. Results for the main parts of rail business, before interest, have been as follows:-

<u>£m cash surplus (loss)</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>
Freight	(53)	(25)	10
Parcels	5	4	11
PSO and PTE grant	634	812	890
Passenger (after receipt of grant)	(3)	29	(103)

This has masked an underlying improvement in the financial performance of the rail business. BRB have been making strenuous efforts to reduce costs, particularly through reductions in staff numbers. As the Table below indicates, costs are indeed beginning to fall in constant price terms, and the slide in revenue is being halted. In unit costs terms, the Board's results have improved since 1981. The 1983 forecast projects a further improvement over the 1982 actual figures (although not the 1982 strike adjusted figures which are necessarily somewhat speculative). The revised grant claim discussed in paragraph 5 below is expected to show some further modest improvement.

CONFIDENTIAL

<u>Rail and Rail Catering</u> <u>£m 1983 constant prices</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1982</u> (Strike adjusted)	<u>1983 (est)</u>
Receipts	2,004	1,892	1,588	1,821	1,774
Expenditure million	2,823	2,823	2,659	2,724	2,693
Loaded Train Miles '000	245	239	212	237	231
Manpower - year end total	178	170	161	161	155

3. Despite the effect of the strikes, the Board finished the financial year £75 million below their revised 1982-83 EFL of £923 million. Compared with their expectations at the start of the financial year (an external financing requirement of £968 million), capital expenditure was cut by £55 million, working capital by £60 million (partly because of the delay in implementing the 1982 pay award) and asset sales were increased by £30 million. In the first quarter of 1983, cost savings began to flow through from the redundancy programme which was financed in 1982 by an increase in the grant ceiling. Overall, however these savings were partly offset by a deterioration of £35 million in the operating result.

4. The Inter-City interim financial target, set in 1980, was to make a contribution of £193 million in 1982 to indirect costs. Inter-City's actual contribution was only some £14 million. The interim target for the freight business was to cover two thirds of current cost depreciation by 1982 after meeting relevant costs. In the event, it covered only 35 per cent. BRB are currently producing fresh plans for freight and Inter City to show how they would achieve commercial viability by the mid 1980's. The current papers for the Rail Plan, on which the initial IFR bid is based, do not show such a return to viability. The financial targets for the main businesses are being reviewed in the context of finalising the brief for the new Chairman.

Outlook

5. The Board are forecasting that they will undershoot their EFL of £956 million for 1983-84 by £30-£60 million. This assumes asset sales continuing at broadly the 1982-83 level after allowing for inflation, and includes as a planning assumption the privatisation of Sealink in January 1984. Underlying this is an improvement in operating results compared with the projections made by the Board in last year's IFR, and the strike adjusted outturn for 1982. Because of this improvement, the Board are preparing a revised grant claim for 1983 - their original claim was only £1 million below the ceiling of £860 million. Consideration of the revised claim in July will form part of a re-assessment of the Board's 1983-84 financial position, which is being conducted separately from the IFR.

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6. For the later years, the Board's bid already implies a reduction in the operating loss (before grant) of the passenger business of about £100 million at 1983 prices in 1986, compared with the figure included in the bid for 1983. In the light of the gross savings identified in the Serpell report, and the improving operating results apparent towards the end of 1982, a more ambitious target has been put to the Board of achieving an additional reduction of £155 million in the 1986 passenger support requirement. This would imply a requirement for PSO and PTE grant in 1986 of £700 million at 1983 prices (£720 million when level crossing grant is included) of which £635 million would be the central Government PSO grant. Translating this target into a cash figure will be of crucial importance to the Board's future performance. Too low an assumption about inflation would result in a target far more demanding than the Serpell Committee thought was achievable. Too high an assumption about inflation would lead to a target less demanding than has been proposed. By way of illustration, the aggregate grant requirement expressed in cash terms in 1986-87 using the GDP deflator would be £830 million but using BRB's RPI assumption, £940 million.

7. As recognised by Serpell, achieving savings on this scale will entail transitional costs - mainly in redundancy, and in necessary cost saving investment. The Board have not yet responded to the target so estimates of these costs remain provisional. Over the period to 1986 they may total £120 million at 1983 prices of which perhaps £70 million could be required for redundancy and £50 million for investment. The table below gives a tentative outline of the possible effect of BRB's external financing requirement of projecting transitional costs and target savings in this way:

	£ million External Finance		
	1984-85	1985-86	1986-87
BRB bid at 1983 prices	957	982	927
Suggested target improvement in operating results	-120	-185	-210
Estimated additional redundancy and investment costs	+50	+50	+20
Revised assessment of BRB bid at 1983 prices	887	847	737
Revised assessment converted outturn prices (changes from BR bid at outturn prices in brackets)			
using GDP deflator	948(-95)	950(-213)	850(-347)
using BRB RPI	980(-63)	1,015(-148)	965(-232)
Cmdnd 8494 baseline	1,013	1,055	1,087

The foregoing tentative assessment makes no allowance for possible changes to other aspects of the IFR bid which are discussed in paragraphs 10-13 below.

Assessment of Economic Assumptions

8. The Board's bid was prepared in constant price terms and revalued to cash using their forecast of the RPI. Their assumed RPI increases are significantly higher than those which would derive from the GDP deflator, as the following table shows:

	<u>1983-84</u>	<u>1984-85</u>	<u>1985-86</u>	<u>1986-87</u>
BRB: RPI	100	110.4	119.9	130.7
GDP Deflator	100	106.9	112.2	115.5

The Board's inflation assumption is only a little higher in terms of both level and profile than those of outside commentators. By 1986-87, the divergence from the GDP deflator is very marked. Given the terms in which the grant target has been set, the choice of inflation assumptions to convert it into cash terms will be of critical importance, and making the wrong judgement would have very significant consequences for the Board.

