E(79) 5th Meeting

COPY NO 56

CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

MINUTES of a Meeting held at
10 Downing Street on
TUESDAY 17 JULY 1979 at 10.00 am

PRESENT

The Rt Hon Margaret Thatcher
Prime Minister

The Rt Hon William Whitelaw MP
Secretary of State for the
Home Department
(Items 1-3)

The Rt Hon Lord Carrington
Secretary of State for Foreign
and Commonwealth Affairs and
Minister of Overseas Development

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
(Items 1-4)

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 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 Nicholas Edwards MP
Secretary of State for Wales
(Item 5)

The Rt Hon Mark Carlisle QC MP
Secretary of State for Education
and Science (Items 1-3)

The Rt Hon Sir Michael Havers QC MP
Attorney General (Item 6)

The Rt Hon Norman Fowler MP
Minister of Transport (Items 1-4)

Earl of Mansfield
Minister of State, Scottish Office
(Items 1-6)

The Rt Hon Reginald Prentice MP
Minister of State, Department of Health and Social Security
(Minister for Social Security)
(Items 1-4)

Sir Kenneth Berrill
Head of Central Policy Review Staff (Items 1-6)

SECRETARIAT

Sir John Hunt
Mr P Le Cheminant
Mr P Mountfield

CONTENTS

CONFIDENTIAL

1. 1980-81 CASH LIMITS AND PAY

The Committee had before them memoranda by the Chancellor of the Exchequer E(79) 15, and E(79) 23, which discussed 1980-81 cash limits and public sector pay, and a minute dated 11 July from the Secretary of State for Industry to the Prime Minister concerning pay increases and public expenditure.

THE CHANCELLOR OF THE EXCHEQUER said that following discussion at the previous meeting of the Committee (E(79) 4th Meeting, Item 2) he had been asked to prepare a paper showing how the cash limits could be devised according to the broad principles of Option A of the paper E(79) 15, while adding to that option a measure of flexibility. Flexibility could be introduced by varying the way overall pay and price restrictions were applied in individual cases, by delaying the fixing of cash limits, by amalgamating cash limits into larger blocks to provide more scope for off-setting action, and by allowing off-setting action for irresistible changes to fall on other public expenditure savings. Some flexibility would be essential; a policy of "horses for courses" was needed in settling cash limits.

In discussion it was agreed that in order to match the Government's general strategy, and approach as close as practicable to Option A was needed. The public sector must not be allowed to increase its overall share of the economy, at the expense of the wealth producing areas. It was important to think in terms of the total wage bill, and not of the pay of individual members of the workforce. If a ceiling could be set to the wage bill, then negotiations would be about the distribution of pay within the total, and about the scope for offsetting savings by manpower reductions. There was however a dilemma here, since if the sum available for the total wage bill were known in advance to the negotiators, the unions would use this as the starting point for negotiations and seek more. But if offsetting savings were allowed from items other than wages, for example investment, or hardware, this might be disastrous for the long-term efficiency of the organisation concerned.

There was a difference between public and private sector cases, because while private sector management could keep private its financial calculations in pay negotiations public sector cash limits were published and the underlying assumption about wage and price movements could be readily derived either by Parliamentary questioning or otherwise. Thus in the public sector pay negotiations, the union side would inevitably have more information than in a private sector negotiation. Given this it was desirable that the chosen cash limits should be such as to provide appropriate signals to both public sector employers and unions, to permit a reasonable negotiation, and should not be so unrealistic as to promote a confrontation.

The paper suggested a novel approach for the setting of RSG cash limits, in which the local authority employers would be told that the proportion of Government support would decline in inverse ratio to the level of pay settlements they agreed, or the level of rate rises levied. This approach was worth further exploration, but it would be important to ensure that it did not penalise the careful authorities, relative to the profligate ones.

