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E(79) 15th Meeting

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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

MINUTES of a Meeting held at
10 Downing Street on
MONDAY 26 NOVEMBER 1979 at 4.30 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 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

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

The Rt Hon Sir Michael Havers QC MP
Attorney General

The Hon Nicholas Ridley MP
Minister of State, Foreign and Commonwealth Office

Mr Norman Tebbitt MP
Parliamentary Under-Secretary of State, Department of Trade (Item 2)

Sir Kenneth Berrill
Central Policy Review Staff

SECRETARIAT

Sir Robert Armstrong
Mr P Le Cheminant
Mr P Mountfield

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1. GAS PRICING POLICY

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

THE COMMITTEE considered a memorandum by the Secretary of State for Energy, E(79) 64, about the timing of increases in domestic gas prices in 1981-82 and later years.

THE SECRETARY OF STATE FOR ENERGY said that the Committee had already agreed that gas prices should be raised in real terms over the period to 1983-84, in order to eliminate the present serious uneconomic pricing of domestic gas, as compared with oil. He had been asked to consider the implications of achieving the necessary price increases by single annual steps or smaller increases twice yearly. His paper showed that bigger increases would be needed if the price were raised twice a year, in April and October, if revenue was not to be lost. However, it was not necessary to take final decisions now on the timing or size of price increases after 1980-81 (where the pattern of price increases had already been decided by the Cabinet) but he needed decisions in principle, both in order to set financial targets for the British Gas Corporation (BGC) and in order to make a public announcement which would give clear signals to gas consumers about the future trend of gas prices.

In discussion, considerable concern was expressed about the likely impact of gas price increases on the scale proposed on the Retail Price Index (RPI). The consequences of such increases for the domestic consumer would be severe, especially on the poorest households, and the Government would come under great pressure to introduce further measures of financial support for poor families facing heavy increases in fuel bills. The future course of world oil prices was very unclear, and it was not certain that increases on the envisaged scale would in the event be needed.

Against this, it was argued that the underlying trend in fuel prices in real terms was bound to be upwards. It was therefore necessary to give the correct signals to the consumer to allow him to adjust his consumption patterns, insulate his house, and over time to switch to alternative fuels. Unrestrained demand for gas supplies by domestic consumers was leading to the prospect of severe shortages for industry. The imbalance between present domestic tariffs and the prices already charged to industry was serious. While the inflationary consequences of gas price increases were damaging, through their impact on the

RPI and thus on wage demands, the alternative of a further increase in the Public Sector Borrowing Requirement (PSBR) compared with that assumed by the Cabinet for planning purposes, would be equally inflationary.

THE PRIME MINISTER, summing up the discussion, said the Committee accepted the need for domestic gas prices to rise on average by 10 per cent a year in real terms in 1981-82 and subsequent years. They were however reluctant to commit themselves to any particular pattern of the staging of gas price increases beyond 1980-81. Any public announcements should be limited to an indication of the likely trend in prices after next year without precise commitment or quantification.

The Committee -

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

2. Invited the Secretary of State for Energy to inform the BGC of the increases for 1980-81 which had already been agreed by the Cabinet, noting that the BGC would announce the increases in due course.

3. Invited the Secretary of State for Energy to agree with the Chief Secretary, Treasury, the precise planning assumptions to be used by Government and by the BGC for the remainder of the Public Expenditure Survey period.

2. GAS REVENUES

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

THE COMMITTEE considered a memorandum by the Chancellor of the Exchequer, E(79) 65, about alternative ways of reducing the excessive profits of the British Gas Corporation (BGC).

THE CHANCELLOR OF THE EXCHEQUER said that, given the decisions on prices which the Committee had just taken, the British Gas Corporation (BGC) would make very substantial profits over the next five years. These profits were in large part the accidental result of BGC's ability to purchase gas very cheaply from the southern basin of the North Sea, while re-selling it to the public at prices which were progressively aligned with the world price of oil. This surplus could either be left with the BGC who, under present arrangements, would then lend it to the Government, or returned as of right to the Government for the benefit of the tax payer. In that case, there were three possible methods of eliminating the surplus. The first was to re-negotiate the earlier, cheap southern basin contracts, and to tax the oil companies on the profits they would make in selling gas to BGC at something nearer to the world price. This course would however leave large additional profits after tax in the hands of the oil companies some of which would depart across the exchanges. The second was to impose a fiscal charge on the BGC, which would appear as a cost in their accounts. The third would be to impose a surcharge on the consumer, collected with his gas bill. The third was politically the least attractive course.