9. The Board's plans assume real passenger fare increases, but do not anticipate equivalent increases in the rate earned per passenger mile. Their expectation is that earnings per passenger mile will fall by 1.5 per cent in 1984-85, but that there will be modest increases in the following two years. The Board's assumptions also include an increase in real earnings of 2.3 per cent in 1984-85 and 0.7 per cent in 1985-86. The justification for such increases has already been raised with the Board, and will need to be discussed in detail with them. 1 per cent on earnings increases the Board's costs by about £17 million a year.

Treasury/Department Preliminary Assessment of External Finance Proposals and Scope for Savings

10. Fixed Asset Expenditure. The Board have never accepted that the baseline figures in Cmnd 8494 provided an adequate recognition of their future investment needs, and indeed, the indicative external financing limits, set before receipt of the Serpell report, merely project forward the limit agreed for 1983-84. Nevertheless, the Board's bid would involve increases in capital expenditure above the baseline of £75 million in 1983-84, £114 million in 1985-86, and £137 million in 1986-87. The most significant items in terms of both volume and rate of growth are investment in track and signalling and in new passenger rolling stock. Questions remain to be pursued with the Board on these matters. The infrastructure investment projected represents an effort by the Board to increase the rate of spend above the low levels of recent years, and represents the highest realistic rate of growth the Board believe can be practicably sustained. Justification for this increase depends on evidence that the Board are taking action to meet criticisms made in the Serpell report about civil engineering standards, which the Department of Transport are currently discussing with them. The projected levels of investment in passenger rolling stock cover replacement

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DMU's for provincial services, EMU's for commuter services, and new Inter City rolling stock. With the exception of the DMU's, the desirable rate and timing of the new rolling stock build remains uncertain pending completion of the Rail Plan and the revised strategy for Inter-City. In respect of DMUs, the appropriate mix between medium and lightweight vehicles remains to be settled.

11. The bid also includes an element of minor electrification schemes, but it does not incorporate any provision for main line electrification. The Board have put forward proposals for electrification of the East Coast Main Line (ECML). If these were approved, additional provision of £16-17 million in 1984-85, £26-27 million in 1985-86 and £50-57 million in 1986-87 would be required (the range derives from the choice of inflation assumption).

12. Working Capital. The Board are projecting no change in the working capital requirements of the rail business after 1983-84; the changes projected arise from the requirements of the subsidiaries. Given the level of investment forecast in the bid, the working capital assessment appears reasonable.

13. Changes in Internal Resource Expectation. There should be scope for significant reductions in the operating loss and a tentative assessment of the possible impact on the EFL is given in paragraph 7 above. Improved operating results of this order would not by themselves be sufficient to enable Inter City to achieve commercial viability, and the Board are reviewing the position. The Board's plans for a marked reduction in the proceeds from asset sales in later years is not satisfactory, and the Department of Transport are taking this up with them.

Overall External Finance Position: Assessment

14. The tentative assessment in paragraph 7 above indicates that if the Board achieves the operating economies envisaged, it should be possible to contain their financing requirements within the baseline. Depending on the inflation assumption used, the headroom within the baseline might be:

	<u>1984-85</u>	<u>1985-86</u>	£ million cash <u>1986-87</u>
On the basis of the Board's inflation assumption	30	40	120
On the basis of the PES assumption	65	105	235

Further scrutiny of the Board's investment bid and of their planned asset sales and the revised Inter City strategy might yield scope for further savings. But to set against this if

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provision is needed for electrification of the ECML, the scope for potential savings would be reduced (see paragraph 11 above). All these projections are, however, tentative and merely illustrative of possible orders of magnitude.

15. This assessment cannot provide an adequate basis for taking immediate decisions. It will be possible to provide a more informed appreciation when the Rail Plan and accompanying strategy studies have been completed in the summer. But a major issue for decision which will have a critical impact on BRB's ability to achieve the grant target will be the basis on which it is converted into a cash figure. It also remains to be seen whether BRB will be able to achieve savings on the scale contemplated in paragraph 7 within the timescale envisaged.

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TABLE 13-1

BRITISH WATERWAYS BOARD

BASELINE £m	1983-84 forecast outturn	1984-85	1985-86	1986-87
Fixed asset investment	3.4	3.5	3.6	3.7
TOTAL CAPITAL REQUIREMENTS	4.0	4.1	4.2	4.3
TOTAL INTERNAL RESOURCES	-37.6	-40.9	-42.5	-43.8
TOTAL EXTERNAL FINANCE	41.6	45.0	46.7	48.1

ADDITIONAL INDUSTRY BIDS £m	1984-85	1985-86	1986-87
Fixed assets in UK	+2.7	+3.0	+3.4
Working capital	-0.5	-0.5	-0.6
Other	+0.5	+0.5	+0.5
TOTAL CAPITAL REQUIREMENT ADDITIONAL BID	+2.7	+3.0	+3.3
EXPECTED CHANGE IN INTERNAL RESOURCES	-	-0.2	-1.9
Grants	-	+0.2	+2.0
FDC	-	-	-
Net temporary borrowing	-	-	-
Net long and medium term borrowing	+2.7	+3.0	+3.2
Leasing	-	-	-
TOTAL EXTERNAL FINANCE ADDITIONAL BID	+2.7	+3.2	+5.2

ASSUMPTIONS % CHANGE	1983-84	1984-85	1985-86	1986-87
GDP	1.5	2.0	1.5	2.0
Retail Price Index	7.0	7.0	7.0	7.0
Average earnings (whole economy)	5.0	5.0	6.0	6.0
Average earnings (own industry)	5.0	5.0	5.0	5.0
Tariffs (overall)	6.0	7.0	7.0	7.0
Tariffs (domestic)	-	-	-	-
Tariffs (industrial)	-	-	-	-
Manpower (no)	3,150	3,150	3,150	3,150

BRITISH WATERWAYS BOARD (BWB)

Status of Bid

BWB are unlike most other nationalised industries in that they have little trading income (about £19m in 1983-84). The majority of their total external finance is from grant aid and their expenditure plans depend primarily upon annual decisions about grant levels. Department of Environment Ministers place a high priority on maintaining present levels of grant in real terms to allow BWB to cope with the problems of waterways maintenance. No reliable estimate of the present backlog exists, but what information is available suggests it may be up to £150 million. Present grant levels have been set with the intention of removing the backlog over the next 10-15 years. BWB's additional bids are for grant levels based on inflation assumptions higher than those underlying the IFR baseline and for additional NLF borrowing to finance additional fixed assets.

