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

E(80) 8th Meeting

COPY NO 56

CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

MINUTES of a Meeting held at
10 Downing Street on
TUESDAY 26 FEBRUARY 1980 at 10.00 am

PRESENT

The Rt Hon Margaret Thatcher MP
Prime Minister

The Rt Hon Lord Carrington
Secretary of State for Foreign and Commonwealth Affairs
(Item 1)

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer

The Rt Hon Sir Keith Joseph MP
Secretary of State for Industry

The Rt Hon James Prior MP
Secretary of State for Employment
(Item 1)

The Rt Hon Peter Walker MP
Minister of Agriculture, Fisheries and Food

The Rt Hon Michael Heseltine MP
Secretary of State for the Environment

The Rt Hon John Nott MP
Secretary of State for Trade

The Rt Hon David Howell MP
Secretary of State for Energy

The Rt Hon John Biffen MP
Chief Secretary, Treasury

THE FOLLOWING WERE ALSO PRESENT

The Rt Hon George Younger MP
Secretary of State for Scotland
(Item 3)

The Rt Hon Patrick Jenkin MP
Secretary of State for Social Services
(Item 1)

Mr Paul Channon
Minister of State
Civil Service Department
(Item 1)

Sir Kenneth Berrill
Central Policy Review Staff

SECRETARIAT

Sir Robert Armstrong
Mr P Le Cheminant
Mr G D Miles

CONTENTS

1. INCENTIVES FOR THE LOWER PAID

Previous reference E(79) 13th Meeting - Item 2.

The Committee considered a memorandum by the Chancellor of the Exchequer (E(80)17) covering a report by officials on factors affecting work incentives for the lower paid.

THE CHANCELLOR OF THE EXCHEQUER said that the official report identified two separate issues: the "in work/out of work" problem, where people could achieve less net family income from work than they would have obtained from supplementary benefit; and the poverty trap problem, where extra earnings from work could be removed by marginal "tax" rates of more than 100 per cent, through the withdrawal of means-tested benefits. Although the figures in the paper tended to imply that the numbers of people genuinely in these categories were relatively small, public attitudes were important. If people believed that they would not benefit from working as opposed to living on social security, this would have serious consequences for the economy. The social security system had departed from the original Beveridge idea of subsistence provision, and had become, over the years, dynamised to maintain levels of benefit relative to other incomes in society. At a time when national prosperity was declining, this could result in a growing burden. Moreover, if decisions on individual benefits were taken piecemeal, the problems could be intensified. Recent examples were the decisions on school transport and school meals. It would not be possible to reverse a long-term trend overnight, and he therefore proposed several immediate steps for limited action. All future decisions on benefits should be taken with the impact on the "will to work" firmly in mind. The so-called "Cohort" study of the unemployed should be completed, so that more information was available on the exact composition of this section of the population. Fraudulent abuse of the social security system should be vigorously attacked. He also proposed further studies of possible methods of preventing a man from receiving benefit greater than some reasonable proportion of the national average wage, merely on the grounds that he had a large family.

In discussion the following main points were made -

a. It was important to keep the scale of the problem in perspective. A number of the measures already decided for introduction would be helpful by widening in-work/out-of-work differentials. Examples were the taxation of short-term benefits, and the decision to reduce the real value of certain short-term benefits at the next uprating.

b. The political arguments for action did not point uniformly in the same direction. Attempts to concentrate benefit on the poorest families could conflict with work incentives, and there were a number of published studies which purported to show that existing benefit rates were not overgenerous in relation to the cost of maintaining families at acceptable standards. Nevertheless occasional well-publicised cases of people who seemed to exploit the system gave rise to considerable public resentment.

c. The restoration of a "cut-off" or "wage stop" on benefit, based on previous earning levels, would be very complicated to administer. The previous "wage-stop" scheme had been dropped without political dissent, in the face of a prolonged and sustained campaign. It was possible that a simple proportionate cut-off could be used, although this would mean in some cases paying out less benefit than the objective needs tests suggested as being required, and would be likely to result in problems of hardship for large families, with consequent adverse publicity. The argument for a cut-off was essentially presentational, since the numbers who might be caught would always be very small.

d. The Family Income Supplement was a particularly effective measure in dealing with the "will to work" problem, because it was payable to those in work, and because payments continued for a full year, even if income rose above qualifying level during that time.

e. The anomalous result of uprating benefits in line with inflation was demonstrated by the fact that the child allowance for Supplementary Benefit was already much higher than Child Benefit, and the gap would increase further as a result of recent decisions. On the other hand, the Supplementary Benefit allowance was intended to cover the full cost of supporting a child, while Child Benefit was only intended as a contribution to family finances.

