CONFIDENTIAL

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

E(80) 104
12 September 1980

COPY NO 56

MINISTERIAL ~~OFFICIAL~~ COMMITTEE ON ECONOMIC ~~POLICY~~ STRATEGY

NATIONALISED INDUSTRIES CONTRIBUTION TO PUBLIC EXPENDITURE 1981-82 TO 1983-84

Memorandum by the Chief Secretary, Treasury

The nationalised industries' investment and financing review (E(80)64) which we discussed in July (E(80)24th meeting) revealed a serious deterioration in the prospects for the industries by comparison with the provision in Cmnd 7841. In the absence of up to date figures for the four major loss making industries, we were unable to reach even provisional decisions. We agreed to return to the issues in September in the light of papers on those industries. In the meantime all the options for cuts in other industries put forward in the review were to be kept open and I have discussed these with the Ministers concerned.

2. There is now an urgent need to reach decisions on the financing of industries both individually (for 1981-82 at least) and in aggregate, to enable

(i) discussions to go ahead on next year's EFLs; and

(ii) the implications for our public expenditure operation as a whole to be assessed.

This note sets out the position in the light of colleagues' proposals on steel, shipbuilding, coal and rail and considers how the resulting problem might be dealt with for 1981-82 and subsequent years.

Present position

(i) Non-Loss Makers

3. E(80)64, identified total bids from the non-loss makers as follows:

£m 1980 Survey Prices		
1981-82	1982-83	1983-84
+473	+416	+600

These have since been reduced by savings on the Post Office following the £100m cut in investment for 1983-84 agreed by Ministers in July. The figures for individual industries are set out in Table 1 attached.

(ii) Loss Makers

4. E(80)64 contained no revised forecasts for the loss makers. The table below sets out the bids (compared with Cmnd 7841) now put forward by the industries before offsetting action (except in the case of NCB, see paragraph 7 below).

Table: Loss makers - comparison with Cmnd 7841 before offsetting action

£m 1980 Survey Prices

		1981-82	1982-83	1983-84
(i)	National Coal Board	+100	+200	+350
(ii)	British Rail	+ 99	+ 95	+ 60
(iii)	British Shipbuilders	+ 50	?	?
(iv)	British Steel	+525	+550	+475

5. The position revealed is very serious. Taking loss makers and non-loss makers together, the nationalised industries contribution to public expenditure will be very significantly in excess of the additional £470m a year for the nationalised industries assumed in

my paper to Cabinet (C(80)40). The papers by sponsor Ministers suggest that some offsetting action is possible. We must press for the maximum possible.

Coal

6. The Secretary of State for Energy's paper (E(80)96) - discussed by E last Monday - describes the prospects for keeping the NCB to their financial strategy; ie, keeping their public expenditure demands to the provision in Cmnd 7841. It draws attention to the real possibility that without offsetting action the Board would require very substantial additional public expenditure mainly because of lower demand leading to higher costs for financing stocks.

7. The figure quoted for the NCB in the table above assumes that the Board will take some offsetting action to deal with this problem ie, the measures referred to in line 3 of Annex C1 to the Secretary of State's paper (increased closures, buying out imports, increased exports and reduced stocks). The figures in the table also assume that the Board's costs increase no faster than planned. Without the offsetting action referred to in Annex C1 and with increases in costs only moderately above planned levels, the Board's public expenditure requirement could be some £150m, £250m and £400m more over the 3 years to 1983-84 than the figures shown in the table.

8. It is already clear that our public expenditure problem with the nationalised industries would be made much harder if action is not taken to eliminate the additional bids for the NCB shown in the table above. The Secretary of State points out in paragraph 4(a) of his paper that the excess can be reduced by cuts in output at continuing pits and in capital investment. We will need to consider the consequences of such a course when the Secretary of State puts forward his further proposals in October, but I can see little option but to eliminate the excess by the sort of measures he suggests if we are to have a chance of maintaining control over the public

expenditure totals.

British Rail

9. In his paper (E(80)105) the Minister of Transport sets out the means by which the Board should be able to keep within the existing provision for 1981-82 provided that their pay settlement is kept within bounds. This will not meet the transitional costs of £40m-£50m (for BRB and NFC together) of withdrawal from the parcels services. I recognise that there is a clear commercial case for this additional bid. For the later years, the Minister defers judgement on the Board's forecasts until he can bring forward new proposals in the New Year based on an assessment of the Board's 1980 Corporate Review and other new material. As with coal, we will need to look for the maximum action to keep within the existing public expenditure provision.