THE PRIME MINISTER, summing up the discussion, said that the Committee were agreed that in setting cash limits an approach as close as possible to Option I should be adopted, but that a measure of flexibility should be introduced in setting the cash limits, according to the special circumstances of each block. The aim must be to provide clear guidance for both employers and unions that the size of public sector expenditure as a whole could not be allowed to increase to accommodate excessive pay increases and that such pay increases, if granted, must result in offsetting savings elsewhere, especially in the manning of the industry or service concerned. As far as possible the system of providing grants to nationalised industries, and other public authorities, should prevent the diversion of money intended for capital items into pay. It would be important that once cash limits were set, Ministers should stand by them, and the unions should be brought to understand that there was no scope for an appeal over their employers' heads to Ministers, as had happened in the past. Given these broad aims, the Committee now needed to see specific proposals before reaching any conclusions about cash limits for 1980-81. The Chancellor of the Exchequer should therefore provide, for a discussion in September, illustrative proposals for cash limits for the Civil Service, the National Health Service, and the Rate Support Grant Settlement. He should also re-examine the extent to which the assumptions underlying the cash limits could be kept

private, in spite of conventions governing Parliamentary publication, and Parliamentary Questioning. The Committee had not had time to discuss the points raised in his minute of 11 July by the Secretary of State for Industry. They agreed however, with the importance he attached to ensuring that all proposals to Ministers on ~~industrial~~ Individual pay cases should contain information to be agreed with the Treasury, on the cash limit implications of the proposals, and the scope for offsetting economies.

The Sub-Committee -

Took note, with approval, of the summing up of their discussion by the Prime Minister, and invited the Ministers concerned to be guided accordingly.

2. PAY, PRICES AND EFFICIENCY IN NATIONALISED INDUSTRIES

The Committee had before them a memorandum by the Secretary of State for Industry E(79) 16, concerning the objectives which the Government might set for the nationalised industries.

THE SECRETARY OF STATE FOR INDUSTRY said that the paper proposed general principles for dealing with pay, prices and efficiency in the nationalised industries, although the specific targets set would need to depend on the circumstances of each individual industry. In general for those nationalised industries which were not monopolies, a cash limit, with a required rate of return on capital, should provide an adequate discipline. For those industries which were monopolies, some additional criteria were needed, to prevent excessive wage increases, or inefficiencies being passed on in higher prices. Some form of price or performance standards might need to be set for these industries; for example the telephone service had adopted a target of not allowing costs of the service to rise in real terms. As far as possible the Government should aim to reduce the monopoly power of the nationalised industries.

In discussion it was noted that cash limits could not be expected to exert a very tight discipline on nationalised industries, since they were applied to the difference between very large gross figures of revenue and outgoings, and could be greatly affected by external factors. Moreover there could be no question of bankruptcy in major service industries which were essential to the life of the community. And many of the unions concerned had considerable muscle which could not realistically be ignored.

In discussion it was suggested that one problem in controlling nationalised industries arose because Governments were often not aware early enough that things were going wrong. A possible way of improving this would be to monitor the cash flow of the industries on a monthly basis against forecasts as was done in most major private enterprises. This would give early notice of any departure from normal. Requests for information of this kind need not imply a reduction in the "arm's length relationship", which the Government considered desirable with nationalised industry management.

THE PRIME MINISTER, summing up the discussion, said that the Committee were agreed that the proposals in the paper should be pursued, and specific proposals were now needed to allow a discussion in parallel with that on cash limits. The Chancellor of the Exchequer should therefore bring forward, for discussion in September, specific proposals as to how the general principles set out in the paper might be applied in the case of each of the main nationalised industries. He should also examine the desirability of obtaining improved information on the cash flow in these industries.

The Committee -

Took note, with approval, of the summing up of their discussion by the Prime Minister and invited the Chancellor of the Exchequer to be guided accordingly.

3. NATIONAL FORUM

The Committee had before them a memorandum from the Chancellor of the Exchequer E(79) 18 discussing the possibilities for a "forum" in which the Government could join with other interested parties, in discussing matters of general economic interest.

