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E(80) 34th Meeting

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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

MINUTES of a Meeting held at
10 Downing Street on
WEDNESDAY 17 SEPTEMBER 1980 at 9.00 am

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 Lord Soames
Lord President of the Council

The Rt Hon James Prior MP
Secretary of State for Employment

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 John Biffen MP
Chief Secretary, Treasury

THE FOLLOWING WERE ALSO PRESENT

The Rt Hon Nicholas Edwards MP
Secretary of State for Wales
(Item 1)

The Rt Hon Humphrey Atkins MP
Secretary of State for Northern Ireland
(Item 2)

The Rt Hon Norman Fowler MP
Minister of Transport

Lord Strathcona
Minister of State
Ministry of Defence
(Item 2)

Mr Alexander Fletcher MP
Parliamentary Under-Secretary of State, Scottish Office

Mr Norman Lamont MP
Parliamentary Under-Secretary of State, Department of Energy

Mr J R Ibbs
Central Policy Review Staff

SECRETARIAT

Sir Robert Armstrong
Mr P Le Cheminant
Mr D J L Moore

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1. BRITISH STEEL CORPORATION FINANCES

The Committee considered a memorandum by the Secretary of State for Industry (E(80) 102) on the finances of the British Steel Corporation (BSC).

THE SECRETARY OF STATE FOR INDUSTRY said that the new Chairman, Mr MacGregor, was in the process of reorganising the Corporation into product-based profit centres with responsibility for both production and marketing. The objective was to achieve competitive cost levels, regain domestic market share and strengthen BSC's position in export markets. In addition BSC had put forward three alternatives to their present objective of capacity to produce 15 million tonnes of liquid steel a year. Their Cases I and II each involved reducing capacity to about $12\frac{3}{4}$ million tonnes, mainly by the mothballing rather than the closure of plants. The essential difference between these two options lay in the location of the plants affected. On present plans the Corporation would reduce their manpower from about 150,000 to 100,000 in the course of 1980; under either Case I or II there would be a further reduction to around 70,000 by the end of 1981. They had also considered more a radical option (the Lower Case) of cutting capacity to 7 or 8 million tonnes, but they considered that this would effectively amount to the liquidation of the Corporation. They would not be able to present him with firm estimates and targets until the end of the year when they would have fully evaluated the effects of re-organisation and of their options. In the meantime the estimates annexed to his memorandum were highly provisional, and took only limited account of the savings for which BSC were aiming. In these circumstances he recommended that a decision on the External Financing Limit (EFL) for 1981-82 and the Corporation's financing requirements for the later years should be deferred until January when they could be considered in the light of this further report. It was however already clear that, mainly because of falling revenue, BSC would need an increase of up to £600 million on their EFL for 1980-81. He recommended that he should increase this EFL by £400 million now - the amount which he had warned the House to expect in his statement of 26 June - and by a further amount in January.

The Secretary of State added that, since his paper was prepared, a new and disquieting development had been brought to his attention. Falling demand was affecting not only BSC but also the private sector steel companies. There was now a serious risk that some private sector plants might have to shut down.

Their difficulties were increased where they were in direct competition with subsidised BSC products. He intended to discuss with the Chairman of BSC the possibility of changes in the frontiers between BSC and the private sector in order to minimise the damaging effects on the latter of subsidised competition from the BSC.

In discussion, the following points were made -

a. The Government would be severely criticised if efficient private sector steel firms collapsed because of competition from the heavily subsidised BSC. Moreover, if private sector capacity to produce, for example specialist steels, were now closed, this could well lead to an increase in imports when markets picked up. The present memorandum was addressed solely to the problems of BSC, but the Committee needed an analysis of the prospects for the United Kingdom's steel industry as a whole, leading into an examination of more radical options for the future of BSC. This assessment should be prepared by Departments, perhaps on the lines of the recent work on BL.

b. It was premature for the Government to take a view on which of the options BSC should pursue. The Corporation should examine both their Cases I and II in detail; and when they put forward recommendations on them Ministers would need to consider the regional and social implications of the closures involved as well as the industrial and financial consequences. There seemed no point in BSC pursuing their Lower Case; but they should understand that more radical options were not ruled out if Cases I or II did not point convincingly to a viable future for the Corporation. Ministers would also need to consider the Corporation's proposals for the location of the headquarters of their new product groups.

c. The Government were vulnerable to criticism for conceding substantial increases in the subsidies to BSC, and to other public sector industries, but at the same time they were given little credit for the fact that these subsidies were preserving employment and essential industrial capacity.

Opportunities should be taken to stress that such subsidies were not a substitute for change; they were a condition of bringing change about and a means of achieving necessary and long-delayed changes in an orderly way by financing transitional costs which were inevitably high.

