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Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

8 November, 1979

Dear Keith

NATIONALISED INDUSTRIES' EXTERNAL FINANCING LIMITS

As you probably know, Sir Francis Tombs has written to me asking for an early meeting between Ministers and the Nationalised Industries' Chairmen's Group, which would discuss the nature of the external financing limits set for the industries, and the Government's attitude towards the allowance to be made within the limits for labour costs. For convenience, I attach a copy of Tombs' letter and of my reply.

Following the Cabinet decisions yesterday, I hope that you and the other nationalised industry sponsor Ministers, to whom I am copying this letter, will be able to arrange very early meetings with the Chairmen concerned, to let them know the figures set by the Government. Given our intention to publish the figures on 16th November, we need to move very quickly on this. Although the Chairmen are not committed to our figures, I believe that the consultations which have already taken place between the industries and the officials concerned in the preparation of the figures should result in their acceptance. Our explicit acceptance of the difference between "external financing limits" set for the industries and "cash limits" as applied in the public services, and of the consequences for Government and the industries should pay and prices deviate from the expected path, should reassure the Chairmen that we are conscious of the problems they could face.

When you (and our other colleagues concerned) talk to the Chairmen, you will want at the same time to ensure that they are under no misapprehensions abour our intentions on pay. In doing so, I suggest that you should emphasise the following points:

(i) There has never been any question of the Government setting a norm of 17½ per cent (or any other figure) for nationalised industry pay increases.

The Rt. Hon. Sir Keith Joseph, M.P.

(ii) What we said was that we should be looking for a reduction in real unit labour costs in nationalised industries in 1980-81, i.e. that - assuming constant output - the paybill should rise by less than the expected increase in the RPI between 1979-80 (taken as a whole) and 1980-81. The FSBR forecast in June put the increase at 13½-14 per cent (and you could tell them in confidence that we are using a rather similar assumption in fixing next year's RSG cash limits). We specifically did not say that the pay bill, let alone the pay of individuals, should increase by the change in the RPI over the 12 months to October or November this year.

(iii) How large a reduction in real unit labour costs can be achieved depends on the particular circumstances of each industry.

(iv) The scope for pay increases depends to a large extent on how far each industry can improve its productivity.

(v) It is essential that nationalised industries secure reductions in real unit labour costs as a vital contribution to the task of squeezing inflation out of the economy. The Government attach importance to the setting of performance aims for costs, particularly for the monopoly industries.

On pay monitoring, we should stick broadly to our decisions reached at E on 20th September. We should make it clear that the Government are not asking to approve pay offers made by the industries - that is the responsibility of management. But we must know when there is any threat or risk of a breach in the external financing limits so that we can discuss with the industry concerned in good time what action should be taken to deal with it. We also need to make sure that we and the industries are in a position to take into account the possible repercussions of any proposed settlement. It may well be that we shall need to encourage an industry to stand firm - even at the expense of a breach in its external financing limit - rather than make a settlement which other industries, possibly less able to afford it, would be under heavy pressure to follow. This is not a matter on which we want to make detailed rules; rather we should rely on the good sense of the industries to comply with the spirit of our decisions, building on the close relationship already established between them and sponsor Departments. But we should leave the Chairmen in no doubt that we do need to know what is going on, and that we shall not be willing to finance inflationary settlements.

It may be helpful to explain to the Chairmen what we shall be saying about the inflation assumptions underlying the external financing limits. Our line will be that the limits for nationalised industries are different from cash limits in the public services, because the industries' limits apply to financing, not expenditure. This covers a multitude of different elements, which vary widely between the industries, but the assumptions used are broadly compatible with those used in setting the RSG cash limits.

It is possible that the Chairmen will ask when they can expect to discuss with Ministers their recent paper about the Framework of Financial Discipline. I understand that the interdepartmental official Committee is to make a start on this next week, with a view to including discussion of it in their general report to Ministers about nationalised industry policy which is due to be delivered to you by the end of this month. So sponsor Ministers could say, if asked, that we hope to be in a position to hold a meeting before Christmas.

I am sending copies of this letter to the Prime Minister, Jim Prior, Michael Heseltine, George Younger, John Nott, David Howell, Norman Fowler and Sir Robert Armstrong.