THE CHANCELLOR OF THE EXCHEQUER said that the proposal had been foreshadowed in the Manifesto. In his view such a body should be primarily educational in purpose. The paper discussed possible ways of setting up such a body, for example by broadening the basis of the National Economic Development Council (NEDC).

In discussion it was argued that the time might not be ripe for setting up a new body, which would inevitably be taken by the Press as a step towards a pay policy. Although there was undoubtedly an important educational job to be done, this might better be achieved by Ministerial speeches, rather than by a mechanism in which strongly conflicting views would inevitably be present and publicised. As to the NEDC while, as at present organised, it was not a particularly newsworthy organisation, and sometimes propagated arguments which were in conflict with Government's general strategy, it nevertheless provided a useful opportunity for Government to meet the TUC and CBI in a formal relationship. It would be a pity to destroy that relationship, in attempting to create a new body of unproven worth.

In further discussion it was argued that all the proposals canvassed in the paper underplayed the possible contribution to the educational process from Parliamentary involvement. The former Expenditure Committee had done a great deal to change the climate of opinion in recent years and although the new Select Committees were untried, and might indeed prove obstructive rather than educative, the possibility of enlisting them in the educational process should be examined.

THE PRIME MINISTER, summing up a brief discussion, said that the Committee were agreed that the proposal for a separate National Forum should not be pursued at present. A possible alternative should be examined, of a special meeting of the NEDC, enlarged for the occasion and held in public, to discuss

the economic prospects of the country. The Chancellor of the Exchequer should take soundings of the CBI, and TUC, at Director-General and General Secretary level respectively, as to whether a proposal on these lines was worth pursuing as an experiment. He should also consider how the Parliamentary Select Committee on the Treasury might be associated with such an initiative if it were adopted.

The Committee -

Took note, with approval, of the summing up of their discussion by the Prime Minister, and invited the Chancellor of the Exchequer to be guided accordingly.

4. FUTURE OF PAY RESEARCH

The Committee had before them a memorandum by the Lord President of the Council E(79) 14 discussing the future of the Civil Service non-industrial pay research system in the light of the Government's wider economic objectives.

THE LORD PRESIDENT OF THE COUNCIL said that as a result of the reviews now in progress the Government aimed to have a slimmer, more efficient Civil Service in the future. It would be important, in order to maintain morale, that staff should feel that the system by which their pay was determined was fair, and, in his view, some form of pay research was essential for this purpose. He therefore proposed that pay research should be retained and adopted regularly, so as to avoid the large "catching up" increases which had occurred from time to time in the past, but that a number of improvements should be made to the Pay Research Unit Board. This might be strengthened, for example, by the addition of a member with actuarial experience, and steps should be taken to make the Pay research process more visibly independent of the Civil Service.

In discussion, it was suggested that the National Association of Pension Funds might be able to suggest a suitable source of advice on pension aspects of Civil Service pay. However, the conclusion reached on the value of the index-linking provision for pensions depended more on the assumptions that were used, rather than the actuarial basis of the calculations. The reasonableness of the assumptions should be further examined in any future study.

THE PRIME MINISTER, summing up a brief discussion, said that the Committee were agreed that pay research should be retained, and that the visible independence of the Pay Research Unit Board should be improved in the manner proposed. On the question of pensions, the assumptions to be employed in future pay negotiations should be re-examined, and the availability of adequate actuarial advice to the PRU Board should be reconsidered, if necessary by the addition of a suitable additional member to the Board. The Committee would defer considering the question of no-strike agreements until a report was available from Ministers on this general question, as requested at the meeting of the Committee on 19 June (E(79) 3rd Meeting, Item 1). Cash limits for the Civil Service would need to be settled in the light of the principles discussed earlier in the meeting.

The Committee -

Took note, with approval, of the summing up of its discussion by the Prime Minister, and invited the Lord President of the Council to be guided accordingly.

