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E(80) 24th Meeting

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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

MINUTES of a Meeting held at
10 Downing Street on
WEDNESDAY 9 JULY 1980 at 10.30 am

PRESENT

The Rt Hon Margaret Thatcher MP
Prime Minister

The Rt Hon William Whitelaw MP
Secretary of State for the
Home Department
(Items 1 and 2)

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 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 Nicholas Edwards MP
Secretary of State for Wales
(Items 1 and 2)

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

The Rt Hon Norman Fowler MP
Minister of Transport

Baroness Young
Minister of State, Department of Education and Science
(Item 1)

Mr Norman Tebbitt MP
Parliamentary Under-Secretary of State, Department of Trade

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\. LOCAL AUTHORITY CURRENT EXPENDITURE - 1980-81.

Previous Reference: E(80) 17th Meeting, Item 2

THE COMMITTEE considered a memorandum by the Secretary of State of the Environment (E(80) 63) on local authority current expenditure in 1980-81.

THE SECRETARY OF STATE FOR THE ENVIRONMENT said that all authorities in England and Wales had been asked to review their expenditure plans and made new returns by 1 August. Their Returns of Expenditure of Rates (RER) in March had suggested that their budgets would be 5.6 per cent, or £900 million, over target. His present judgement was that, provided that the majority of local authorities responded to the call for revised budgets, the prospect would be of an excess of 2 per cent to 3 per cent, or £300 to £500 million, above target. About half of this might not be spent, leaving a net excess in the order of £150 million to £250 million. He would report in September on the revised assessment and put forward proposals for action to deal with it. The options for such action fell into two groups: those directed at offsetting reductions in capital expenditure, which would penalise authorities indiscriminately and would cut investment to protect revenue expenditure and jobs, and those acting through the Rate Support Grant (RSG) arrangements, to which authorities could respond by turning to other sources of finance, including increases in the rates. Pending his further report in September, he recommended that Ministers should establish a close control over approvals for local authority capital schemes; let only those which were essential go ahead; and guard against any attempt to accelerate capital expenditure against the possibility of a moratorium later in the year.

THE SECRETARY OF STATE FOR SCOTLAND said that he was hopeful that, following the action he had already taken, the Scottish local authorities would bring their budgets down to target. He would report further in September.

In discussion there was general support for the approach proposed by the Secretary of State for the Environment and for keeping all the options open for offsetting action. Local authorities should know of the possibility

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that these options might be deployed, in order to encourage them to take vigorous action to get back on target. Failure to control local authority current expenditure would be highly damaging to confidence in the Government's will to control public expenditure.

In further discussion the following points were made -

a. It was important not to forfeit the co-operation of local authorities who were genuinely trying to control the growth in ~~bear~~ their expenditure by adopting measures which would affect all authorities indiscriminately.

b. Under the proposed new Block Grant arrangements it would be possible to put differential pressure on over-spending authorities. The current problems presented an opportunity to bring home to the local authorities that these new arrangements were fairer to authorities which did control their expenditure.

c. There was little scope for further savings on capital expenditure in 1980-81, since most of it was committed already. If action had to be taken, it might be best to act through the RSG, even though this would be at the expense of all authorities and not solely those who were over-spending.

d. A weakness of the present arrangements was that local authorities could respond to financial pressures on them by putting up the rates. Rate-payers collectively did not react vigorously enough to this. Consideration might be given to making some financial decisions by local authorities ~~were~~ subject to specific approval by the electorate. The position of industrial and commercial rate-payers should also be reviewed to see whether the disadvantage that they were taxed but not represented, could be overcome. Another possibility would be to bring pressure on the authorities by exposing them more fully to market disciplines.

THE PRIME MINISTER, summing up the discussion, said that the Committee would consider the position further in September in the light of the revised assessment and of specific proposals which the Secretaries of State for the Environment

and for Scotland would be putting to them. In the meantime all the options for possible offsetting action which the Secretary of State for the Environment had suggested should be kept open. In the meantime only essential new approvals of capital schemes should be given.

The Committee -

1. Invited the Secretaries of State for the Environment and for Scotland to report further in September on the likely out-turn of local authority current expenditure in 1980-81 and to make proposals for any further action which might be necessary to deal with prospective over-spending.

2. Invited the Secretary of State for the Environment to consider whether there were other means which might be deployed of subjecting local authority finances to greater democratic control and to deal with the disadvantaged position of industrial and commercial rate-payers.

2. THE NATIONALISED INDUSTRIES: 1980 INVESTMENT AND FINANCING REVIEW

The Committee considered a memorandum by the Chief Secretary, Treasury (E(80) 64) covering a report by officials on the 1980 Investment and Financing Review of the Nationalised Industries.

