

CONFIDENTIAL

THIS DOCUMENT IS THE PROPERTY OF HER BRITANNIC MAJESTY'S GOVERNMENT

E(80)125

COPY No. 55

3 November 1980

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

NATIONALISED INDUSTRIES: EXTERNAL FINANCING LIMITS 1981-82

Memorandum by the Chief Secretary
to the Treasury

At our discussion of this subject on 22 October it was agreed that sponsor Ministers should give further consideration to the measures necessary to achieve the EFLs set out in column 2 in Annex A of E(80)121; and I was asked to circulate a paper reporting the outcome of these considerations. We agreed that on the basis of these reports we would consider further how that part of the industries' external financing requirements which exceeded the levels agreed by Cabinet in July (C(80)40) could be minimised. My paper proposed further cuts to the EFLs in column 2, which would have reduced the excess over the July levels to £300 million.

2. The reports that I have received from colleagues can be summarised as follows (figures for EFLs are at outturn prices).

(i) Energy

An EFL for the British Gas Corporation of -£309m is proposed, compared with BGC's original proposal of -£99m and the Treasury proposal of -£399m. The Secretary of State for Energy's proposal incorporates a moderation of the domestic tariff increase, with a reduced inflation increase in April, and a return to phasing in the agreed 10 per cent real price increase in October. He endorses BGC's revised view that the industrial and commercial market will not now require further relaxation in pricing policy; contract renewal prices for e.g. firm gas will continue to be about 75 per cent of the industrial gas oil price, and should be significantly below German and possibly other Continental gas prices. The Secretary of State identifies, but does not support, measures which could reduce the EFL towards -£399m:

- a) retaining the higher inflation assumption for the domestic increase, recognising that lower inflation would require a lower increase whose revenue impact would be met by the impact of lower inflation on BGC's costs (£30m);

- 1 -

CONFIDENTIAL

CONFIDENTIAL

b) a combination of cutting manpower by 5,000, split roughly 50/50 between contractors and BGC employees, and reducing profitable investment (£60m).

The proposed EFL for BNO of -£360m is acceptable to the Secretary of State.

For the Electricity Supply Industry the Secretary of State offers an EFL of -£100m, against -£221m proposed by the Treasury. His proposal assumes that the industry are able to make further economies through efficiency savings and reductions in capital expenditure (not specifically identified), and that the tariff increase next April averages 12%, rather than the 16½% put forward in the industry's original EFL submission. To achieve an EFL of -£221m from tariff increases, the Secretary of State says that it would be necessary to raise prices by a further 2½%, making an increase of 14½%. His letter indicates that this would still leave tariffs below economic levels. He neither supports, nor specifically identifies, other measures to bring back the EFL to -£221m. He rules out further savings from greater efficiency or running down fuel stocks. Delaying or cancelling work on power stations under construction, including Heysham and Drax, is also rejected.

The National Coal Board EFL has already been set at £882m.

The Secretary of State for Scotland accepts EFLs for the two Scottish Electricity Boards combined of £108m, but only if tariffs rise by 15% in April. If the tariff increase is only 12%, as proposed by the Energy Secretary, then on comparable fuel price assumptions the EFLs for the Scottish Boards would rise to £127m, £92m for the SSEB and £35m for the NSHEB.

(ii) Industry

For telecommunications, the Secretary of State for Industry has agreed to an EFL of £300m, as recommended by the Treasury. This assumes that it will be possible to defer £150m payments into 1982-83. It also assumes a 10% increase in tariffs in the autumn, calculated on the basis of a pay settlement of around 10-11%.

For posts and British Shipbuilders, the Secretary of State has confirmed the recommended EFLs of £24m and £153m respectively. The steel figure is notional until Mr MacGregor reports in December.

- 2 -
CONFIDENTIAL

CONFIDENTIAL

iii) Trade

For the British Airports Authority, the Secretary of State for Trade proposes an EFL of £21m at outturn prices, in place of the £16m sought by the Treasury. This offer is based on the bilateral agreement of a 10% cut in the original investment programme, but now assumes that landing-fees will not be increased by the full amount needed to meet the financial target. The pay increase assumption still remains at 14%, although the Authority will use every means to settle in single figures. However, each 1% saving only amounts to about £½m.

For British Airways, the Secretary of State has agreed to the Treasury suggested EFL of £125m at outturn prices which assumes the substitution of an operating lease for the purchase of a Boeing 747. No further savings are offered as assumptions on price, profit margins and capital expenditure are already judged to be as tight as possible and the effective total wage bill increase is already well within single figures.

(iv) Transport

With the exception of British Rail, the level of external finance now proposed for the 6 surface transport industries is the same as that entered in column 2 in Annex A of E(80)121. The figure of £945m for British Rail represents an increase of £57m on the previous figure although it remains £80m below the Board's original estimate. These figures include the special additional borrowing of £53m which Ministers have agreed should be applied only to meeting the transitional costs arising from closure of the parcels business.

The Board's original estimates indicated an excess financing requirement of £139m due mainly to traffic loss. In discussion with the Minister of Transport, the Chairman has agreed to revise downwards his pay assumption from 10.7% to 8%, to seek savings in maintenance costs of £25m, and to increase sales of assets well beyond the originally planned figure. These measures will save £80m. The Minister of Transport has concluded that significant further current economies are not available and that the remaining excess of £57m could only be offset by a 10% cut in investment (entailing deferral of the Advanced Passenger Train, signalling schemes and shipping investment); or by bringing forward the next fares increase currently planned for November 1981.