Recent performance

2. No financial targets have been set for BWB and BWB have as yet no agreed performance indicators for maintenance expenditure. Consequently it has been impossible to judge the effectiveness with which the Board have employed their grant receipts. A system of specific grants for backlog projects has been introduced to ensure value for money.

3. BWB's trading activities, and in particular its freight operations, are subsidised at present by land and property development. There is no yardstick for assessing the return on capital values but BWB are in the process of revaluing their estates holdings. Returns from the newly opened Sheffield and South Yorkshire Navigation Improvement scheme will be closely monitored by DOE officials.

Outlook

4. A new Chairman is being sought for appointment on 1 January 1984 and he will be charged with a fundamental re-assessment of BWB's activities. This will include its main commercial activities, freight and estates, which constitute a small proportion of its activities. Until the outcome of this review has been considered it is not possible to forecast likely future trading performance. BWB's present strategic intentions need substantial change and re-emphasis before an adequate corporate plan can be put forward. The new Chairman will be expected to put the highest priority on the re-assessment of BWB's present activities and to produce a Corporate Plan as soon as possible.

Assessment of Economic Assumptions

5. BWB's assumptions are in line with those of other industries and outside forecasters.

Treasury/Departmental Preliminary Assessment of External Finance Proposals and Scope

Savings

Investment

6. Most of BWB's external finance additional bid is for increased NLF finance for enhanced investment programme. BWB undershot its investment allocation in 1982-83 19 per cent. The bid would lead to an increase in investment of 90 per cent over baseline 1986-87. This is clearly unrealistic. The present baseline figures are able to accommodate projects already in progress or likely to be approved in the near future. Further proposals are at early stages of consideration and appraisal, and a number are likely to be unacceptable on policy grounds (eg £½ million per year to a holding company for unspecified joint ventures). Most of the bids for additional NLF borrowing are generally unconvincing and DOE and Treasury officials agree that no more than the original baseline at £1.1 million (net) is required for 1984-85. If the new Chairman develops worthwhile joint venture projects for implementation in 1985-86 onwards, these can be considered in the context of the 1984 IFR. In the meantime officials consider that the present investment baseline should be maintained for 1985-86 and 1986-87 and reviewed in next year's IFR.

Grant-in-aid

7. Present levels of grant expenditure are generally agreed to be sufficient to allow removal of the maintenance backlog in 10 or 15 years. BWB's bid for additional grant-in-aid is based upon the Board's own inflation assumptions, and, crucially, makes no provision for increases in efficiency and productivity. The INBUCON Consultants study which reported last year identified numerous areas where efficiency savings could be made. Additionally there seems scope for a greater use of contracting-out. Department of Environment and Treasury officials agree that maintaining grant levels no higher than the baseline will act as a discipline to promote efficiency.

8. BWB's Grant is in two parts; "General Grant" for normal maintenance and "Specific Grant" earmarked for particular projects which reduce the maintenance backlog. As part of their bid BWB have asked for a higher level of General grant at the expense of Specific grant, with overall grant levels unchanged. Once more, this proposal assumes that productivity improvements will take place, and would result in an unnecessary slowing down of backlog reduction. Officials agree that the planned allocation of overall grant between Specific and General should be maintained.

CONFIDENTIAL

Asset Disposals

9. In addition to prospective efficiency improvements, revaluation of estates holdings in 1983 may pave the way for asset disposals which would benefit BWB's internal resources. BWB's bid makes no allowance for this.

Overall External Finance

10. As an incentive to improving efficiency and to encourage asset disposals, officials agree that BWB's external finance should at the present time not rise above the baseline in any of the survey years. Financing requirements for 1985-86 and 1986-87 will be further reviewed next year in light of proposals from the new Chairman.

TABLE 14-1

BASLINE £m	1983-84 forecast outturn	1984-85	1985-86	1986-87
Fixed asset investment	62.5	72.0	87.5	90.1
TOTAL CAPITAL REQUIREMENTS	60.3	77.0	92.5	95.3
TOTAL INTERNAL RESOURCES	-5.5	9.6	22.2	22.9
TOTAL EXTERNAL FINANCE	65.8	67.4	70.3	72.4

ADDITIONAL INDUSTRY BIDS £m	1984-85	1985-86	1986-87
Fixed assets in UK	-	-8.5	-2.1
Working capital	-3.0	-3.0	-1.1
Other	-	-	-
TOTAL CAPITAL REQUIREMENT ADDITIONAL BID	-3.0	-11.5	-3.3
EXPECTED CHANGE IN INTERNAL RESOURCES	-3.0	-11.5	-9.9
Grants	-2.0	-4.0	+0.7
EDC	-	-	-
Net temporary borrowing	+0.3	+3.8	+4.5
Net long and medium term borrowing	-	-	-
Leasing	+1.7	+0.2	+1.4
TOTAL EXTERNAL FINANCE ADDITIONAL BID	-	-	+6.6

ASSUMPTIONS % CHANGE	1983-84	1984-85	1985-86	1986-87
GDP	1.0	1.0	1.0	1.0
Retail Price Index	7.0	7.0	7.0	7.0
Average earnings (whole economy)	8.0	8.0	8.0	8.0
Average earnings (own industry)	6.0	7.0	7.0	8.0
Tariffs (overall)	7.3	7.8	7.7	7.8
Tariffs (domestic)	-	-	-	-
Tariffs (industrial)	-	-	-	-
Manpower (no)	51,694	50,010	50,386	50,055

NATIONAL BUS COMPANY (NBC)

Status of Bid

The IFR submission is consistent with the Corporate Plan covering the period 1983-86, which is still under discussion with the Company. The figures are consistent with the baseline except for 1986-87.