71

5. STRATEGY FOR THE COAL INDUSTRY

The Committee considered a memorandum by the Secretary of State for Energy (E(79) 19) on the strategy for the coal industry. They also had before them a memorandum by the Secretary of State for Energy, E(EA)(79) 22, previously considered by the Sub-Committee on Economic Affairs (E(EA)(79) 7th Meeting, Item 2) to which was attached a note by officials.

THE SECRETARY OF STATE FOR ENERGY said that he was seeking the Committee's confirmation of the endorsement which the Sub-Committee on Economic Affairs (E(EA)) had already given to his general approach to the coal industry and its problems. He recognised that there was a number of financial matters still outstanding which he would need to resolve with the Chief Secretary, Treasury. The coal industry was essential to the nation but currently made heavy losses. The main thrust of his proposals was to accelerate the closure of uneconomic pits while maintaining investment in new capacity with a potential for high productivity. Such investment was justified on its own account but it was unrealistic to believe that accelerated closures could be achieved without it or without a generous approach to redundancy payments and transfer allowances. Even though there were risks in the strategy he was proposing, he believed that it struck a realistic balance between what was desirable and what stood a reasonable chance of being attained.

THE CHIEF SECRETARY, TREASURY, said that whilst he did not dissent from the broad strategy which the Secretary of State for Energy had advocated, he was concerned at the very poor state of the NCB's finances and that so much public money was locked up in high cost pits for which there was no future. In his view the aim should be to close uneconomic pits more rapidly than the Secretary of State for Energy had proposed and to reduce the prospective heavy drain on the public purse which the NCB's forecast implied. A start must be made to this end in 1980-81 with progressive improvement thereafter.

THE SECRETARY OF STATE FOR WALES, said that there was a risk that between 8,000 and 12,000 jobs would be lost from pit closures in South Wales over the next three years. A clear statement that the Government intended to invest in the development of mines which had the prospect of being viable was even more important than generous redundancy payments. The tripartite group

which had examined the prospects of the South Wales coalfield earlier in the year had recommended an annual investment of £25 to £30 million, in addition to the sums required to develop the Margam mine. If an investment programme on broadly that scale were accepted there was a reasonable hope that the miners might co-operate on the closure of uneconomic pits. Without such an investment programme the chance of co-operation was remote.

In discussion, it was argued that the strategies that had been adopted for the coal industry over the last 30 years had all failed. Resources provided for investment had been absorbed in wage increases for mineworkers. The latest productivity deal had not produced the additional output that had been expected and the cost had been high. Any new strategy would have to avoid repeating these mistakes. Local investment decisions were important as well as the total national sum involved. Great responsibilities rested on the NCB, but the Board's management did not inspire confidence, as ~~endorsed~~ evidenced by the way they had recently mishandled the proposed closure of the Deep Duffryn Pit. Moreover, it was difficult to reconcile the forecast of substantial redundancies in South Wales with the expectation that in most of the pits proposed for closure alternative jobs in nearby pits would be available for the miners displaced.

THE PRIME MINISTER, summing up the discussion, said that the Committee were broadly agreed on the desirability of accelerating the closure of uneconomic pits and accepted the need for continuing investment in those pits which had the prospect of profitability and high productivity. At the same time it was essential that the Government should avoid repeating past mistakes. In particular it would be necessary to avoid a situation in which money provided for investment was diverted to meet current pay demands. The financial prospects of the NCB were at the heart of the problem. A decision on the amount of finance to be made available to the NCB in 1980-81 was urgently required as part of the Government's review of public expenditure in that year. The Secretary of State for Energy and the Chief Secretary, Treasury should seek to reach quick agreement on this. Otherwise the matter would fall to be settled by the Cabinet at its imminent meetings on public expenditure. Similarly the two Ministers should seek to reach agreement on the finance required for the later years of the public expenditure programme which Cabinet would be considering in the autumn. If they failed to agree the issues should be brought back to the Committee before the Cabinet considered its expenditure programmes to 1983-84. The question of pit closures was obviously central to the NCB's financial prospects. Given that many of the pits at risk were in Scotland and Wales the Secretary of State for Energy, the Chief Secretary, Treasury and the Secretaries of State for Scotland and Wales should consider further what rates of phasing out of uneconomic capacity might be realistically obtained; what investment would be required to develop high productivity pits in these areas; and what level of redundancy and redundancy payments were likely to be needed. The Secretary of State for Employment should be associated with consideration of the latter issue. If the Ministers concerned were unable to reach a common view she would arrange for decisions to be taken in a suitable forum. Similarly the Secretary of State for Energy's proposals for the capital restructuring of the NCB should be considered in the first instance between himself and the Chancellor of the Exchequer. They should then report to her on the conclusions they reached so that she could decide whether any further collective discussion was necessary. Meanwhile the Secretary of State for Energy should examine and report to her, on the measures which might be necessary to improve the management of the coal industry. Questions of the structure of the NCB were not excluded from this examination.