THE PRIME MINISTER, summing up the discussion, said that the Committee were agreed that the "will to work" problem was important, and should be kept in mind when new policies were being considered. All relevant papers coming to Cabinet Committees should contain a paragraph on the implications of the proposals for

this issue. The "Cohort" study should be completed, and the conclusions from it reported to the Committee in due course. Action against fraudulent use of the benefit system was already in hand, and should be pursued vigorously, though any increase in staff needed for this purpose should be found by deploying staff from other duties rather than by an increase in total manpower. The Committee did not favour the reintroduction of a "cut-off" or "wage-stop" on benefit in its previous form, but agreed that other alternatives should be further examined.

The Committee -

1. Took note, with approval, of the summing up of their discussion by the Prime Minister.

2. Invited all Ministers to ensure that any papers for Cabinet Committees which included proposals which might bear on the question of "the will to work" should include a paragraph discussing this issue.

3. Invited the Secretary of State for Social Services to ensure that conclusions of the "Cohort" study were reported to the Committee later in the year.

4. Invited the Secretary of State for Social Services, and the Secretary of State for Employment, to ensure that, within existing staff resources, fraudulent use of the benefit system should be vigorously attacked.

5. Invited the Chancellor of the Exchequer to arrange for officials to examine further the possibility of imposing some form of "cut-off" on the size of benefit payment.

2. A GAS TAX OR LEVY

Previous Reference: E(79) 14th Meeting, Item 1

The Committee considered a note by the Chancellor of the Exchequer and the Secretary of State for Energy (E(80) 19) discussing possible methods of reducing the profits of the British Gas Corporation (BGC).

THE SECRETARY OF STATE FOR ENERGY said that the British Gas Corporation had long-term contracts for the supply of gas from the Southern Basin of the North Sea at prices well below current world energy costs. These contracts, taken together with the decision to raise progressively the price of gas to consumers towards the world energy level, meant that the BGC would generate increasing profits in future years. Although the BGC's financial targets took account of this, and the resulting profits were loaned to the Exchequer, there was a presentational difficulty in justifying price rises in the face of apparent large profits. The paper discussed possible methods of tackling this presentational problem, and recommended a levy which would be applied on BGC purchases of gas from those fields which were not already subject to Petroleum Revenue Tax (PRT). He proposed an early announcement of the Government's intention to impose such a levy.

In discussion it was suggested that the precise handling and description of the levy were important. To call it a tax and announce it in the Budget statement or the Budget debate could be misunderstood as a new burden on consumers. The announcement should be kept separate from the Budget and legislation to give effect to the levy could be held over until the next Session of Parliament. The title adopted for the levy should associate it explicitly with the North Sea, and it might be useful to introduce the concept of the levy as a rent: this suggested some such title as "North Sea Gas Rental Levy".

THE PRIME MINISTER, summing up the discussion, said that the Committee were agreed that a levy should be imposed on the GVC purchases of PRT-exempt gas. They had noted that this would not affect pricing decisions for the current year. There was no need for early legislation, but it was desirable that an announcement should not be unduly delayed. There should be early consultations with the BGC, with a view to an announcement once those consultations were completed (but not during the Budget debate). The Chancellor of the Exchequer and the Secretary of State for Energy should further consider the issues, including the presentation and timing of an announcement, in the light of the points made in discussion. The text and timing of an announcement should be cleared with colleagues in advance.

The Committee -

1. Approved the proposals in E(80) 19 for the introduction of a rental levy on Petroleum Revenue Tax-exempt gas from the Southern Basin in the North Sea.

2. Invited the Secretary of State for Energy, in consultation with the Chancellor of the Exchequer, to give further consideration to the issues involved, including the nature and timing of consultation with the British Gas Corporation, and the title of the proposed levy.

3. Invited the Secretary of State for Energy in consultation with the Chancellor of the Exchequer, to clear with colleagues in advance the text and timing of any announcement about the Government's intentions.