Recent Performance

2. In 1980, NBC recorded a current cost loss of £17m. Since then, NBC have progressively got their financial performance back on course. They bettered by £9m the first milestone (current cost breakeven before interest in 1982) towards their financial target of a current cost operating surplus before interest of £18.5m at 1980 prices (£27.5m in cash) in 1985. A separate target was set for the National Express and National Holidays part of the business of a contribution towards long run avoidable costs of £7m. This target was also achieved. But NBC failed in 1982 to achieve their performance aim of 1.5 per cent reduction in real operating costs per vehicle mile. The outturn was a reduction of 0.9 per cent in 1982. Vehicles were reduced by 2½ per cent, vehicle miles by 1½ per cent and staff by 2½ per cent in 1982. Passenger journeys fell by 3 per cent.

3. NBC met their forecast investment figure for 1982-83 of £55m, but undershot their EFL of £68m by £6m. This was largely because of the sale for £5.7m of their share in BM(H) which was not taken into account when the EFL was set. Within the EFL, NBC's positive cash flow, helped by a higher level of revenue support grant from local authorities, enabled them to repay NLF debt of £9.8m.

Outlook

4. NBC's forecast performance falls short of their financial target in 1985-86 and 1986-87 - the figures in the IFR amount only to CCA break even after interest for those years. NBC argue that their hands are tied by local authorities who are not prepared to contribute towards profits in excess of CCA breakeven. Consequently NBC claim that efforts to achieve the financial target would be self defeating since local authorities would merely reduce their revenue support as profits improved.

5. The IFR bid incorporates no further reductions in real operating costs per vehicle mile. Maintenance costs are projected to remain flat, both as a proportion of total costs and as cost per vehicle.

6. The Corporate Plan envisages that passenger journeys will have declined by 5 per cent between 1983 and 1986, but vehicle miles by only 1½ per cent, while revenue, including the support grant, is expected to be held constant after allowing for inflation. Within this total, revenue support grant is projected to increase slightly faster than the rate of inflation, which may appear inconsistent with NBC's view of the reluctance of local authorities to raise the level of support beyond a certain point. All this would however be consistent with the view that local authorities are prepared to provide increasing levels of revenue support for services for which patronage is declining.

7. These projections of performance raise a number of important issues. First, consideration needs to be given to the reasons for the forecast shortfall against the financial target. NBC's assumptions about both the scope for real fare increases and for further increases in local authority revenue support will need to be examined in the light of past performance. Unless Ministers decide to privatise NBC as a whole there will also be the question of what target should be set after 1985. Secondly, consideration needs to be given to a separate target for National Express and National Holidays, having regard to the different nature of those businesses from stage carriage, and to the possibility of introducing private capital into them separately. Thirdly, a fresh performance aim needs to be set. Provisional agreement had been reached at official level on a further 1 per cent per annum reduction in real operating costs excluding depreciation in the year 1983-1986 but because of the Election no decision was reached. All these are issues which will be dealt with in the Corporate Plan and Performance Review with a view to reaching decisions in the summer.

Assessment of Economic Assumptions

8. NBC's economic assumptions are not out of line with those of outside commentators. The most significant change compared with previous projections they have made is that they are now significantly less optimistic about the scope for real fare increases, because of the effects of the recession, increased competition, and customer resistance. Nevertheless small real fare increases are planned for each year of the IFR. This point needs further examination in the Performance and Corporate Plan Review.

Treasury/Departmental Preliminary Assessment of External Finance Proposals and Scope for Savings

9. Fixed Asset Expenditure. Most of the NBC's investment is in vehicles. The Plan incorporates an assumption that new vehicle prices will increase by 4 per cent per annum faster than the rate of inflation. The empirical evidence for this in recent years seems questionable especially in the case of stage carriage vehicles, although this has been the rate of increase averaged over the last 10 years. However, nearly half, by numbers,

NBC's planned investment in vehicles over the period is in coaches and dual purpose vehicles. For these the market has changed and the demand is for much more sophisticated and luxurious vehicles. For the present, however, the case for accepting the assumption on vehicle prices must be regarded as not proven. If the assumption that vehicle prices would rise only in line with inflation were substituted, the effect would be to reduce NBC's projected capital requirements by £2m in 1984-85, £4.5m in 1985-86 and £7m in 1986-87.

10. The other major questions, in addition to vehicle prices, under this heading for the Corporate Plan and Performance Review are whether the overall level of investment is justified in relation to the desirability of minimising whole life vehicle costs and whether the balance between stage and non-stage vehicles is right in the light of the projected performance of the different parts of the business.

11. Working Capital. NBC's performance on working capital has been mixed in recent years. An increased requirement of £9m in 1981-82 was followed by a fall of nearly £6m in 1982-83. In the period covered by the IFR, the projected cash increases in stocks and work in progress represent a modest decline after allowing for inflation. But NBC could almost certainly manage within an unchanged level of working capital overall (subject to debt repayment). If they were to, reductions in NBC's capital requirements would amount to £2m in 1984-85 and 1985-86, and to £4m in 1986-87.

Changes in Internal Resources Expectation

12.a. Interest: A recurrent feature of NBC's financial performance in recent years has been the generation of large cash surpluses which have been lent temporarily to public sector bodies. The ability of NBC to repay without difficulty £9.8m of NLF debt in 1982-83 suggests that their assumption that further tranches due to repayment will be rolled over is unduly cautious. If instead the tranches were repaid when they fell due, there would be a gross reduction in NBC's interest burden of some £2.5m in 1984-85, £6.5m in 1985-86 and £8m in 1986-87, offset by a loss of income from the temporary lending of cash surpluses.

b. Operating result: The forecast current cost operating loss falls short of the financial target by £6.5m in 1985-86 and £8m in 1986-87. If NBC were to achieve the provisionally agreed performance aim of a 1 per cent per annum real reduction in operating costs to 1985, the effect would be to reduce the operating costs in 1984-85 by £9.5m.