The Committee -

Took note, with approval, of the Prime Minister's summing up of their discussion and invited the Ministers concerned to be guided accordingly.

6. FUTURE OF THE BRITISH NATIONAL OIL CORPORATION

The Committee considered papers by the Secretary of State for Energy, E(79) 20, 21 and 22, and E(DL)(79) 6. Their discussion and conclusions reached are recorded separately.

Cabinet Office

18 July 1979

Sir John
The PM has this in her folder.
JL

SECRET

CABINET OFFICE
A 2608
12 JUL 1979
FILING INSTRUCTIONS
FILE No. 115/4

cc Sir K. Berrill
x Mr. G. [illegible] 17/9/79
Mr. Mountfield
+ Copy Des. Lin Campbell. 18/7/79
G. Brown
K L Cawley
D. J. Mossman
Dup 1/8/79

FOLIO 70M

TOTAL COPIES 17

COPY No. 12

[PR]IME MINISTER

[P]AY INCREASES AND PUBLIC EXPENDITURE

[I] am increasingly concerned about soaring public expenditure on [p]ay. The Chancellor of the Exchequer's paper on "Public [E]xpenditure: the Economic Background" (C(79)27) has shown that [e]arnings in the public sector in 1980/81 are likely to be as [mu]ch as 18½% higher than in 1979/80 - largely as a result of [c]omparability awards - and that increases in pay are likely to add enormously to the projected total of public expenditure. This development leads me to think that we need to reconsider some of the decisions we have taken in our attempts to restrain the impact of pay increases on our public expenditure plans.

We have taken a series of decisions which we intended would impose some discipline on pay negotiations in the public sector and prevent the full cost of pay settlements feeding through into public expenditure. These decisions have been largely ineffectual:

a) we decided to reduce manpower expenditure in the civil service by 3% in the current year but to allow cash limits to be increased by the full amount of any pay settlements that might be reached. The pay of non-industrial civil servants has increased by 25%, the pay of industrial civil servants seems set to increase by about the same percentage (not all in this financial year) and London Weighting may go up by between 18% and 48%, but compensating economies are limited to the 3% figure, which is out of all proportion to the expenditure involved;

b we have reduced our expenditure on the Rate Support Grant by £300 million in England and Wales and by £35 million in Scotland but, although we have said the size of the cuts will be reviewed in the light of pay settlements, we are apparently committed to meeting a large percentage of the cost of any award which the Clegg Commission may give to the local authority manuals and the local authorities themselves are making a string of expensive settlements for which we are committed to pay the lion's share;

c we have (quite rightly in my view) increased cash limits to meet the cost of the pay settlements for the armed forces and the police but we have not considered whether manpower is deployed to best effect in either area and our decisions are being prayed in aid as a justification for other groups loosely connected with law and order to receive increases unmatched by offsetting economies;

d we decided to reduce Health Service cash limits by £24 million but, although we have said this figure will be reviewed in the light of pay settlements, our action seems to have done nothing to stop proposals for pay increases being put forward without consideration being given to offsetting economies; and

e we have not considered the expenditure implications of pay settlements in those few areas which are not cash limited and the idea seems to be abroad that, if an item of expenditure is not subject to a cash limit, there is no objection to it being increased to accommodate pay increases.

