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E(80) 38th Meeting

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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

MINUTES of a Meeting held at
10 Downing Street on
WEDNESDAY 22 OCTOBER 1980 at 3.00 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 Lord Soames
Lord President of the Council

The Rt Hon James Prior MP
Secretary of State for Employment

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 Francis Pym MP
Secretary of State for Defence
(Item 1)

The Rt Hon Sir Ian Gilmour MP
Lord Privy Seal

The Rt Hon Nicholas Edwards MP
Secretary of State for Wales
(Item 2)

The Rt Hon Humphrey Atkins MP
Secretary of State for Northern Ireland

The Rt Hon Norman Fowler MP
Minister of Transport
(Item 2)

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

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 SHIPBUILDERS: STRATEGY AND FINANCE

Previous Reference: E(80) 34th Meeting, Item 4

THE COMMITTEE considered a memorandum by the Secretary of State for Industry (E(80)112) on British Shipbuilders' (BS) strategy and finances.

THE SECRETARY OF STATE FOR INDUSTRY said that the prospects for BS remained gloomy and uncertain. Employment in merchant yards had fallen from 38,600 in July 1977 to 17,000 by the end of this year, and BS were now planning further contraction. Their strategy was to make no further applications for Intervention Fund assistance in support of merchant ship orders for Cammell Laird, Scott Lithgow and Smith's Dock. The future of Cammell Laird and Scott Lithgow would depend on orders for naval ships and for the offshore oil industry. There was no possibility of private sector involvement at present in the construction of semi-submersibles because United Kingdom private sector companies had neither the experience nor the technology. To break into this market BS would have to succeed against fierce international competition and to show that the business would be profitable to them. In general they should not take initial orders at less than break-even; if it became necessary exceptionally to consider proposals for taking an initial order at a loss if it would otherwise go abroad, he would bring them to the Sub-Committee on Economic Affairs (E(EA)) for decision BS might want to make a case for keeping Smiths' Dock open to build the first of six ships which British and Commonwealth (B and C) were likely to order. They hoped, however, to persuade B and C to accept later delivery of this ship in which case the order could go to Swan Hunter and Smith's Dock would close. BS planned to withdraw from ship repair activities by sale to the private sector, insofar as existing legislation permitted, and closures. Longer term decisions on BS's strategy, and on the prospects for privatisation, would have to be deferred until they produced a new corporate plan in spring 1981.

In discussion the following points were made -

a. The naval programme was under review but the implications for BS could not be seen until the current public expenditure exercise had been completed and decisions taken on the Defence Budget. In the

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meantime the outlook for further naval orders for BS looked poor, and nothing was in sight for Cammell Laird and Scott Lithgow. In recent months warships had been built and delivered more quickly than hitherto. While this improvement in management and performance was welcome, the acceleration of payments had added to the difficulties of managing the Defence Budget. As a result the Royal Navy might have to slow down its orders.

b. Although it might be necessary to withdraw merchant orders from Scott Lithgow, there was a case for allowing them Intervention Fund Grants exceptionally if this would enable them to win an order for a ship supplying the offshore market. On the other hand the Chairman of BS had taken a firm decision not to apply for Intervention Fund Grants for Scott Lithgow and, unless he were to take the initiative in seeking an exception to that rule, the Government should not intervene.

c. It would be helpful, in the context of the Government's general dealings with the European Commission, if the application for extension of the Intervention Fund could be made as soon as possible.

THE PRIME MINISTER, summing up the discussion, said that the Committee accepted the recommendations put forward by the Secretary of State for Industry. They would consider BS longer term strategy in the light of their next corporate plan which would be ready in spring 1981.

The Committee -

1. Approved the recommendations in paragraph 17 of E(80)112.

2. Invited the Secretary of State to proceed accordingly, taking account of the points made in discussion.

2. NATIONALISED INDUSTRIES: FINANCING

The Committee considered a memorandum by the Chief Secretary, Treasury (E(80) 121), on the nationalised industries' External Financing Limits (EFLs) for 1981-82 and their financing requirements in 1982-83 and 1983-84.