3. ELECTRICITY INDUSTRY (ENGLAND AND WALES): EXTERNAL FINANCING LIMIT 1979/80

The Committee considered a memorandum by the Secretary of State for Energy (E(80)20) proposing an adjustment of the External Financing Limit (EFL) for the Electricity Industry in England and Wales in 1979-80.

THE SECRETARY OF STATE FOR ENERGY said that it was now inevitable that the Electricity Industry would breach their EFL for 1979-80 by a substantial margin. Present indications suggested an overrun of some £325 million by the end of the financial year, of which a major component would be £161 million spent on providing extra coal and oil stocks as a contingency against a coal strike. Other causes included coal and oil prices higher than had originally been envisaged, and a shortfall in demand as a result of the relatively mild winter. The current steel strike was also adding about £4 million per week to the deficit. A particularly disturbing feature had been the very late warning which the industry had given to his Department. This arose partly from failures of communication between the Electricity Council and the Central Electricity Generating Board. There was only limited action which the industry could now take to reduce the overshoot, although by speeding up cash-in-transit at the end of the year, and by deferring some fuel payments into the following year, the figure at the year's end might be contained within £200 million. It had to be remembered that the EFL represented the difference between expenditure and revenue of an industry with a turnover of about £12 billion per annum, and was thus vulnerable to quite small changes in the assumptions on which it was calculated. Nevertheless the performance of the industry in complying with the EFL regime had been far from satisfactory. It was already clear that the position in 1980-81 would also be very difficult. He would wish to bring proposals about this to colleagues shortly; an immediate decision was, however, required on his proposal that the EFL for the Electricity supply industry in England and Wales for 1979-80 should be increased by £200 million.

48

In discussion the following main points were made -

a. Although it was inevitable that the EFL for 1979-80 would need to be raised, and there were disadvantages in appearing to authorise this by restrospective validation, there were overriding objections to making a change in the electricity industry's EFL while the strike in steel industry continued. Although the problems there related to the EFL for 1980-81, there would be great difficulty in explaining an apparent difference in treatment.

b. Since a major portion of the overspend arose from the creation of a contingency stock of fuel, it was arguable that the Government should find some means of financing this separately. The contingency arrangements of an industry should not depend on the vagaries of the EFL position in a particular year.

c. The structure of the whole industry should again be reconsidered, bearing in mind the proposals from the committee under Lord Plowden, which had recommended greater centralisation. But these would involve legislation and the creation of a major new authority. An alternative course might be to seek such changes as could be achieved without legislation, including the introduction of private capital where possible.

d. The inclusion of the External Financing Limits for nationalised industries in a common pool with the other elements of public expenditure presented particular problems. Hard won cuts in public expenditure could be almost capriciously swamped by unexpected changes in the fortunes of the nationalised industries. This was partly a problem of definition, since the types of expenditure were not strictly comparable. The general issues raised would be the subject of study by the new established Ministerial Sub-Committee on Nationalised Industry Financing.

THE PRIME MINISTER, summing up the discussion, said that the Committee were deeply concerned at the overrun in the Electricity Industry External Financing Limit, and the failure of the management to inform the Department of Energy at an early stage. Arrangements would be needed to prevent a recurrence of this problem, and the industry would need to consider

substantial action, including the possible deferment of capital programmes, to re-establish their plans within the limits provided for 1980-81. For the current year, the possibility of financing fuel stocks for contingency purposes as a separate item should be further considered. Subject to the outcome of that examination, the External Financing Limit for the industry should be raised by an appropriate amount, not exceeding £200 million, to cover the overrun. No announcement should be made while the steel strike was in progress. The Committee, aided as necessary by the new Ministerial Sub-Committee on Nationalised Industry Financing, would need to return to the question of the Electricity Industry's EFL for 1980/81 at an early meeting.

The Committee -

1. Invited the Chief Secretary Treasury, in consultation with the Secretary of State for Energy, to consider whether the fuel stocks held by the Electricity Supply Industry for contingency purposes could and should be financed separately from the industry's External Financing Limit.

2. Invited the Secretary of State for Energy to agree with the Chief Secretary, Treasury, a suitable addition to the External Financing Limit of the Electricity Supply Industry in England and Wales for 1979-80, taking account of the points made in discussion and within an upper limit of £200 million.

3. Invited the Secretary of State for Energy, in consultation with the Chief Secretary, Treasury, to consider how the changed External Financing Limit for 1979-80 should be announced, once the steel strike was over.

Cabinet Office

26 February 1980