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E(79) 12th Meeting

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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

MINUTES of a Meeting held at
10 Downing Street on
WEDNESDAY 17 OCTOBER 1979 at 4.00 pm

PRESENT

The Rt Hon Margaret Thatcher MP
Prime Minister

The Rt Hon William Whitelaw MP
Secretary of State for the
Home Department

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

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

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 Nicholas Edwards MP
Secretary of State for Wales

The Rt Hon Patrick Jenkin MP
Secretary of State for Social Services

The Rt Hon Tom King MP
Minister of State, Department of
the Environment (Minister for Local
Government and Environmental Services)

Earl of Mansfield
Minister of State
Scottish Office

Sir Kenneth Berrill
Head of Central Policy
Review Staff

SECRETARIAT

Sir John Hunt
Mr P Le Cheminant
Mr P Mountfield (Item 1)
Mr G D Miles (Items 2 and 3)

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1. STRATEGY FOR THE COAL INDUSTRY

The Committee considered a joint memorandum, E(79) 50, by the Secretary of State for Energy, and the Chief Secretary, Treasury, setting out their respective views on the strategy for the coal industry over the next five years, and a note by the Central Policy Review Staff (E(79) 56) bringing out the main issues for Ministers raised by this paper.

THE SECRETARY OF STATE FOR ENERGY said that the National Coal Board (NCB) had submitted two alternative strategies in the summer, both of which he had rejected. Their third set of proposals, produced at his instigation, cost £260 million less over the period, although the cost in the first year (1980-81) was £30 million higher than the figures Cabinet had approved in the summer. This was a strategy which he had imposed on the NCB rather than a blanket endorsement of the Board's own proposals. The Chief Secretary's proposals required a reduction of a further £170 million over the period. This would, in his view, require unacceptable cuts in the NCB investment programme. It was not realistic to suppose that the balance could be found by further price increases. In his view it was not prudent to plan on price increases of more than 2 per cent a year in real terms. If, unexpectedly, the relative cost of other fuels moved so as to permit bigger increases, this would ease the financing problem. But it was not correct to argue that the National Union of Mineworkers (NUM) would be able, as in the past, to finance higher wages by robbing the funds allocated to investment. The remaining points in his paper, including those dealing with the capital structure of the industry, were secondary. The background to his proposals was a disgruntled industry, where the extremist wing of the NUM could very easily be provoked into industrial action.

THE CHIEF SECRETARY, TREASURY, said that it was difficult on the figures available to the Committee to justify a programme of the size proposed by the Secretary of State for Energy. He advocated a level of Government support for the industry £140 million lower over the whole period. There were great uncertainties about the productivity assumptions in the Secretary of State's proposals, and about the rate of pit closures which they assumed. The assumption of a 3 per cent increase in real wages was optimistic. All past experience showed that any money allocated to the NCB ended up in the pockets of the miners. He was also sceptical about the room for a 2 per cent real increase in prices, given that the NCB was already committed to the Central Electricity Generating Board (CEGB) to maintain a constant real price of coal over five years. In his view, the strategy should start from financial targets for the industry, and other factors should be adjusted to fit this. He saw no need for any changes in the capital structure of the industry at this stage. Any redundancy arrangements should impose no further charge on public funds.

SIR KENNETH BERRILL said that the CPRS would stress the crucial link between this and the other papers before the Committee at their present meeting, dealing with gas and with electricity prices. Prices were the main link. There were doubts about productivity, real earnings, prices and the rate of closures. The Government could not do much to improve productivity in the industry or influence the closure rate. These were matters which could only be determined at local level, pit by pit. The only real variables were cash limits and coal prices. There were obvious constraints on the NCB's freedom to increase its prices, as the agreement with the CEGB demonstrated. It was, however, relevant that the CEGB's own working assumption was that coal prices to them would increase significantly faster than the rate allowed for in the NCB's calculations. The burden of adjustment therefore could and should fall on prices.