Overall External Finance Position.

13. For these reasons it seems probable that NBC could achieve their planned performance within a lower external finance requirement than the baseline figures. The foregoing assessment indicates some of the main areas where there might be scope for reductions.

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But it would not be appropriate merely to add all of them together to reach a global figure because of the interactions between them and other elements of the IFR. For example, reductions in the interest rate burden due to repayment of debt would also reduce the amount of revenue support grant payable by local authorities. The NBC would need to persuade the local authorities to pay more if they were to aim to achieve their financial target.

DTp/Treasury Assessment.

14. Rather than seeking to put a figure on the scope for savings within the baseline, the main issues raised will be the subject of more detailed study in the Corporate Plan Performance Review, so that decisions can be taken in the summer.

TABLE 15-1

BASILINE £m	1983-84 forecast outturn	1984-85	1985-86	1986-87
Fixed asset investment	17.4	16.6	18.8	19.4
TOTAL CAPITAL REQUIREMENTS	17.3	17.2	19.5	20.1
TOTAL INTERNAL RESOURCES	-1.0	-2.1	-5.3	-5.5
TOTAL EXTERNAL FINANCE	18.3	19.3	24.8	25.5

ADDITIONAL INDUSTRY BIDS £m	1984-85	1985-86	1986-87
Fixed assets in UK	+5.1	+1.1	+0.3
Working capital	-	-0.1	-
Other	-	-	-
TOTAL CAPITAL REQUIREMENT ADDITIONAL BID	+5.1	+1.0	+0.3
EXPECTED CHANGE IN INTERNAL RESOURCES	+3.5	+6.3	+3.6
Grants	-5.4	-6.2	-2.1
PDC	-	-	-
Net temporary borrowing	+5.6	+1.0	-6.5
Net long and medium term borrowing	+1.4	-0.1	+5.3
Leasing	-	-	-
TOTAL EXTERNAL FINANCE ADDITIONAL BID	+1.6	-5.3	-3.2

ASSUMPTIONS % CHANGE	1983-84	1984-85	1985-86	1986-87
GDP	-	-	-	-
Retail Price Index	6.0	7.0	8.0	8.0
Average earnings (whole economy)	-	-	-	-
Average earnings (own industry)	-	8.0	9.0	9.0
Tariffs (overall)	3.0	6.5	8.5	8.5
Tariffs (domestic)	-	-	-	-
Tariffs (industrial)	-	-	-	-
Manpower (no)	10,241	9,940	9,890	9,840

SCOTTISH TRANSPORT GROUP (STG)

Status of Bid

The Group's IFR proposals are derived from the current Corporate Plan which was submitted by the STG Board in April. The Corporate Plan is to be reviewed in the coming weeks.

Recent Performance

2. Although the demand for stage services continues to be affected by a secular decline, the Group's traffic has held up well during the recession. The Group is once more expected to undershoot its EFL, but by a smaller margin than in 1982-83. This divergence derives in the main from their over-cautious assumptions on costs, giving rise to bids for greater local authority support for bus services that would otherwise be required. A particular cause of uncertainty has been the implementation of SCOTMAP proposals for revised bus networks. The demand for shipping services has been steady and the outturn requirement for subsidy will be close to that indicated in the IFR. Outturn figures for investment in fixed assets are up to the levels indicated in the IFR.

Outlook

3. In its main activity, bus services, the Group is projecting a continuation of the long-standing decline in passenger traffic and remains pessimistic about costs - the savings from the introduction of one man operated buses having now come to an end and those from the re-organisation of networks (SCOTMAP) having also been largely realised. The Group has consequently prepared its IFR bid on the basis of a real increase in local authority subsidy for each of the 3 years forecast. The Group's projection of local authority revenue support is more modest than last year, but even so its realism will have to be examined more fully. The Group have assumed the continuation of the present medium-term financial target for the Scottish Bus Group. This is reasonable pending further progress on the financial target after end 1983.

Assessment of Assumptions

4. The Group's central assumptions on price movements are in line with outside forecasts. However, for wage and other bus costs the Group have attempted to build an element for differential inflation into their costs which is not fully justified by past relationships or present price movements. Assumptions on future GDP levels are not considered, the Group relying instead on the secular trends in patronage for bus stage services. The only option examined by the Plan for bus services is that based upon the Group's assumptions on

increasing local authority support and operating costs and continuing downward trend of patronage.

Treasury/Departmental Preliminary Assessment of External Finance Proposals and Scope for

Savings

- 5.(i) The level of fixed asset expenditure in the IFR is not adequately justified either in respect of the proposed purchase of new vehicles for the express coach market or for the replacement of stage carriage buses. Additional information (eg on staff savings and running costs) is also required in justification of proposals for new data processing and electronic ticket equipment; and proposals for capital expenditure on office accommodation needs to be justified.
 - (ii) Working capital is of relatively minor significance to the Group but the level of trade debtors is expected to increase over the forecast years.
 - (iii) Internal resources are projected to decline, reflecting a worsening in the Group's current cost operating loss partly offset by increased depreciation allowances. The assumptions underlying this projected worsening need to be scrutinised further and the scope for cost economies considered further.
 - (iv) The external finance requirement reflects the expectation of increased local authority subsidy partly offset by NLF repayments and fluctuations in temporary borrowing. The market borrowing from the Shipbuilding Mortgage Finance Company reflects the Group's programme of new vessel acquisition. The NLF repayments are subject to re-scheduling by repayment of £10.8 million in 1983-84 which will affect the Group's capacity for making temporary deposits and also the EFL for the first 2 of the 3 years in view. There may be scope for reduction in Central Government grants to the shipping company Caledonian MacBrayne as a result of the implementation of the Monopolies and Mergers Commission recommendations.
6. These issues are being pursued in detail in the Corporate Plan review. Overall, the Group's requirement for external finance is likely to be below the baseline.