In discussion, there was general agreement that the third option need not be further pursued. It was argued that the first option came closer to the appropriate market behaviour. It would have been the natural course to follow, had the BGC not been given a statutory right of purchase when the gas fields were first developed and before Petroleum Revenue Tax (PRT) was introduced. It might nevertheless be possible to find ways of charging PRT on those gas fields at present exempt without leaving surplus profits in the hands of the oil companies. The second option would be resisted by the BGC, although it was in many ways the simplest, most certain, and easiest to handle.

There was no need for an immediate decision, provided it were agreed in principle that some way should be found of reducing the BGC'S apparently high profits for the benefit of the Exchequer.

THE PRIME MINISTER, summing up the discussion, said that the Committee agreed that the choice lay between the first and second options in E(79) 65. The Chancellor of the Exchequer and the Secretary of State for Energy should jointly consider these options in more detail and bring fresh proposals to the Committee in due course.

The Committee -

1. Took note with approval, of the Prime Minister's summing up of their discussion:

2. Invited the Chancellor of the Exchequer, in consultation with the Secretary of State for Energy, to consider further the first two options listed in his paper E(79) 65, and to submit fresh proposals to the Committee in due course, with a view to legislation either in the 1980 Finance Bill or elsewhere.

3. GOVAN SHIPBUILDERS

THE COMMITTEE had before them a minute from the Secretary of State for Industry to the Prime Minister dated 16 November, reporting discussion in the Ministerial Sub-Committee on Economic Affairs (E(EA)), about a proposed order for two ships from Liberty Maritime Limited, to be placed with the Fairfields Yard of Govan Shipbuilders on Clydeside, together with a note by the Central Policy Review Staff, E(79) 66.

THE SECRETARY OF STATE FOR INDUSTRY said that the Government had already decided upon a substantial reduction in the capacity of British Shipbuilders, especially in merchant shipbuilding. This involved a reduction from 29,000 to 18,000 jobs; 2,000 jobs had already been lost since the election and 9,000 more would go before the end of 1980. The Confederation of Shipbuilding and Engineering Unions (CSEU) had co-operated with this strategy so far. It had always been envisaged that the Scotstoun and Fairfields yards of Govan Shipbuilders would not close simultaneously. Scotstoun was due to close in the Spring of 1980. The Fairfield Yard was already running down. A further order was desirable, in order to bridge the gap and keep Fairfield going for a few more months. In the normal course of business, British Shipbuilders had in July (before the Government's statement about Shipbuilding policy) secured an order from Liberty Maritime for the construction of two ships. This involved a large Government subsidy and a heavy contingent risk, but within the limits normally accepted. It was true, as the CPRS had pointed out, that the company involved was a small one, with few assets and little cash at risk, whose recent accounts have not been filed with the Department of Trade. However, the Greek Shipowner who stood behind the company owned 24 similar one-ship companies and was a man of substance. He was prepared to put £0.5 million at risk on this order. There should be no difficulty in securing the approval of the European Commission. If the order were not accepted, the alternative would be the rapid run-down of the Fairfield Yard, with the risk that British Shipbuilders would lose the support of the CSEU. If that happened, there could be strike action, which would involve serious delays to the ships now under construction for Poland, with consequent risk of heavy penalty payments, and quite possibly in the Naval Shipbuilding Yards, with consequent disruption to Defence orders. It was obviously important that the Government should not be seen to be pouring money into the Fairfield Yard simply to postpone its closure. This would lead to mounting pressure from the workforce at British Leyland and at the British Steel Corporation. But the proposed order could be defended as a normal piece of business, undertaken within the normal subsidy limits applying to merchant shipbuilding.

In discussion, it was argued that the proposed financial support for this order was unacceptable. It was the sort of deal for which the present Government, when in Opposition, had criticised its predecessors. It involved a maximum exposure of up to £21 million, in exchange for which the proposed purchaser would be at risk for only £~~.05~~ 0.5 million. The Government would lose financial credibility if it were seen to acquiesce in deals of this kind.

Against this, it was argued that the position in the shipyards, and in particular on Clydeside, was becoming desperate. The CSEU had co-operated remarkably well so far. It would be a great mistake to put this co-operation at risk, and to incur the financial and other penalties flowing from industrial action, both on Clydeside and elsewhere. It was necessary to reassure the workforce very rapidly. If the Greek order were not acceptable, it might be possible to place a Government or other public sector order at Fairfields very quickly. This would be a better use of such funds as the Department of Industry had been prepared to allocate to the Greek order.

THE PRIME MINISTER, summing up the discussion, said that the Committee had considerable doubts about the proposed deal with Liberty Maritime and would prefer the funds involved to be used in a more constructive way. They were however also anxious to secure a further order for Fairfield, if possible, so as to avoid the simultaneous closure of the Scotstoun and Fairfield Yards. The possibility of a further public sector order for Fairfield should therefore be explored urgently.