In discussion, it was argued that there would be a long term need for coal, well into the future, both as an alternative fuel and as a feed-stock for petro-chemical development. In the short term, at least until a large nuclear programme had been completed, there was no alternative to continued high dependance on coal. While some conflict with the NUM might be inevitable during the life-time of the present Government, it was desirable to avoid it in the immediate future. The NUM attached great importance, symbolic and real to the maintenance of a high level of coal investment. Earlier investment in the industry was nearing the point at which it would begin to pay off. There was thus some prospect, for the first time in many years, of a real improvement in productivity. It would be wrong to cut back the programme below the level agreed, with such difficulty, with the NCB.

Against this, it was argued that the NCB had persuaded previous Governments to accept optimistic assessments of their position, and to endorse over-ambitious investment programmes. The expected improvements in the productivity had never arisen. Real wages had always increased, and in the short term often at the expense of investment. The NUM could not guarantee any long term improvement in productivity. On the other hand, recent and expected improvements in the world oil price left plenty of headroom for further increases in coal prices in real terms. This made it important that the Government's financial commitment should be limited, and that the NCB's needs, both for investment and for operating costs, should be met at the margin by an increase in prices. The consequences of this for electricity prices would have to be accepted, and made clear to the miners and to the public. It would also be necessary to seek improvements in the management of the NCB, and if possible to improve the reliability of the figures they presented to Government. It was more than ever important to invest in a new generation of nuclear power stations.

THE PRIME MINISTER, summing up the discussion, said that the Committee agreed to the revised strategy suggested by the Chief Secretary, Treasury, in Appendix B to E(79) 50, with the exception that the allocation for 1980-81 should be increased by £15 million (instead of the £30 million proposed by the Secretary of State for Energy). Any additional funds needed by the NCB to finance investments or to pay for excessive wage increases would have to be financed by increases in the price of coal. The Secretary of State for Energy should immediately arrange to see the Chairman of the NCB, and explain this decision to him. If the NCB argued that it was impossible, within their market situation, to finance the desired programme from the funds the Government was prepared to make available, the Secretary of State should report back to her and she would arrange for further Ministerial discussions in the near future. It was important that these discussions should be concluded before the Cabinet settled the cash limits for the NCB and other nationalised industries on 25 October. If necessary, the tripartite meeting between the Government, the NCB and the NUM arranged for 22 October should be postponed.

The Committee -

Took note, with approval, of the Prime Minister's summing up of their discussion, and invited the Secretary of State for Energy to proceed accordingly.

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2. GAS PRICING POLICY AND THE FINANCIAL TARGET FOR THE BRITISH GAS CORPORATION

The Committee had before them a note by the Secretary of State for Energy (E(79) 51) proposing a future pricing policy for gas, and the method for determining the financial target for the British Gas Corporation (BGC).

THE SECRETARY OF STATE FOR ENERGY said that there were good reasons for regarding domestic gas prices as being between 25 and 50 per cent too low at present. This was distorting the market by creating an excessive demand for gas, which meant that the BGC was having to refuse to accept new industrial customers, and might have difficulty in meeting the full requirements of its existing customers if weather conditions were adverse during the winter. Arbitrary rationing by the BGC was undesirable, and there were very strong economic arguments for raising the price of gas over a period to the full economic level. This would also produce a large income which would help to reduce the Public Sector Borrowing Requirement (PSBR) and would finance the necessary additional investment in the gas industry. He proposed a price increase in real terms of 10 per cent per annum for three years starting next April, and that he should give the BGC a three year financial target consistent with that pricing policy.

In discussion there was a general recognition of the economic desirability of raising gas prices substantially, and of the contribution that such increases could make to the Government's wider policies on taxation. But serious problems were envisaged as arising from the proposed timing of price increases. Next April the Retail Price Index (RPI) would still be relatively high, and at the same time the public would face increases in rate bills, and, on the proposals before the Committee, price rises in real terms in the cost of coal, gas and electricity. In the case of both gas and electricity the industry made apparent large profits, and it would be extremely difficult to justify publicly an increase in prices at that time on the basis of general economic arguments. It might be necessary therefore to consider a different phasing of price increases, with the increase in April not exceeding the rise in the RPI, and with a further increase timed for later in the year, when the rate of increase in the RPI might be beginning to moderate. Thought should also be given to the most appropriate pattern of price rises in future years.