THE CHIEF SECRETARY, TREASURY, said that it had been agreed in July that an additional £470 million, at 1980 Survey prices, should be allocated in each year to the nationalised industry programme. The industries had now submitted their bids for their 1981-82 EFLs which would be announced in November. These bids were £1270 million, at 1980 prices, in excess of a baseline inclusive of the extra £470 million already allocated to them. This was in part attributable to the requirements of the major loss makers but mainly to the effect on the industries markets of the recession. Following discussions with the sponsoring Departments and the industries, the Treasury had concluded that the increase of £1,270 million could be reduced to £500 million. The savings would be found by a combination of making low assumptions for pay increases, further cuts on capital investment and, in some cases, higher and earlier tariff increases. These proposals had not all been accepted by Departments. He proposed that the remaining excess of £500 million should be reduced by at least £200 million. This could be achieved either by an across the board cut in each industry's financing requirement equivalent to 4 per cent of their investment programme, but with the decision on how to find the saving left to each industry, or by selective cuts falling on the electricity, telecommunications and rail programmes. He had not yet had detailed discussions on 1982-83 and 1983-84, but he recommended that the aim should be to find savings sufficient to ensure that there would be no further increases for the nationalised industries beyond the £470 million allocated to them in each year.

In general discussion the following points were made -

a. The analysis failed to quantify the effects of the proposed cuts on private sector industry. Cuts in investment would further damage the prospects of private sector suppliers, and might well lead to the

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collapse of some of them. The gross savings from the cuts could be significantly offset by further public expenditure on account of the increased redundancies which would follow. On the other hand, unless the Public Sector Borrowing Requirement (PSBR) were reduced, inflation would come down more slowly, interest rates could not be reduced and that could have a far more damaging effect on industry generally. Unless substantial cuts were made on the nationalised industries' programmes, the savings would have to be sought from Departmental programmes which were already under acute pressure. As it was, private sector industry was reducing investment in response to falling demand and, unless they were to have over-capacity, it was reasonable for the nationalised industries to do likewise.

b. Although the pay assumptions had been reduced, and it was to be expected and accepted that there would be variations between industries, the average was still too high. It would be very difficult to negotiate settlements in the public services well down in single figures if the nationalised industries, and in particular the loss-making industries, were seen to be settling for significantly more. It was, moreover, unacceptable if they effectively sought to finance high pay increases by cuts in their productive investment and, in the case of monopoly industries, high price increases. It was a deficiency of the present controls that essential capital investment could not be protected within the EFL. Although the Government could not determine pay settlements in the nationalised industries, the sponsoring Ministers should continue to press the Chairmen to seek low settlements.

c. It was argued that it was necessary to adopt reliable pay assumptions in setting EFLs, to reduce the risk of early breaches of the limits when pay settlements were concluded. On the other hand it was suggested that the pay assumptions in the ELFs were bound to become known, and the imposition of cash limits for public services pay, and the achievement of settlements within those limits, would be made more difficult if the Government was seen to have provided for much higher increases in the nationalised industries. On this argument a better course would be

to base the EFLs on pay assumptions which reflected the level of pay increases which the Government had in mind for the public services, but to make increased provision in the contingency reserve for the possibility of breaches of the EFLs as a result of pay settlements out of line with the assumptions.

d. It was unsatisfactory that the borrowing requirements of successful and profitable nationalised industries fell within the PSBR and were therefore liable to the constraints and cuts applying to the public sector as a whole. The Chancellor of the Exchequer was currently considering this question with other Ministers. There were however limits to any changes which could be made. Unless industries, or parts of them, could be transferred to the private sector, their borrowing would be regarded as backed by Government guarantee, whether formal or implicit. Moreover, even if the borrowing of profitable nationalised industries was regarded as outside the PSBR the fundamental problems of their inefficiency and of their high pricing would remain.