THE CHIEF SECRETARY, TREASURY, said that the review indicated substantial increases in the borrowing requirements of the nationalised industries by comparison with the provision in the last Public Expenditure White Paper (Cmnd 7841). The financial difficulties of the four loss-making industries - coal, rail, steel and shipbuilding presented a serious threat to the Government's financial strategy. There were additional bids for investment and external finance by the Post Office for telecommunications. The requirements of the other industries could increase if, as now seemed likely, their present assumptions about the prospects for economic growth proved to be too optimistic. It was no longer prudent to take credit for any of the £470 million short-fall which had been assumed in arriving at the Cmnd 7841 totals. Either the provision for the nationalised industries or other spending programmes, would have to be cut in order to keep within the overall public expenditure totals. He had set out proposals for cuts which might be applied to each of the nationalised industries, other than the loss makers, for discussion with sponsoring Ministers. In the light of this it would be possible to provide a basis for setting the External Financing Limits (EFLs) in the autumn. Until the EFLs were settled, he recommended that the industries should not be given approval to make investment commitments above the "85 per cent level" approved last year. This year's review had highlighted a number of problems about the assessment of the industries' investment proposals and some of the industries had been unco-operative in responding to questions from Departments. He invited the Committee to agree to recommendations by officials for improving the arrangements for future reviews.

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In discussion the following points were made -

a. The Secretary of State for Industry would be discussing the prospects of the British Steel Corporation (BSC) and British Shipbuilders (BS) with the new Chairmen and would report on the outcome in September. British Rail's (BR) freight business was suffering from loss of customers, and on the passenger side the returns from inter-city services were disappointing. Remedial action was under consideration to deal with BR's EFL in 1980-81. The Minister of Transport would put proposals to the Committee in September.

b. The Secretary of State for Energy would report on the finances of the National Coal Board (NCB) later this month. The Government would be faced with a number of problems on coal. The National Union of Mineworkers would probably make a political issue of what they regarded as a severe financial target and they would compare the subsidies paid in the United Kingdom unfavourably with those elsewhere in the European Community. There could be acute difficulties in South Wales, because of the collapse of the demand for home-produced coking coal: it could not compete on price with imported coal; BSC's demand was down, and the Corporation was likely to meet an increasing part of their reduced needs from imports.

c. In the profitable nationalised industries cuts should not fall on strategically essential, as distinct from commercially desirable, investment. It would be important not to lose the co-operation of those industries which kept within their EFLs and which had already made substantial cuts, otherwise there was a strong risk that in future they would protect themselves by building fat into their forecasts.

d. It was generally agreed that the proposals for improving the arrangements for future reviews should be pursued. Any necessary co-ordination would be handled by the Sub-Committee on Nationalised Industry Financing (E(NF)). The Sub-Committee would usefully look into the broader question of regulating the pricing policies of the monopoly nationalised industries.

THE PRIME MINISTER, summing up the discussion, said that the review revealed a serious deterioration in the prospects for the nationalised industries by comparison with the provision in Cmnd 7841. The Committee wished to have as soon as possible reports on the four main loss making industries, giving an up to date assessment of the figures and making proposals for any new policy measures which might be necessary. All the options proposed by the Chief Secretary for cuts in the other industries should be kept open. The Committee would discuss them further after the Recess and in the light of the discussions which the Chief Secretary would have on each of them with the sponsoring Ministers.

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 circulate a report on the finances of the National Coal Board in time for discussion in the week beginning 21 July, and to make proposals in due course on the timing of the development of the Clyde oil field and of the British Gas Corporation's Morecambe Bay gas field.

3. Invited the Secretary of State for Industry to report as soon as possible in September on the finances of the British Steel Corporation and of British Shipbuilders.

4. Invited the Minister of Transport to report as quickly as possible, but in any case not later than early September, on the finances of British Rail.

5. Invited the Chief Secretary, Treasury, to discuss with each of the sponsoring Ministers concerned the options for cuts listed in Table 3 of the report by officials attached to E(80) 64 and to report the outcome after the Recess.

6. Agreed to the recommendations for improving the arrangements for future reviews and the co-operation of the industries in paragraphs 16-17 of the report by officials attached to E(80) 64, and invited the Chancellor of the Exchequer to arrange for the Sub-Committee on Nationalised Industry Financing (E(NF)) to co-ordinate this work as necessary and also to consider possible methods of regulating the pricing policies of the nationalised monopolies; and

7. agreed that, until the External Financing Limits for 1981-82 were settled, the nationalised industries should not be given approval to make investment commitments above the "85 per cent level" approved last year.

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3. INVESTMENT AND FINANCING REVIEW: TELECOMMUNICATIONS

The Committee considered a memorandum by the Secretary of State for Industry (E(80) 65) on the possibilities for cuts on the telecommunications investment programme proposed by the Post Office and also on the level of the financial target.