Part of the problem may have arisen because, of necessity, we took decisions in haste before the budget. Another part of the problem may stem from a belief that we are in a transitional period between the old and the new ways and that all will be well when we introduce our new disciplines in the next financial year. The fact of the matter is that public expenditure on pay is soaring without real restraint, while the decisions on phased pay increases which have been taken, and which we are shortly about to take, have expenditure implications for the 1980/81 financial year and beyond. Although few major settlements are due before the end of the calendar year, the new pay round starts in August and will affect public expenditure in 1980/81. In my view it is critically important to ensure that from this moment on, all concerned with public sector pay negotiations understand that:

a pay increases involve increases in public expenditure;

b increases in public expenditure limit our scope for reducing the PSBR and taxation; and

c public expenditure should not be increased while there is realistic scope for offsetting the cost of pay settlements through manpower reductions or increased productivity.

I have attempted to deal with some of the symptoms of the problem by instructing the Secretaries to E(EA) that they should not circulate papers which do not identify the cost of proposed pay settlements, the effect on cash limits (if any), the scope for offsetting action to keep expenditure within cash limits (including price increases and reductions in manpower), and, where economies are not practicable, the cost of proposed pay increases in terms of tax or rate increases. The responses of my colleagues have varied but that is a matter I can pursue in E(EA) Committee. There are it seems more serious underlying problems which need discussion either in E Committee or Cabinet.

I suggest that we should consider the following points:

a the desirability of reopening Cabinet's decision that this year's cash limits on Civil Service pay-related items should be reduced by only 3% before being increased to take account of pay increases to establish whether we can substitute a significantly larger percentage reduction in particular areas to offset the costs of particular settlements, for example the industrial civil service;

b the need to review those few areas of public expenditure which involve pay costs but which are not cash limited to establish the scope for manpower economics to offset the cost of pay increases and to identify any changes which may be required in practices and procedures (or in legislation) to make it possible to achieve such economies;

c the need to review the decisions that the health authorities and the universities should bear only the first £24 million and 2% respectively of the cost of pay settlements over the provision in their respective cash limits to ascertain whether there is scope for further economies to offset the cost of pay settlements in the current financial year;

d the need to bring home to the local authorities that any excessive settlements for their APTC grades and for other groups will be met by a further reduction in the Rate Support Grant over and above the £335 million we have cut so far;

e the need to identify the extent to which decisions we have taken on Clegg awards etc. (and the decisions we are about to take on the industrial Civil Service) have committed us to extra expenditure next year and the nature of the economies needed next year to offset these costs;

f the desirability of amending the Rate Support Grant arrangements for the next financial year so as to ensure that our contribution to local authority pay settlements is a <u>fixed sum of money</u> rather than a percentage of whatever extra expenditure the local authorities choose to commit themselves to;

g the scope for dealing separately with local authority

the scope for dealing separately with local authority

and for fixing separate limits on our RSG contributions to each so as to force local authorities to consider offsetting pay increases by cuts in manpower rather than in services; and

h the desirability of some reform in the Whitehall Committee machinery to ensure that those concerned with the administration of cash limits comment directly on proposals for pay increases and the scope for offsetting economies before papers are submitted to Departmental Ministers or to E(EA) Committee.

I realise that these proposals will not be popular with all our colleagues but something needs to be done if we are to achieve our overall objectives. Apart from point (h) which is a matter for you alone, I suggest that we need a discussion in E Committee which could recommend that Cabinet should reopen its decision on points (a) to (d) and that papers should be prepared on points (e) to (g) for discussion in E(EA) Committee.

I am copying this minute to members of E Committee and to Sir John Hunt.