In further discussion the following points were made on the detailed proposals for reductions to the EFLs proposed in column 2 of Annex A to E(80) 121 -

Energy industries

a. The EFL of minus £221 million for the electricity supply industry in England and Wales assumed a tariff increase of about 16 per cent on 1 April 1981. An increase of this order would represent too fast a move towards economic pricing. The industry themselves regarded 12 per cent as the maximum which was defensible to their consumers. In order to stay within their proposed EFL they should therefore be urged to propose alternative measures. They should not however be encouraged to sell surplus coal stocks abroad at prices which would represent a subsidy to companies overseas competing with our own manufacturers. A better course might be for the electricity industry

to keep this coal and run down their stocks at the margin by reducing their orders from the National Coal Board (NCB), although it was recognised that this would increase the difficulties for the NCB of keeping within their EFL.

b. The proposed EFL of minus £339 million for the British Gas Corporation (BGC) assumed an increase in domestic gas prices of 27 per cent in April 1981, reflecting a 10 per cent real increase, which had already been approved in principle, together with BGC's assessment of a 17 per cent year on year retail price increase in December 1980. This assumption, and the resulting proposal of an increase of 27 per cent, was too high. BGC should therefore be asked to make proposals for achieving the proposed EFL by lower domestic price increases and without putting an undue burden on industrial consumers who, in some instances, were already at a disadvantage with their international competitors. A reduction in BGC's share of the financing of the gas gathering pipeline from the reduced levels already agreed by the Committee (E(80) 19th Meeting, Item 2) could not be made without risking delay to the project and increasing the overall costs of financing it.

c. The British National Oil Corporation did not have direct control over their revenues but it should be possible for them to achieve the proposed minus £360 million, and it was possible that they could be persuaded to contribute more.

Telecommunications and Posts

d. It would be possible to make the reductions necessary to bring down the EFLs for Telecommunications and Posts to £300 million and £24 million respectively, although there was a very strong case for avoiding cuts in investment especially in telecommunications. There were however possibilities for participation arrangements with the private sector which would take the financing of some telecommunications investment outside the PSBR.

Airways and Airports

e. The proposals for British Airways were acceptable, provided that agreement could be reached on leasing arrangements for aircraft. In view of the current legal battle with the airlines over landing fees, it would be impracticable for the British Airports Authority to increase fees further to the extent envisaged by the Treasury in proposing an EFL of £16 million. The Secretary of State for Trade would, however, consider alternative ways of meeting this target; and he would press the Authority to make a lower pay assumption.

Transport Industries

f. The Minister of Transport was currently considering with British Rail a number of measures to get their EFL down as far as possible towards the proposed £888 million. In particular he would urge them to reduce their pay assumption to 8 per cent.

g. The British Transport Docks Board and the National Freight Corporation were to be privatised and, while cuts could be made in their investment, this could have a damaging effect on the price for them. Further cuts on the National Bus Company could mean the closure of the Leyland bus factory at Bristol.

THE PRIME MINISTER, summing up the discussion, said that the Committee had had a useful first discussion of the proposals in Column 2 of Annex A to E(80) 121. It was clear that savings of at least this order were necessary, and each sponsoring Minister who had not felt able to accept the proposals relating to his industries should consider the matter urgently with the Chairmen of the industries concerned and report the outcome as soon as possible to the Chief Secretary, Treasury. In looking for savings they should seek to avoid excessive price increases and should continue to impress on their Chairmen the utmost importance which the Government attached to

achieving lower pay settlements in the nationalised industries. The Chief Secretary, Treasury should report the outcome as soon as possible to the Committee, which would then reach final decisions on the proposals in Column 2 of Annex A to E(80) 121 and on the Chief Secretary's further proposals for additional cuts of £200 million beyond those figures.

The Committee -

1. Invited each Minister sponsoring nationalised industries to consider further the measures necessary to achieve the External Financing Limits for 1981-82 listed in Column 2 of Annex A to E(80) 121 and to report the outcome urgently to the Chief Secretary, Treasury.

2. Invited the Chief Secretary, Treasury, to circulate as soon as possible a memorandum on the reports of the sponsoring Ministers to him.

3. Agreed to resume their discussion at an early date, when they would consider both the further report now to be produced by the Chief Secretary, Treasury, and the outstanding issue of additional cuts as set out in paragraphs 9-11 of E(80) 121.

Cabinet Office

23 October 1980