THE PRIME MINISTER, summing up the discussion, said that the Committee reluctantly agreed that BSC's EFL for 1980-81 should be increased by £400 million and that this should be announced when the House returned. They would consider proposals for any further adjustment of the EFL for 1980-81, for the EFL in 1981-82, and for the Corporation's financing requirements in later years, when the Secretary of State for Industry put forward his recommendations following the further proposals which the Corporation would be putting to him by the end of the year. He should invite the Chairman of BSC to proceed to a full evaluation of both Cases I and II, more fundamental options were not ruled out. There was no point in pursuing the Lower Case. But the Government must be able to consider the future of BSC in the context of the steel industry as a whole. The Committee were particularly concerned with the problems of the private sector steel industry which had now been reported to them and that good private sector firms should not collapse because of subsidised competition from BSC. The Secretary of State for Industry should now arrange for an urgent examination by his Department, in consultation with the Treasury and the Central Policy Review Staff, of the prospects of the steel industry as a whole in the United Kingdom, as a basis for further consideration of the options for the future of BSC.

The Committee -

1. Agreed that the British Steel Corporation's External Financing Limit for 1980-81 should be increased by £400 million forthwith.

2. Agreed that a decision on the External Financing Limit for 1981-82 should be deferred until January.

3. Invited the Secretary of State for Industry -

i. To consult them on the draft of his statement on the increase in the External Financing Limit for 1980-81.

ii. To arrange for his Department, in consultation with the Central Policy Review Staff and with the Treasury, to assess the prospects of the steel industry in the United Kingdom, and as a basis for further consideration of options for the British Steel Corporation, and to report by the end of October.

iii. To report in January in the light of the British Steel Corporation's further proposals and with particular reference to their financial and regional implications.

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2. BRITISH SHIPBUILDERS' FINANCES

The Committee considered memoranda by the Secretary of State for Industry (E(80) 103) and by the Central Policy Review Staff (CPRS) (E(80) 106) on the financing requirements of British Shipbuilders (BS).

THE SECRETARY OF STATE FOR INDUSTRY said that, although BS had substantially reduced employment in merchant shipbuilding, and had closed a number of yards, they were still uncompetitive and in need of continuing subsidies. Under their new Chairman, Mr Atkinson, they proposed to continue the rundown; in particular, they were considering the possibility of closure of Smith's Dock on Teesside and withdrawing Intervention Fund assistance for merchant shipbuilding from Cammell Laird and Scott Lithgow whose future would then be dependent on naval work and oil rigs. If these two yards were to diversify into oil rigs, they would have to take orders initially at a loss. He recommended that this general strategy should be endorsed, although he could still give no assurance that BS would become competitive. He would review again next year the possibility of some privatisation of BS. In the meantime it was unlikely that the action which BS were proposing to take would be in time to prevent an excess of £65 million on their External Financing Limit of £120 million for 1980-81 and an excess of £50 million on their public expenditure provision for 1981-82.

MR IBBS said that it was still not clear that BS were facing up to financial realities. The CPRS recommended that before increases in their provision for 1980-81 and 1981-82 were agreed BS should be required to re-examine policies that influenced their cash requirements and in particular the points on purchasing, short-time working and pay and productivity discussed in paragraph 3 of E(80) 106. They further recommended that BS should be required to produce a yard by yard restructuring plan as a basis for decisions on the use of Intervention Fund grants at particular yards and on the diversification into oil rigs by Cammell Laird and Scott Lithgow.

In discussion it was pointed out that, if Cammell Laird and Scott Lithgow were to succeed in the fiercely competitive oil rig markets, they would have to improve their productivity and adopt more flexible manning arrangements. The possibility should be examined of achieving this objective either by partial disposal of the yards or by their entering into partnership with private sector firms for this work.

THE PRIME MINISTER, summing up the discussion, said that the Committee were not yet persuaded that BS were taking sufficiently tough action to reduce their costs or that they were slimming down sufficiently in the face of poor market prospects. The Secretary of State for Industry should arrange for these questions, and the suggestions made by the CPRS, to be examined further. He should also examine the possibilities for introducing private sector involvement with Cammell Laird and Scott Lithgow in the manufacture of oil rigs. The Committee would then reconsider the strategy for BS in the light of this further report.

The Committee -

Invited the Secretary of State for Industry to arrange for his Department, in consultation with the Treasury and the Central Policy Review Staff, to arrange for a further review, taking account of the points made in discussion and in E(80) 106, of British Shipbuilders' financing and strategy, and to report by mid-October.

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3. BRITISH RAIL FINANCES

The Committee considered a memorandum by the Minister of Transport (E(80) 105) about British Rail's (BR) finances.

THE MINISTER OF TRANSPORT said that BR were now taking a much tougher line on productivity and, in the last year, had been persuaded to support privatisation. Their finances had however suffered from the steel strike, from the general reduction in demand and from the last pay settlement. He would require BR to find savings to offset some of their increased requirements but, in the circumstances, he had agreed with the Chief Secretary that their External Financing Limit (EFL) should be increased by £40 million. He proposed that any further over-shooting on the 1980-81 EFL should be recovered in 1981-82 by deferring investment unless it could be financed by additional asset sales. He proposed to make no increases in the volume investment and financing figures for BR in 1981-82. This would lead to further cuts in train services (particularly on the freight side) and put strong pressure on them to contain their next pay settlement within single figures. As an exception in 1981-82 he recommended that there should be a special provision, outside the EFL, for borrowing of up to £50 million for the purpose of covering the transitional costs of withdrawing from the collection and delivery of parcels. This business has been making heavy losses for many years. There were no prospects of it competing successfully with either the private sector or the Post Office and its withdrawal would in time lead to savings of over £30 million a year. 6,800 jobs would be lost in BR and in the National Freight Corporation and because of this there was a risk of industrial action. He would be putting further proposals to the Committee early in 1981 in the light of BR's next corporate review.