In further discussion it was suggested that the justification for the price rise would be more evident, if there were a tax, perhaps comparable in effect to the Petroleum Revenue Tax which creamed off some of the profit, and could be seen as contributing to the Government's policy of reducing personal taxation. It would also be important to ensure that some of the increased income to the Exchequer was diverted to schemes which would assist with the fuel costs of the poorer sections of the community. The scheme for the current winter, which the Secretary of State for Social Services would be announcing shortly, would probably need to be increased in scale in future years in the context of future rises in the price of energy. It was also arguable that greater emphasis should be given to policies on energy conservation. Although higher prices would in themselves encourage economy, better insulation was a potential source of great economies in fuel use.

In continued discussion it was suggested that many of the economic advantages of encouraging a more balanced usage of the different fuels could be achieved if the Government announced a long-term aim of raising gas prices to a level of equivalence with oil. People making decisions on heating systems would then know where they would stand in the future. But on the other hand, unless the moment for, and context of, the announcement was carefully chosen there was a danger of adverse public reaction.

THE PRIME MINISTER, summing up the discussion, said that the Committee were agreed that as a long-term aim the price of gas should be raised over a period of 4 years to the oil-related level. They were also agreed that the price rise next April should not exceed the rise in the RPI. The Secretary of State for Energy, in consultation with the Chancellor of the Exchequer, and the Chief Secretary, Treasury, should propose a phasing for subsequent price increases, which would achieve the desired objective. In considering the phasing they should take note of the long-term trend of the RPI, and also the seasonal impact of changes in it. Because the income arising to the Exchequer would be lower, particularly in the early years, compared to the assumptions in the paper, the Chief Secretary, Treasury, should report to the Committee on the consequences of the proposed phasing for public expenditure decisions. These studies should be pursued urgently, so that they would not disrupt the programme for settling the cash limits of nationalised industries, which

would be considered by the Committee in a week's time. In addition the Minister of State, Department of the Environment, should let her have a note on existing energy saving schemes and incentives.

The Committee -

Took note, with approval, of the summing up of their discussion by the Prime Minister, and invited the Secretary of State for Energy, and the Chancellor of the Exchequer and the Chief Secretary, Treasury, to be guided accordingly.

5. PRICING POLICY AND THE FINANCIAL TARGET FOR THE ELECTRICITY SUPPLY INDUSTRY (ENGLAND AND WALES)

The Committee had before them a memorandum by the Secretary of State for Energy (E(79) 52) seeking agreement to proposals for a financial target and associated pricing strategy for the electricity industry in England and Wales.

THE SECRETARY OF STATE FOR ENERGY said that as with gas, it was desirable that the proper economic price should be charged for electricity. In this case the current degree of underpricing was estimated to be between 5 and 10 per cent, and he proposed a programme of increases over a number of years to correct this.

THE PRICE MINISTER, summing up a brief discussion, said that the same basic arguments applied as in the case of gas. There was more uncertainty about the appropriate economic price for electricity, because it was not directly in competition with oil, and the long run marginal cost estimates relied on the assumed efficiency of the industry. Nevertheless, it was reasonable to have a target of raising the price in real terms over a 3 or 4 year period, provided that the increase in April 1980 was not larger than the RPI. As in the case of gas, the Ministers concerned should prepare proposals for, and examine the financial implications of, a phased programme of increases to bring electricity prices to the appropriate economic level.

The Committee -

Took note, with approval, of the summing up of their discussion by the Prime Minister, and invited the Secretary of State for Energy, the Chancellor of the Exchequer, and the Chief Secretary, Treasury, to proceed accordingly.

Cabinet Office
18 October 1979