GEOFFREY HOWE

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Nationalised Industries' Chairmen's Group

Chairman
Sir Francis Tombs †

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London SW1X 7JG

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TOP COPY CH/EX ACR LAY

CH/EXCHEQUER	
REC.	26 OCT 1979
ACTION	Mr Norton
COPIES TO	CST, FST, MST(C), MST(L)
	Sir D. Wass
	Sir L. Airey
	Sir A. Rawlinson

Mr J. Jones
Mr Dixon
Mr Barratt
Mr Wicks Mr Fonblanque
Mr Walker Mr Ridley.

26/10

24 October 1979

The Rt. Hon. Sir Geoffrey Howe, QC, MP,
Chancellor of the Exchequer,
H.M. Treasury,
Parliament Street,
London, SW1P 3HE.

Dear Chancellor,

Framework of Financial Discipline

Having returned from leave, I am writing to follow up Bill Barlow's letter of 18 October, covering our paper on the Framework of Financial Discipline.

Since the paper is a comprehensive one, we appreciate that you and your colleagues may need a little time before you are ready to discuss it as a whole. Nevertheless, we hope that the opening of talks will not be long delayed, since the broad issues raised - and especially the primacy of the Financial Targets vis-a-vis the Cash Limits - ought to be shaping current developments.

Meanwhile, two points are causing my colleagues and me immediate concern. The first is that discussions on Cash Limits are moving forward at a rate which appears to ignore all the complications attendant on the special character of the Corporations' "external financing limits": here, as you know, we have suggested a palliative. The second concerns the letters sent out recently by most of the sponsoring Secretaries of State about the pay aspects of the Cash Limit calculations and the future monitoring of negotiations, where the wording has left the Corporations both worried and confused in equal measure, and the highly-unfortunate leakage to the Press is already provoking hostile Union reactions. I hope that you will agree to meet the Chairmen's Group to discuss these immediate issues as soon as possible, ahead of the wider-ranging talks referred to in my previous caragraph.

Yours sincerely,

Frank Tombs

URGENT ADVICE

cc CST
FST
Sir D Wass
Sir A Rawlinson
Sir L. Airey
Mr G Jones
Mr LITTLER
Mr F E R Butler
Mr Lovelle
Mr Unwin Mr Monck
Mr Wiggins
Mr P G. Davies
Mr Wicks
Mr Norton
Mr Kerr
Mr Robson
Mr Ridley.

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Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

5th November 1979

Dear Sir Frank,

FRAMEWORK OF FINANCIAL DISCIPLINE

I am sorry that it has taken rather longer than I had hoped to give you a first reaction to the very valuable paper on this subject which Bill Barlow sent me on 18th October.

As you will have seen, the White Paper on Public Expenditure in 1980/81 did not give figures for individual industries, but only a single figure for total borrowing. This is in line with a suggestion in your paper.

So far as cash limits are concerned I think you recognise that it will not be possible to complete discussions of your paper in time for this round. As I think you know, the Government has decided to set limits for individual industries this autumn before major pay settlements are concluded and the aim is to announce these later this month. We have of course noted your doubts about the effectiveness of cash limits in the pay area but we consider that it is right to get the limits in place in good time. Sponsor Ministers will be getting in touch with the Chairmen about this urgently, and will of course deal with the two questions you raise in your letter of 24th October. I do not expect that a collective meeting with me would add much to that even if it were possible to fix one in the time available.

Meanwhile, however, it may be helpful if I make one or two general points. First we agree that it would be useful to recognise the special nature of the limits in the case of the nationalised industries, which as you say was acknowledged in Cmnd 6440 by adopting the term "external financing limit". It will remain true that "there will be no presumption that a financing deficit will be met by a further injection of external finance" even if prices or

/pay rise

Sir Francis Tombs

pay rise faster than assumed when the limit is fixed. But we accept that in such a case the industries can reasonably expect the Government "either to reconsider their ... limits or alternatively to accept the need for whatever action is necessary to enable them to stay within those limits". We cannot have it both ways.

I recognise that in this letter I am giving a reaction to only a few of the important points you have raised. I look forward to a full discussion later this year.

Geoffrey Howe

(GEOFFREY HOWE)