KJ

K J

11 July 1979

Department of Industry
Ashdown House

SECRET

ca

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

COPY NO 18

CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

LIMITED CIRCULATION ANNEX
E(79) 5TH MEETING, MINUTE 6,
TUESDAY 17 JULY 1979 at 10.00 am

SECRET

6. FUTURE OF THE BRITISH NATIONAL OIL CORPORATION

The Committee had before them three memoranda by the Secretary of State for Energy, E(79) 20, 21 and 22, together with an earlier paper E(DL)(79) 6, all dealing with the future of the British National Oil Corporation and with various ways of disposing of some or all of its assets.

THE PRIME MINISTER said that the Chancellor of the Exchequer, in his Budget, had taken credit for the sale of part of the Government's holding of shares in British Petroleum (BP) during the financial year 1979-80, as part of his programme of disposals. Since the Budget, a number of Ministers had reconsidered the advisability of a sale of BP shares this year, given the prospect that they might appreciate considerably in future, and that they gave an additional measure of control over oil meanwhile. It had therefore been suggested that, instead of selling BP shares, the Government should arrange for the sale of some or all of the up-stream assets of the British National Oil Corporation (BNOC) to BP, which would be financed by a loan and rights issue by BP. HMG would have to relinquish its share of any rights issue. But this would leave BNOC assets under BP control. The method involved would require legislation. The sale price would have to be negotiated with BP. The rights of existing partners in the fields would have to be taken into account. It was not clear that the operation would be completed within the present financial year. But if this proved possible, this would be an attractive alternative to the original proposal of selling the BP shares.

SECRET

80
RA

THE SECRETARY OF STATE FOR ENERGY said that BNOC had at present three main functions: to develop its 'up-stream' assets, which involved an equity stake in a large number of existing oil fields; a major role as an oil trading company, using oil to which it had access under its participation agreements; and a statutory role of adviser to the Government on oil policy. In his paper E(DL) 6, which had been considered by the Sub-Committee on disposals of assets at an earlier meeting, (E(DL)(79) 2nd meeting) he had suggested that the Corporation's various activities should now be dis-entangled. It should be deprived of its formal advisory role, and removed from membership of the operating committees of fields in which it had no equity interest. It should retain its oil trading role, at least in present conditions, because of the important control which this gave over the destination of oil; its up-stream assets should be placed in a subsidiary company, shares of which could then be offered for public sale so as to secure the widest possible dispersal of ownership in a way which would be politically irreversable. The last proposal could be varied, for example by selling the whole of BNOC's up-stream assets to BP. Though this raised a number of other complicated problems, stemming, in part, from the rights of BNOC's existing partners. He also proposed that BNOC should shed its current license obligations, especially those which it would obtain under the sixth round of licensing, on which an announcement was due shortly. In the immediate future, he was prepared to ensure that BNOC would dispose of assets worth around £250 million, by selling their interest in Viking and Statfjord fields, and possibly those in the Dunlin, Murchison and part of the Ninian fields. The risk of carrying disposals to the point of including the whole of the Ninian field was that BNOC would be thereby deprived of its major source of current revenue and forced to rely on additional public finance. Moreover, in order to ensure continued British control of the oil in these fields the sales would have to be made to BP and this could lead to difficulty with BNOC's existing partners who enjoyed various pre-emptive rights in the event of a sale of BNOC's share of the fields concerned. He had also considered the sale of the British Gas Corporation's on-shore oil field at Wytch Farm to BP, but it was now clear that BP did not wish to purchase this.

In discussion, it was first argued that the Government was committed to make disposals totalling £1,000 million in 1979-80. £180 million had already been firmly agreed, from the National Enterprise Board and other sources. There was a possibility of another £70 million from disposals of assets of the New Towns Corporations. Sales of two or three oil field interests by BNOC, on the lines already suggested, might yield up to a further £250 million. The Government would still be £500 million short. It might be possible to find more, either through additional disposals, or through bringing forward disposals planned for 1980-81, or by making savings in on-going programmes. For example, some of the investment of the nationalised industries might be deferred to the following year. However it seemed unlikely that measures of this kind would be enough to bridge the gap. It was therefore necessary to keep open the option of disposing of at least some of the BP shares later in the year.