- 3 -

CONFIDENTIAL

126
127
128
129
130
131
32
3
5

CONFIDENTIAL

The reduction in investment might save some £30m. An earlier price increase might yield £20-30m. The Minister of Transport believes that the disadvantages of both these options outweigh their advantages.

3. The position we have reached on the basis of these replies is summarised in the tables below:

	<u>Outturn Prices</u> £m.	<u>1980 Survey Prices*</u> £m.
a) Original EFL bids by NIs	3335	2546 (previously 2490)
b) Change on amounts agreed by Cabinet in July (C(80)40)	-	+1270
c) Treasury proposals in E(80)121 Annex A, col.2	2317	1769 (previously 1730)
d) Change on amounts agreed by Cabinet in July (C(80)40)	-	+540 (previously +500)
e) Latest proposals by departments	2590	1977
f) Change on amounts agreed by Cabinet in July (C(80)40)	-	+757

4. A combination of measures are proposed by industries and departments to reduce their EFLs to the line (e) levels. They include reduced pay assumptions (over £100m), additional tariff increases (about £130m, primarily for telecommunications), investment cuts or deferments (over £200m) and other measures. There seems little scope for further reductions in pay assumptions or action on current costs that will secure benefits in 1981-82. Since there seems little room for manoeuvre on tariff increases further cuts will largely fall on investment.

5. The position for the industries in the present recession is clearly a difficult one, and I recognise that a number of them have already made substantial efforts to reduce their calls on external finance. Nevertheless, as I made clear in E(80)121, the increase in their demands poses very serious problems for our public expenditure

- 4 -

*using revised deflator to reflect the latest prospect for prices. increases the figures previously shown in E(80)121.

CONFIDENTIAL

CONFIDENTIAL

objectives. It will be exceedingly difficult to accommodate any part of the excess over the July levels in other public expenditure programmes. Moreover it seems right at a time when private industry is under such acute pressure and is having to cut back severely on its investment plans that the nationalised industries should help to share the burden by making comparable adjustments. It therefore remains essential that the industries should make the contribution to reducing the excess that I had earlier proposed i.e. to limit the total excess to £300m over the July totals. This now means a further aggregate reduction of £457m.

6. The choice of how to achieve this remains as set out in E(80)121, although the size of the cut required is necessarily greater:

a) selective cuts - although these would now have to go further than paragraph 10 of E(80)121 in order to achieve the necessary total reduction;

b) across-the-board cuts equivalent to 9 per cent of the proposed level of fixed investments in the IFR attached to my paper E(80)64.

In view of the difficulty in securing agreement to selective cuts, an across-the-board cut seems the most practical option. However it would be open to Ministers to vary the severity of the percentage cuts between their industries if they wished, provided that they achieved in aggregate the equivalent of a 9 per cent cut for their industries.

7. The cuts themselves, although calculated on the basis of investment programmes, could be made by each industry according to its own circumstances. The emphasis should clearly be on reducing current costs, especially pay, wherever possible, although I recognise that investment would inevitably be affected.

Recommendation

8. I invite the Committee to agree to reduce the financing requirement for each industry shown in ^{column 2 of} Annex A by an amount equivalent to 9 per cent of the proposed level of fixed investment in the IFR attached to my paper E(80)64, subject to the element of flexibility set out in paragraph 6 above.

W.J.B.

H.M.Treasury
Parliament Street
SW1
3 November 1980

- 5 -

CONFIDENTIAL

138

126

127

128

129

130

134

131

145

132

146

133

147

134

135

19

150

136

151

137

CONFIDENTIAL

ANNEX A

NATIONALISED INDUSTRIES
EXTERNAL FINANCING LIMITS 1981-82

£m at 1981-82 outturn prices

	<u>Original bids</u>	<u>Current offer</u>
National Coal Board	882	882
Electricity Council & Boards	-221	-100 ⁽¹⁾
North of Scotland Hydro-Electric Board	+34	108 ⁽²⁾
South of Scotland Electricity Board	+87	
British Gas Corporation	-99	-309
British National Oil Corporation ⁽³⁾	-323	-360
British Steel Corporation ⁽⁴⁾	<u>£670</u>	<u>£670</u>
Post Office Telecoms	738	300
Post Office Posts & Giro	53	24
British Airways Board	154	125
British Airports Authority	35	21
British Railways Board	1025	945
British Transport Docks Board	-5	-9
British Waterways Board	35	31
National Freight Corporation	19	15
National Bus Company	80	76
Scottish Transport Group	18	18
British Aerospace ⁽⁵⁾	-	-
British Shipbuilders	153	153
	<u>3335</u>	<u>2590</u>
Equivalent at 1980 Survey prices (1.31 deflator)	2546	1977
Change on proposals in C(80)40	+1326	+757

- 1) Assumes tariff increase of 12%
- 2) Assumes tariff increase of 15%; becomes £127m if increase is 12%
- 3) BNOC are not set a formal EFL
- 4) Figures not yet firm
- 5) No EFL on assumption of privatisation before 1981-82

CONFIDENTIAL

138
126
127
128
129
130
144
131
145
132
146
133
147
134
135 9
50
136
151
137