The Committee -

1. Took note, with approval of the Prime Minister's summing up of their discussion;

2. Instructed the Secretaries to arrange for Officials to consider urgently whether further public sector orders for ships could be placed at the Fairfield Yard of Govan Shipbuilders to replace the proposed order from Liberty Maritime Limited, and to report to the Prime Minister as quickly as possible.

4. BNOC - FUTURE STRUCTURE AND PRIVATE SECTOR PARTICIPATION

Previous Reference: E(79) 7th Meeting, Item 4

THE COMMITTEE had before it a memorandum by the Secretary of State for Energy, E(79) 67, setting out the broad approach which he proposed towards private sector participation in the upstream operations of the British National Oil Corporation (BNOC), and other related matters.

THE PRIME MINISTER said that the Committee would not be able to take final decisions at this meeting; Ministers would need more time to consider the important and complicated proposals in the paper. However, early decisions would be needed if legislation were to be introduced, as proposed, in the present Session of Parliament.

THE SECRETARY OF STATE FOR ENERGY, said that Ministers had already agreed to retain BNOC's trading activities within the public sector, to give the Government an instrument to influence the disposal of North Sea oil. They had also agreed in principle that private capital should be introduced into the upstream operation, in which assets of between £1.5 and 2 billion were employed. The simplest solution would be to separate these two operations, to place the upstream assets in a subsidiary company, and to sell off part of the Government's interest in that. The alternatives would be to retain the unitary BNOC, with a continuing Government interest. But this would fail to secure the objective of privatisation, and would not relieve the Public Sector Borrowing Requirement (PSBR). He therefore recommended the division of the Corporation into operative and trading activities and the introduction of private capital by an offer for sale of a substantial part of the equity in the operating subsidiary, in two or more tranches. He would himself like to keep open the option that some of these shares might be disposed of by a free issue to the general public, on the lines of the issue recently made in British Columbia.

In discussion, it was argued that the course proposed by the Secretary of State was the best way of retaining control of North Sea oil, while at the same time introducing private capital into the operations of BNOC. This would be a popular and irreversible act of de-nationalisation which would in the end be accepted, albeit reluctantly, even by its critics, as the introduction of commercial television had been. It did not seem to involve any greater risks of objections from the European Commission than were already inherent in the present arrangements, although the introduction of new arrangements would inevitably prompt questions from the Commission. It would benefit the PSBR substantially in the early years at the cost of revenue foregone later. This was inherent in any privatisation scheme.

Against this, it was argued that the proposal would involve the loss of control of some part of BNOC's equity interest in oil, amounting to three or four million tons a year at peak, or alternatively, of building in an option for BNOC (trading) to purchase this oil, at market prices, thus reducing the saleability of shares in BNOC (operating). It had been estimated that this might reduce the eventual sale value by anything up to 10 per cent. Segregation of the operating activities into a separate company would make the whole operation more transparent in community terms and thus increase the risk of challenge. Government intervention was better disguised if the operations were all grouped together in a unitary BNOC. The operation required the sacrifice of long term income in the interests of short term receipts. The calculation of the revenues foregone was complicated by taxation effects, and it was not clear that the figures in Annex 2 to the Secretary of State's paper accurately reflected the position.

In further discussion, it was argued that the British Columbia option, of a free issue of shares to part of the general public had political attractions but would be administratively complicated and expensive, even if confined to a small section of the general public. It would also involve a significant loss of revenue. In present circumstances a straightforward offer of sale was to be preferred though this need not rule out future developments on British Colombia lines either in relation to BNOC or more widely. The sale of shares in BNOC's (operating) would be best spread over three years rather than two, to take advantage of a rising market, provided the operation could be completed within the life-time of the present Parliament.

If possible, preference in the sale should be given to small investors and to existing employers of BNOC. In carrying through the proposed changes in BNOC's structure it would be necessary to avoid any technical infringement of the provisions of the Treaty of Rome. In any case, at least 25 per cent of the shares should be retained in public ownership.

In further discussion, it was noted that the chances of early legislation were slight, unless it could be introduced very quickly after Christmas. Early decisions were therefore necessary.

THE PRIME MINISTER, summing up the discussion, said that the Committee's first impressions were favourable to most of the proposals put forward by the Secretary of State for Energy. It would however need time to consider them in more detail before taking decisions and should resume its discussion before Christmas.

The Committee -

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

2. Invited the Secretary of State for Energy to discuss his proposals in detail with the Ministers concerned, and to make a further report to the Committee during December so as to retain the option of legislation in the New Year.

Cabinet Office

28 November 1979