THE SECRETARY OF STATE FOR INDUSTRY, said that telecommunications had put in additional bids for finance totalling nearly £500 million over the three years 1981-82 to 1983-84. He recommended that the investment programme should be approved in its entirety for 1981-82 and 1982-83 (£1545 million and £1500 million respectively,) but that in 1983-84 it should be cut back by £100 million from the proposed total of £1578 million. This would allow more time to examine the possibilities and implications of privatisation of activities such as Prestel and Radiopaging but he could not recommend further cuts in telecommunications investment by the Post Office, which had a pivotal role to play in the development and promotion of the nation's information technology hardware and software. Cuts in new exchange equipment orders would affect both the cash flow to manufacturing industry and employment in it. He would be contented that the Telecommunications financial target should be a real return on net assets of 6½ per cent in 1981-82 and 1982-83, on the understanding that consideration would be given to reducing the level of the target when financial constraints permitted and if there were any significant alteration in cash flow as a result of accounting changes. If this were not accepted, there would be further substantial increases in the Post Office's bids for extra finance in the period.

The Committee -

1. Agreed that the Post Office telecommunications financial target should be set at 6½ per cent for 1981-82 and 1982-83, subject to the reservations made by the Secretary of State for Industry on the possibility of revision at a later stage.

2. Agreed that the capital investment programme should be cut by £100 million in 1983-84.

3. Invited the Secretary of State for Industry to discuss with the Chief Secretary, Treasury the case for further investment cuts in the period 1981-82 to 1983-84.

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4. TELECOMMUNICATIONS: PAY NEGOTIATIONS AND 1980-81 EXTERNAL FINANCING LIMIT

The Committee had before them a letter of 4 July from the Secretary of State for Industry to the Chancellor of the Exchequer, and a minute of the same date from the Chancellor of the Exchequer to the Prime Minister, about negotiations with the Post Office Engineering Union (POEU) on its 1979-80 pay settlement and the consequences for the External Financing Limit (EFL) of Post Office Telecommunications.

THE SECRETARY OF STATE FOR INDUSTRY said that the Chairman of the Post Office was reasonably confident that the POEU Executive would be willing to accept a settlement of around 20 per cent, rather than the 37 per cent which they had claimed. It would be unrealistic to expect them to agree to anything significantly less. Strike action would be highly damaging both to the public sector borrowing requirement - as last year when telephone billing was disrupted - and to business and the international networks on which the City was dependent. A settlement at this level would add to the overrun on the Telecommunications EFL for 1980-81 and it would be necessary to take action to offset an excess in the order of £470 million. He proposed that this should be done by a 20 per cent tariff increase from 1 October which would yield about £240 million in the year; by deferring investment of £50 million; by deferring payments of £100 million to creditors; and by delaying the pay increase or deferring further investment to find the balance of £80 million. Subject to the views of the Secretary of State for Trade, he considered that the tariff increase should be accompanied by a reference to the Monopolies and Mergers Commission. He also intended to accelerate the introduction of measures to reduce the Telecommunications monopoly.

In discussion the following points were made -

a. It was deplorable that the Post Office should be expected to find a considerable part of their offsetting savings from deferring payments to their creditors, often at the expense of smaller companies who were already in cash flow difficulties and would effectively be called upon to give interest free loans to the Post Office.

b. It would be preferable to find more money by further investment cuts which, even at this late stage in the year, should be practicable on a programme of over £1½ billion, and by deferring the implementation of the pay increases. It was recognised that there were limits to the extent to which the Post Office could cut investment without breaking contracts and being forced to pay compensation costs.

c. The Post Office management should be required to prepare, or allow to be prepared, a comprehensive report on restrictive labour practices in the corporation. Under present arrangements the management of the business appeared to be dominated by the unions.

THE PRIME MINISTER, summing up the discussion, said that the Committee accepted that the Post Office should be left to settle the Post Office Engineers' 1979-80 claim, at about 20 per cent if that were the least that was negotiable. They further reluctantly accepted that to deal with the prospective excess of £470 million on the Telecommunications EFL there should be an increase in Telecommunications' tariffs of 20 per cent from 1 October. The Government should make clear that this increase was directly attributable to the POEU's wage claim and the Post Office's failure to manage their finances within the EFL. The Committee were particularly concerned by the proposal that £100 million of the excess on the EFL should be financed by the deferring of payments to creditors. The Secretary of State for Industry should press the Post Office to replace the savings to be found in this way as far as possible by further investment cuts or a longer deferment of the payment of the pay increases.

The Committee -

1. Approved the proposals of the Secretary of State for Industry for bringing the Post Office's external financing requirement in 1980-81 back within the External Financing Limit, including the proposal for a 20 per cent telephone tariff increase from 1 October 1980.

2. Took note that the Prime Minister would consider further with the Chancellor of the Exchequer, the Secretary of State for Industry and the Secretary of State for Trade the possibility of a reference on Telecommunications to the Monopolies Commission.

3. Invited the Secretary of State for Industry, in consultation with the Secretary of State for Employment, to consider seeking a report from the Post Office management on restrictive practices within their telecommunications business.

4. Invited the Secretary of State for Industry to inform the Chairman of the Post Office of the Government's concern over the situation which had arisen, and to urge him to seek an opportunity to make a major speech on the need to stamp out restrictive practices in the Post Office.

Cabinet Office

10 July 1980