TABLE 16-1

BASELINE £m	1983-84 forecast outturn	1984-85	1985-86	1986-87
Fixed asset investment	90	128	118	122
TOTAL CAPITAL REQUIREMENTS	95	117	139	143
TOTAL INTERNAL RESOURCES	-115	28	70	72
TOTAL EXTERNAL FINANCE	210	89	69	71

ADDITIONAL INDUSTRY BIDS £m	1984-85	1985-86	1986-87
Fixed assets in UK	+18	+7	-27
Working capital	-27	-4	-10
Other	+2	+2	+2
TOTAL CAPITAL REQUIREMENT ADDITIONAL BID	-7	+5	-34
EXPECTED CHANGE IN INTERNAL RESOURCES	-91	-76	-55
Grants	+20	+28	+12
FDC	+40	+32	-1
Net temporary borrowing	+1	+1	+1
Net long and medium term borrowing	+23	+20	+8
Leasing	-	-	-
TOTAL EXTERNAL FINANCE ADDITIONAL BID	+84	+81	+21

ASSUMPTIONS % CHANGE	1983-84	1984-85	1985-86	1986-87
GDP	3.5	3.0	2.3	1.8
Retail Price Index	8.0	8.0	8.0	8.0
Average earnings (whole economy)	-	-	-	-
Average earnings (own industry)	4.0	7.0	7.0	7.0
Tariffs (overall)	-	-	-	-
Tariffs (domestic)	-	-	-	-
Tariffs (industrial)	-	-	-	-
Manpower (no)	60,000	55,692	55,692	55,692

BRITISH SHIPBUILDERS (BS)

Status of Bid

BS' IFR bid for 1984-5 to 1986-87 broadly reflects their preferred strategy defined in their 1983 Corporate Plan. The Plan was delivered in June and currently awaits consideration by E(NI).

Recent Performance

2. In 1980/81 and 1981/82 BS both met their loss targets and stayed within their EFL. Investment, low since nationalisation, started to increase in 1981-2. However BS' 1982-83 performance was extremely poor. A trading loss of £115m is expected - as against a loss target of £10m. The deterioration to some extent reflects the continued worldwide recession in shipbuilding, but is more directly the result of appalling performance on existing contracts. However BS have remained within their 1982-83 EFL partly because a large part of the trading losses are future provisions (with cash consequences only in later years) and partly by cutting back on capital expenditure from a planned £76m to £43m.

Outlook

3. BS' trading performance for the foreseeable future will be dominated by the world recession in merchant shipbuilding and the cost-price gap they face. Given the present regime of limited price support, BS do not believe they can remain in merchant shipbuilding. They have therefore sought further support as "crisis aid" to tide them over the current workload crisis until order levels and prices pick up.

Assessment of Economic Assumptions

4. BS have made two key assumptions; that the market will pick up in the next year or so: and that they can double their merchant shipbuilding productivity over four years. Officials believe the market assumption to be dubious and that the recession could well prove to be longer and deeper than BS believe. More importantly they do not believe that BS can achieve their crucially important productivity target.

Treasury/Departmental Preliminary Assessment of External Finance Proposals

5. Given that the key underlying assumption on the merchant side is quite unrealistic, the current IFR bid is effectively undermined. The financing requirements will thus depend on what Ministers decide to do (at E(NI) on 14 July) in the face of an unacceptable Plan. The

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Secretary of State for Trade and Industry will recommend that the new Chairman (Grab Day, arriving in July and taking over in September) should as a matter of urgency draw up a new business plan based on a strategy concentrating BS merchant activity on a small number of "core" yards.

6. In the interval before this plan is prepared and approved, BS will need to have access to extra financial support to get orders for potentially viable yards that might otherwise close. This extra support, (which would also need to be negotiated with the European Commission), would have some cash consequences in 1983-84 and later years. The Secretary of State for Trade and Industry will be asking for approval at E(NI) in July for an increase in the 1983-4 EFL, currently set at £159m, to accommodate this.

7. The external finance requirement may also be affected by the privatisation of warship yards. Apart from the trading cash flows associated with these companies, the removal of the £150m (over the IFR period) Vickers modernisation project from BS will greatly affect the external financing requirement of BS - although the Vickers project will still need to be funded by the Government. However the timing and terms of privatisation are speculative at present.

8. BS' bid also assumes continuation of the whole of their offshore operation. We do not believe this is feasible. We believe that Scott Lithgow will be closed or reduced to a support operation at the end of 1984-5.

9. The bid assumes BS to be continuing in the shiprepair business. Ministers have already instructed the Corporation to close/dispose of such yards by the end of 1983-4 and will continue to ensure that this happens.

10. In the light of these considerations Table 16-2 below attempts to estimate the external financing requirement for BS - on the assumption that Ministers' at E(NI) in July adopt the course of action set out below. It must be emphasised that at this stage, in advance of a Ministerial decision, and in advance of a revised business plan for BS this assessment must be treated as provisional. It is drawn up both for the case where the naval yards are to be privatised and for the case where they remain in the public sector. Specific assumptions include:

- (i) concentration of merchant activity through the closure of three small yards and the equivalent of two large yards;
- (ii) disposal of shiprepair in 1983-4;
- (iii) closure of Scott Lithgow (offshore) by end 1984-5;

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- (iv) privatisation/closure of the engineering division;
- (v) that no other costs arise as a result of industrial action during the closure of merchant yards (if there were industrial action the cost could be significant).

TABLE 16-2: BS' LIKELY EXTERNAL FINANCE REQUIREMENT COMPARED WITH BASELINE

£m	1984/5	1985/6	1986/7
Baseline	89	69	71
Assuming naval yards in public sector	195-210	100-135	35-85
- of which:			
capital expenditure	120	110	80
BS redundancy costs	15-20	5	0
Assuming naval yards privatised in 84-5 and 85-6	145-160	55-90	25-75
- of which, capital expenditure	20	20	20

Ranges - reflect BS' extreme assumptions of either no productivity improvement or doubling productivity in four years.