Against this, it was argued that it would be a mistake to dispose of the BP shares. They might appreciate substantially in price in the next few years. They afforded a degree of control over the destination of British oil. It would be politically difficult to explain why the Government was intent on disposing of these valuable assets to meet short term requirements. Although 51 per cent of the share in the company were held in the public sector, 20 per cent, now owned by the Bank of England, and previously belonging to Burmah Oil Company, were still the subject of Court action and might have to be returned to their original owners. There was a risk therefore that a sale of approximately 15 per cent, as envisaged at the time of the Budget, might reduce the Government's stake to about 16 per cent which was insufficient to ensure that control would remain in British hands. It was important to be seen not to dispose of any major national asset of this kind. On the other hand, there was less objection to a small reduction in the Government's holding through failure to take up the Government's share in a future rights issue. This had happened before.

In further discussion, it was suggested that the most straightforward alternative to sale of the BP shares was, the transfer of all BNOC's up-stream assets to BP. There were, however, serious difficulties in this course. It would in particular require the consent of the other partners in each individual field on a case-by-case basis, depending on the terms of the original consortium arrangements. The Attorney-General's advice on each case would be essential. In many cases, the other partners would have to be prepared to relinquish their pre-emption rights, to facilitate the sale to BP. Unless and until such agreement was secured, the

Government could not announce that it was disposing of the assets to BP. Clearly the complex negotiations involved would take some time to complete and it might be that the proceeds of the sale could not be received in the present financial year when they were required. There was, moreover, a complication arising from BP's tax position which might reduce the net benefit to the Exchequer of sales of BNOC assets to that company. On the other hand BP, as a British company, was the best potential purchaser in sight, and had the technical expertise to develop the BNOC assets speedily. Whereas BNOC's own technical capacity was in doubt.

In yet further discussion attention focussed on a mixed solution with early disposal of only some part of BNOC's upstream assets in the present year with further sales, or privatisation, following later. The balance of the Chancellor's requirement could then be made up from a more limited sale of BP stock. The possibilities for early sale, in order of preference, were the BNOC interests in Viking, Statfjord, Dunlin, Murchison, and possibly part or all of Ninian. These sales would still leave BNOC with substantial upstream interests whose future could be decided later. Such assets would make it easier to attract private capital into BNOC in a way which would not be possible if it were confined to a trading role. To finance the purchase of this size, and still more of the complete assets, BP would need to raise fresh capital, and in order to preserve its debt/equity ratio, it would be necessary to find part of this by means of a rights issue. The Government would presumably not wish to take up its share of these rights, and its present holding would therefore be diluted. But this might be preferable to the very much larger direct sale of BP stock originally proposed.

It was also argued that it was now important to proceed with the issuing of licences awarded in the Sixth Round. The terms on which applications had been sought included an automatic right for BNOC to participate in every licence. Given that it was not now the intention for BNOC to be granted such rights, the alternatives were to allocate the licences on the present basis, but then to extricate BNOC from its involvement; or to delay the issue of new licences while fresh offers were sought without BNOC's participation. The latter course would set back exploration programmes under these licences and delay the issue of Seventh and subsequent rounds of licences. It would thus risk a considerable loss of momentum in the development of North Sea assets.

THE PRIME MINISTER, summing up the discussion, said that the Committee had reached no decision either about the future of BNOC, or about the disposal of its assets or of the Government holding of BP shares. The Chancellor of the Exchequer should arrange for the Sub-Committee on Disposal of Assets (E(DL)), together with the Attorney General, to consider at its next meeting on 19 July the legal difficulties in the way of a sale of some or all of BNOC's upstream assets to BP, the legislation which would be required and the timing and scale of receipts under the various options. He should report the Sub-Committee's conclusions in time for the Committee to resume its discussion at its meeting the following week. The Option of selling some or all of the BP shares should be kept open for the time being. No announcement should be made about the sixth round of licencing or of the future of the BNOC pending that discussion.

The Committee -

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

Cabinet Office

17 July 1979