In discussion it was pointed out that, while substantial manpower savings had been identified in 1976, little progress had been made so far in achieving them. The last pay settlement had assumed that productivity improvements would be made and it was essential that these should be achieved and that they should be additional to the savings flowing from the closure of the parcels business, since the Government was providing additional money to finance that.

THE PRIME MINISTER, summing up the discussion, said that the Committee approved the proposals put forward by the Minister of Transport, subject to the reservation that the volume investment and financing figures for 1981-82 could not be determined until the Government had reached final decisions on the distribution of cuts on the total nationalised industry programme for that year. It should be made clear to BR that the Government expected them to achieve the productivity improvements assumed at the time of the last pay settlement and that these should be additional to the improvements which would flow from the closure of the parcel service for which the Government were providing special financial support. The Committee would consider on another occasion the proposals discussed in E(80) 100 and 101 for rail services between Victoria Station and Gatwick Airport.

The Committee -

1. Approved the recommendations in paragraph 9(a), (c) and (d) of E(80) 105.

2. Deferred a decision on the volume investment and financing figures for British Rail in 1981-82 (paragraph 9(b) of E(80) 105) until decisions were taken on the financing of nationalised industries as a whole for that year.

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4. NATIONALISED INDUSTRIES' CONTRIBUTION TO PUBLIC EXPENDITURE 1981-82 TO 1983-84

The Committee considered a memorandum by the Chief Secretary, Treasury (E(80)104) on the external financing requirements of the nationalised industries from 1981-82 to 1983-84.

THE CHANCELLOR OF THE EXCHEQUER said that it was crucial to convince the markets that the Government would meet its monetary and public expenditure objectives in the current, and later, years. The increases in the financing requirements of the nationalised industries were a root cause of the Government's difficulties in meeting these objectives. It was essential for sponsoring Ministers, and their Departments, to impress on the industries the urgency with which they needed to take action to control their pay and other costs, as did private sector companies which were subject to more effective financial disciplines.

THE CHIEF SECRETARY, TREASURY, said that he now estimated that it would be necessary to identify measures to offset excesses in the nationalised industries' total requirements of £413 million in 1981-82, £166 million in 1982-83 and £200 million in 1983-84. He had arrived at this estimate after allowing for additional finance for the non-loss makers, for the likely net additional bids after offsetting action by the coal, rail, steel and shipbuilding industries, and for the provision of £470 million a year which it had been agreed should be made for the nationalised industries at the expense of other public expenditure programmes. He recommended that these offsetting measures should be taken by the industries themselves. Otherwise they would have to be found from other public expenditure programmes; and the Government would be criticised for failing to bring about the improvement in the financing of the nationalised industries, assumed in the last Public Expenditure White Paper. He recommended that the savings should be found either from the list of options in Table 2 attached to his memorandum or by a generalised squeeze on investment by the industries of about 8 per cent to which any agreed option cuts in Table 2 would contribute.

In discussion it was argued that, while the excess had to be offset, and it was certainly desirable that there should be maximum pressure on nationalised industries to achieve the greatest possible efficiency and economy on their running costs, the option cuts proposed by the Chief Secretary would fall for the most part on investment, and would thus in effect impinge largely on the private sector. It was preferable to find savings from disposals and from cutting running costs. Indeed, it could be argued that, rather than seek to meet the whole of the excess by offsetting measures within nationalised industries, if that entailed damaging cuts in investment, it might be preferable to look for some part of the offset to further savings in central Government current expenditure programmes.

THE PRIME MINISTER, summing up the discussion, said that the Committee agreed that the remaining excesses identified by the Chief Secretary should be covered by offsetting measures by the nationalised industries. The Chief Secretary should discuss with each sponsoring Minister how this should be achieved, and report. So far as was practicable, the Committee would prefer to find the savings from disposals and cost savings rather than from cuts in investment. Sponsoring Ministers should, however, satisfy themselves that the cuts they were proposing were realistic. They, and officials at all levels in their Departments, should seek every opportunity to impress on the industries the importance of vigorous and urgent action to cut their costs and reduce their financing requirements.

The Committee -

1. Agreed that the remaining excesses identified in paragraph 12 of E(80) 104 (£413 million in 1981-82, £166 million in 1982-83 and £200 million in 1983-84) should be covered by offsetting measures within the nationalised industry programme.

2. Invited the Chief Secretary, Treasury, to discuss urgently with each of the Ministers concerned how the savings should be achieved and to report as soon as possible.

Cabinet Office

18 September 1980