British Shipbuilders

10. For British Shipbuilders we are faced with substantial bids for additional finance although the amounts for the later years have not yet been costed. In my view the Government must decide this autumn that some contraction of loss-making facilities in merchant yards must be resumed. It is clear that additional funding cannot be avoided this year and next. But before we settle the financing requirements for 1980-81 and 1981-82 I think we must ask the Chairman for urgent proposals to slim capacity by say 10 per cent next year in the merchant yards in addition to any steps which may be necessary at the mixed merchant and naval yards. In my view we must not put more money into BS without securing a commitment to a further rundown. Next year we shall have to decide whether a more drastic rundown is unavoidable if the industry is to achieve viability.

British Steel

11. Any possible reduction in the figures shown for Steel can be no more than a best guess, on our present very limited information,

of what the eventual "MacGregor Plan" might produce by way of an external financing requirement. The Steel situation is explained in a separate paper being circulated to the Committee by the Secretary of State for Industry (E(80)102).

12. The table below sets out the position after the offsetting action for the loss-maker industries proposed in the sponsor Ministers' papers.

Table

	£m 1980 Survey Prices		
	1981-82	1982-83	1983-84
Additional finance for non-loss makers as in E(80)64	+473	+416	+600
Less changes already agreed (Post Office)	- 15	- 55	-105
Loss makers additional bids after offsetting action			
National Coal Board	-	-	-
British Rail (and NFC)	+ 50	-	-
British Shipbuilders	+ 50	?	?
British Steel	+325	+275	+175
TOTAL	+883	+636	+670
Provision for nationalised industries in C(80)40	-470	-470	-470
Remaining excess	+413	+166	+200
Option cuts identified (Annex Table 2)	437	495	583

13. The bulk of the new additional requirement for the loss makers would be for steel, although it includes in 1981-82 extra funds for BS on the basis outlined in paragraph 10 above to finance the costs of contraction of shipbuilding capacity and for BRB to meet the cost of contraction of the parcels service: measures which are in line with our general policy and should improve the position in the later years. But figures for the later years, in the absence of the further papers promised by the Ministers concerned, can be no more

than targets with very considerable downside risks. We have also to bear in mind the very real risk that new forecasts from the industries for their 1981-82 EFLs will show a considerably greater financing requirement than postulated in the review because of the deterioration in the economic situation since the review forecasts were prepared.

14. Clearly we cannot accept now a further addition of £400m in 1981-82 and about £200m in later years to the financing requirements for the nationalised industries beyond the £470m already provided. Given the criticism to which the nationalised industry figures in Cmnd 7841 were subject, such an increase would be taken as a signal that our policies were unrealistic. I have therefore considered the ways in which this might be offset.

Options for reductions

15. Within the nationalised industry field there are three options for containing the additional financing needs identified. The first, which I do not propose we should adopt, is the restoration of all or part of the Cmnd 7841 shortfall allowance of £470m. It would be unwise to do so at this stage, given the continuing uncertainty about the figures, especially for the loss makers.

16. The second would be to adopt all (or some) of the option cuts proposed in July. Table 2 annexed recalls the options for reductions put forward in July. They must be revised downwards to reflect our decision to press ahead with a sale of BAe in 1980-81 and the incorporation of agreed savings on the Post Office in the figures in the table in paragraph 12 above. My bilateral discussions indicated considerable difficulty in achieving some of the remaining savings. The majority would entail delaying or cutting back investment which the industries consider profitable and these could only be justified by the stringency of the public expenditure position. If all or most of them were adopted they would be enough to deal with the problem so far identified for the later years.

But unless we can implement them completely there will be a problem for 1981-82.

17. The remaining option to deal with this would be a generalised squeeze on investment. We agreed in July that the industries should not be given approval for investment commitments above the "85% level" approved last year until EFLs for 1981-82 had been settled. In aggregate that would save about £750m on the proposed investment levels for 1981-82. Holding back investment would clearly be unwelcome to the industries and could only be contemplated as a one year device to deal with an extremely difficult public expenditure prospect. It is not a course we should adopt lightly. But on the assumption that there is no scope for offsetting savings on other public expenditure programmes to meet the nationalised industries' excess and the selective option cuts are not enough, it is the only means open to us by which we can meet the excess. To get £413m by a uniform investment squeeze would entail a cut of about 8% on the investment level proposed in the review.