11. This revised profile (assuming the naval yards to remain in the public sector) reflects extra expenditure in 1984-5 as labour is shed, followed by a lower financing requirement in subsequent years as the burdens of Scott Lithgow and the least efficient merchant yards are removed. It does not include costs to Government falling outside the EFL net. In particular there would be redundancy costs (statutory payments plus SRPS) falling roughly as in Table 16-3 below:

TABLE 16-3: ADDITIONAL (NON-EFL) REDUNDANCY COSTS

£m	1984/5	1985/6	1986/7
Redundancy costs to Govt.	22	3	0

Note: about £50m would also arise in 1983-4 in addition to £30 million to be paid by BS within the EFL.

TABLE 17-1

BASELINE £m	1983-84 forecast outturn	1984-85	1985-86	1986-87
Fixed asset investment	27.4	30.0	33.6	34.6
TOTAL CAPITAL REQUIREMENTS	20.6	31.6	34.2	35.2
TOTAL INTERNAL RESOURCES	11.3	13.8	16.1	16.6
TOTAL EXTERNAL FINANCE	9.3	17.8	18.1	18.6

ADDITIONAL INDUSTRY BIDS £m	1984-85	1985-86	1986-87
Fixed assets in UK	-0.6	-0.7	-0.1
Working capital	-2.0	-0.4	+5.8
Other	-	-	-
TOTAL CAPITAL REQUIREMENT ADDITIONAL BID	-2.6	-1.1	+5.7
EXPECTED CHANGE IN INTERNAL RESOURCES	-9.9	-19.5	-1.6
Grants	-1.2	-1.3	-1.3
FDC	-	-	-
Net temporary borrowing	-	-	-
Net long and medium term borrowing	+8.5	+19.7	+8.6
Leasing	-	-	-
TOTAL EXTERNAL FINANCE ADDITIONAL BID	+7.3	+18.4	+7.3

ASSUMPTIONS % CHANGE	1983-84	1984-85	1985-86	1986-87
GDP	1.1	2.4	1.5	1.8
Retail Price Index	6.0	5.0	5.0	5.0
Average earnings (whole economy)	7.1	6.7	5.0	5.0
Average earnings (own industry)	4.5	5.0	5.0	5.0
Tariffs (overall)	-	-0.7	-1.6	12.6
Tariffs (domestic)	-	-	-	-
Tariffs (industrial)	-	-	-	-
Manpower (no)	7,370	7,233	7,117	7,017

CIVIL AVIATION AUTHORITY (CAA)

Status of Bid

The CAA's IFR figures are reflected in their 1983 Corporate Plan. In the main they reflect a reduction in internal resources, caused by the operation of the Eurocontrol price adjustment mechanism.

Recent Performance

2. Because the value of the £ fell against the dollar, this has resulted in a profit surge in 1982-83 which is continuing into 1983-84. Other income in recent years has been broadly as forecast but expenditure on fixed assets during 1982-83 was 10 per cent below budget. For 1982-83 (the first year that it was regarded as a nationalised industry), the net effect of these factors was that the CAA finished £32m below its EFL.

Outlook

3. The traffic forecasts are lower than those contained in the 1982 Corporate Plan in common with air traffic forecasts being made elsewhere. Because of the Eurocontrol adjustment mechanism, overrecoveries in 1982-83 and 1983-84 will be returned to the airline industry to produce net losses in the first two years of the IFR while a small profit is forecast for 1986-87.

Assessment of Economic Assumptions

The interest rate assumptions appear to be 2 to 3 per cent too high compared with an assumed low rate of inflation. Other assumptions are broadly in line with Government forecasts.

Treasury/Departmental Preliminary Assessment of External Finance Proposals and Scope for Savings

Fixed Asset Expenditure

5. Fixed asset expenditure is planned at the current level until the 1990's by which time the CAA anticipate that the major part of their replacement programme will have been completed. However, the CAA has agreed that certain projects can be delayed so that the expenditure can be spread over a greater time scale. This and allowance for the fact that the Authority in the past has tended to underspend on its investment on a regular basis

would permit reductions in the original bids of £4.1m, £5.5m and £6.6m in the 3 years question.

Changes in Internal Resources Expectations

6. The operation of the Eurocontrol adjustment mechanism together with other changes has resulted in a reduction in internal resources of £9.9m, £19.5m and £1.6m in 3 years covered.

Overall External Finance Position

7. The generation of windfall profits in past years and the Eurocontrol requirement these to be refunded in future years means that the Authority will require some additional external finance over the IFR period. The largest increase is in 1985-86 when a repayment effect will be most severely felt. Work is in hand to negotiate a satisfactory way of mitigating the effect of exchange rate changes on Eurocontrol income.

Treasury/Departmental Assessment

8. As a result of the savings in expenditure on fixed assets mentioned above together with other minor savings the additional bids for 1984-85 and 1985-86 can be cut £3 million and £12.4 million respectively. That for 1986-87 can be withdrawn completely. There is unlikely to be scope for further significant savings beyond this.