Conclusion

18. The additional bids from the loss making industries, particularly steel, pose a very serious threat to our public expenditure objectives. Moreover, there remain large uncertainties about the industries' total financing needs in 1981-82 and in the later years. Decisions on the nationalised industries at this stage can only be provisional. Nevertheless, there is an urgent need to take decisions, particularly on the volume financing figures for 1981-82 for individual industries. For that year, in the absence of further savings from other programmes and unless we can make the whole of the option cuts, it is unlikely that we can meet our agreed objective of keeping to the Cmnd 7841 public expenditure totals overall without a generalised squeeze on investment by the industries of about 8% to which any agreed selective option cuts in Table 2 would contribute.

19. I therefore propose that

(i) we agree to cover the remaining excesses identified in paragraph 12 (£413m in 1981-2, £166m in 1982-83 and £200 in 1983-84) by offsetting measures within the industries themselves;

(ii) we should agree on the maximum savings which can be achieved through the selective options cuts from Table 2;

(iii)to the extent that agreed option cuts may/insufficient to cover the gap for 1981-82, we should decide on a general cut in investment of the amount required to give us the saving we need (ie an even percentage cut for all industries including any investment cuts agreed in the "option cuts");

(iv) officials' discussions on the 1981-82 EFLs should proceed on the basis of the investment and financing figures for individual industries in Table 1 modified in (ii) and (iii) above (handling BS as proposed in paragraph 10 above).

W.J.B.

H M Treasury
12 September 1980

TABLE 1

NATIONALISED INDUSTRIES: TOTAL EXTERNAL FINANCE
(as in E(80)64)

£ million at 1979-80 prices

	1981-82	1982-83	1983-84
National Coal Board	658	553	430
Electricity Council and Boards	-232	-348	-429
North of Scotland Hydro-Electric Board	27	18	15
South of Scotland Electricity Board	65	139	144
British Gas Corporation	-368	-612	-347
British National Oil Corporation	-336	-126	-157
British Steel Corporation	199	-	-
revised figures (E(80)102	525	275	175
Post Office	183	69	73
after further savings agreed	168	14	-32
British Airways Board	96	95	105
British Airports Authority	26	51	12
British Railways Board	623	579	572
revised figures (E(80)105)	663	-	-
British Transport Docks Board	-6	-6	-5
British Waterways Board	23	22	22
National Freight Corporation	6	4	3
E(80)105	16	-	-
National Bus Company	56	54	56
Scottish Transport Group	11	11	10
British Aerospace	108	78	57
British Shipbuilders	81	38	16
revised figures	131	?	?
(a) Total (as in IFR)	1220	619	77
(b) Revised total	1631	839	147
(a) Compared with Cmnd 7841	+473	+416	+600
(b) Compared with Cmnd 7841	+884	+636	+670

CONFIDENTIAL

E 2

Option Cuts

£m at 1980 Survey prices

	1981-82	1982-83	1983-84	
1. Electricity (a) England & Wales			100	Further possible real increases in tariffs after period of current financial target. Final decision when next target settled in 1982.
(b) England & Wales	25	25	30	Investment (baseline already includes reduction to offset cost of extra capacity in form of cross Channel link.
(c) Scotland	5	10	10	Investment
2. BNOC (a)	15	30	40	Investment
(b)	30	40	36	Delays in the Clyde field (discussed in E(80)98)
3. Gas (a)	75	75	75	Industrial prices (centre of 50-100 range)
(b)	20	20	20	Investment
(c)	100	100	100	Deferment of Morecombe Bay - to be considered separately
4. British Aerospace				
⌈Option of cancelling 146 not relevant given E(DL) decision to work towards 1980/81 flotation⌋				
5. Telecommunications				
(a)⌈Investment cuts to reflect relaxation of the monopoly agreed⌋				
(b)	100	100	100	General squeeze including delayed completion of Strowger replacement to 1995 instead of 1992
6. British Airways	35	60	35	Investment reduced (close to BA's contingency plan for higher oil prices/lower growth
7. British Airports	20	20	20	Investment
8. Buses, Docks, Posts	12	15	17	
⌈of which (a) NBC	3	5	7	Borrowing
(b) BTDB	1	2	2	Investment
(c) Posts	8	8	8	Investment⌋
TOTAL (revised) rounded	437	495	583	