TABLE 18-1

WATER (ENGLAND AND WALES)

BASILINE £m	1983-84 forecast outturn	1984-85	1985-86	1986-87
Fixed asset investment	791	869	941	969
TOTAL CAPITAL REQUIREMENTS	781	862	936	964
TOTAL INTERNAL RESOURCES	425	511	596	614
TOTAL EXTERNAL FINANCE	356	352	340	350

ADDITIONAL INDUSTRY BIDS £m	1984-85	1985-86	1986-87
Fixed assets in UK	+ 40	+ 53	+ 107
Working capital	- 3	-	- 2
Other	+ 2	+ 3	+ 3
TOTAL CAPITAL REQUIREMENT ADDITIONAL BID	+ 40	+ 55	+ 108
EXPECTED CHANGE IN INTERNAL RESOURCES	- 21	- 9	+ 67
Grants	+ 4	+ 12	+ 17
PDC	-	-	-
Net temporary borrowing	- 1	+ 2	- 8
Net long and medium term borrowing	+ 53	+ 48	+ 29
Leasing	+ 5	+ 2	+ 3
TOTAL EXTERNAL FINANCE ADDITIONAL BID	+ 60	+ 64	+ 41

ASSUMPTIONS % CHANGE	1983-84	1984-85	1985-86	1986-87
GDP	1.8	1.9	1.6	2.1
Retail Price Index	6.0	7.5	7.5	7.5
Average earnings (whole economy)	-	-	-	-
Average earnings (own industry)	6.0	7.0	7.5	7.5
Tariffs (overall)	5.5	8.7	8.9	8.3
Tariffs (domestic)	7.4	9.7	9.4	8.3
Tariffs (industrial)	3.1	7.7	8.4	8.3
Manpower (no)	57,849	57,245	56,900	56,600

WATER (ENGLAND AND WALES)

1. Status of Bid

A first estimate of the investment and financing requirements of the 10 water authorities is set out in the attached table. These figures are based on the corporate plans submitted by the water authorities. The Department of the Environment and the Welsh Office held discussions with their respective authorities during May and June to scrutinise the justification for the proposed investment, the realism of external finance bids, the proposals for operating cost savings and the scope for containing charges.

Recent Performance

2. Financial Targets: Targets for the 3 year period commencing 1981-82 have been set with the objective that all the English water authorities should be achieving a rate on net current cost assets of at least 1.25 per cent by 1983-84 (authorities already earning more than 1.25 per cent being required to continue to achieve that higher figure), and the Welsh Authority should achieve 1.25 per cent by 1985-86. The targets set for 1981-82 were achieved by all but one authority, whose under-achievement is anticipated to be recovered in 1982-83. For 1982-83, the authorities are expected generally to over-achieve their targets, mainly because of favourable movements in inflation reducing CCA depreciation charges below budget and because revenue has held up better than expected in most areas despite continuing recession (but not in Northumbria). For 1983-84, targets have been agreed that will bring all the English authorities to a rate of return of at least 1.25 per cent and the Welsh Authority to a rate of return of 1.20 per cent.

3. Performance Aims: Manpower in the authorities was reduced by 3½ per cent during 1982-83. Performance aims were agreed last year to bring real operating costs in 1983-84 some 2 per cent below the 1982-83 level, reversing the earlier trend of real increases. Present forecasts show a very small overshoot in 1983-84 but there is still time for corrective action. Further savings of 2½ per cent up to 1986-87 are forecast, offset by increases due to growth in demand, etc. The Departments will of course be pressing for continuing improvement beyond 1983-84 as a basis for new performance aims targets for the period to 1986-87.

4. Fixed Investment: The latest available returns indicate that most authorities are likely to over-achieve in volume terms although a cash underspend of about 5 per cent in total is forecast for 1982-83. This is the result of continuing favourable movements in construction prices. Unfortunately, it is the authorities with the greatest investment needs

which have encountered the greatest difficulties in programme implementation but this is expected to improve following internal re-organisations.

Assessment of Economic Assumptions

5. It has been the custom for the water authorities to draw up common economic assumptions in the autumn and most of the authorities have adopted these for their plans. The assumptions are broadly in line with those provided by outside forecasters. The assumed growth in GDP is at the low end of the range of outside forecasts, but the water authorities' external financing requirements are not particularly sensitive to changes in the level of economic activity.

6. The assumptions used about general inflation are at the upper end of the range of outside forecasts, but again the forecasts of external financing requirements are not very sensitive to assumptions. Because of the industry's monopolistic position, increased revenue requirements can be readily passed on to the consumer, so increases in operating costs add to charges rather than to external financing requirements. The plans forecasts charges rising on average about 1 per cent point above inflation. For the purpose of their plans, water authorities have adopted the "neutral" assumption that future settlements will be in line with inflation. For 1983-84, the industry undertook to meet the cost of the recent high settlement by economies in operating and manpower costs. The authorities will be pressed to carry these economies forward into the later years through tight performance aims.

7. The assumptions which do have a significant effect on the industry's external financing requirements are interest rates and construction prices. The industry has now come forward with revised (lower) assumptions for construction prices and the implications of these are still being examined. They will reduce the cost of the investment programme but also reduce the level of internal resources through their effect on the CCA asset base.

Charges

8. On plan assumptions average charges rise at approximately 1 per cent per annum more than the RPI. The increase for domestic charges is higher due to the last stages of tariff realignments to remove cross-subsidisation from industrial customers. The high rate of increase is attributable to forecast index movements which raise the financing costs of the industry.

Additional Bids

9. A number of authorities are bidding for additional external finance in order to increase capital expenditure above base-line levels. The recent House of Lords Science and

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Technology Select Committee Report on the water industry supported the need for additional expenditure as did the Committee on Welsh Affairs. One major requirement is the need to tackle underground dereliction with increasing vigour. Surveys being carried out by authorities continue to show a need for major investment. Authorities are also having to invest in order to remedy unacceptably low levels of service (reliability and quality of water supplies, incidents of flooding and pollution of tidal and river waters) and to meet the needs of new residential and industrial development. The provision made for new development has fallen by over half in real terms since 1978-79 and would need to be substantially increased if there was to be a sustained recovery in new house or commercial building. Indeed, in view of recent underspends and likely slippage on certain large schemes, MAFF are proposing in the current Public Expenditure Survey, a reduction of the existing baseline arterial drainage.

10. Authorities have assumed that financial targets stand still at 1983-84 levels in drawing up their plans. Decisions on the actual level of targets for 1984-85 and later years will, however, have to be taken shortly. A number of factors will need to be taken into account in deciding the extent to which targets can be increased, including the effect on water charges, which remain a politically sensitive issue particularly in certain areas of the country, the extent to which that effect can be offset by tighter performance aims and the implications for the industry's investment programme and external financing requirements.