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E(80) 14th Meeting

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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

MINUTES of a Meeting held at
10 Downing Street on
THURSDAY 24 APRIL 1980 at 9.45 am

PRESENT

The Rt Hon Margaret Thatcher MP
Prime Minister

The Rt Hon William Whitelaw MP
Secretary of State for the Home Department
(Item 1 only)

The Rt Hon Lord Carrington
Secretary of State for Foreign and Commonwealth Affairs
(Item 1 only)

The Rt Hon Sir Keith Joseph MP
Secretary of State for Industry

The Rt Hon James Prior MP
Secretary of State for Employment

The Rt Hon Michael Heseltine MP
Secretary of State for the Environment

The Rt Hon John Nott MP
Secretary of State for Trade

The Rt Hon 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
(Item 1 only)

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. INMOS
Previous Reference: E(80) 10th Meeting, Item 2

The Committee considered a further memorandum by the Secretary of State for Industry (E(80) 36) on the application by INMOS for an Industrial Development Certificate (IDC) to enable their first production unit to be built at Bristol.

THE SECRETARY OF STATE FOR INDUSTRY recalled that, at its previous discussion on this subject, the Committee had decided not to issue an IDC to enable INMOS to build a factory at Bristol unless new facts emerged in the course of his discussion with the Company which invalidated the grounds on which this decision had been taken. Two such facts had emerged. First, INMOS had now indicated that, if the Government would not grant an IDC for Bristol, they would withdraw their application for a further £25 million funding from the Government and, instead, seek private capital in the United States and transfer their operations to Colorado Springs where a pre-production unit had already been built, at a cost of £20 million to the National Enterprise Board (NEB). INMOS were convinced that they could raise private capital in the USA for this purpose, and could establish a profitable operation out of which to repay - eventually - the £25 million made available to them by the last British Government. The result would be a purely American venture, with no facilities or jobs in the United Kingdom, either in the Assisted Areas or elsewhere. The NEB could be expected to consent to this operation in the interests of recovering their present equity investment as soon as possible. In the meantime both the NEB and INMOS claimed that the delay by the Government in reaching a decision was putting the whole project at risk.

Secondly, Sir Arnold Weinstock was still considering the possibility that the General Electric Company Ltd (GEC) might invest in INMOS. GEC's own micro-electronics collaborative partnership with Fairchilde had run into difficulties and could well founder. GEC had a high regard for Mr Schroder of INMOS. They had a site at Neston in Lancashire which could be used for INMOS production and which was already being supported by regional grants. The NEB and GEC were still negotiating and the outcome was highly uncertain. Even if GEC decided they wanted to go ahead, it could well be that INMOS would not want to work with them, particularly if their present highly attractive contracts had to be amended.

There was thus a dilemma. There was now no possibility of INMOS siting its first production unit at Cardiff. If the Government now approved an IDC at Bristol and the further £25 million investment, GEC could publicly criticise their decision on the grounds that public expenditure had been committed when private sector finance was available. On the other hand, if there were undue delays for negotiations with GEC, INMOS could decide to withdraw their application and to concentrate on their Colorado Springs plant alone. This could provoke a major confrontation between the Government and the NEB, whose members had only recently been appointed following the resignation of the previous Board. He recommended that the Committee should decide provisionally in favour of granting an IDC for the Bristol site. This decision should be reported in confidence to the Chairman of the NEB, but it should not otherwise be made known. The NEB and GEC would be given one month to negotiate further. If the outcome were successful, and GEC were willing to invest, that could save further public expenditure. INMOS' first production unit might then go to Neston, but that would be a matter between GEC and INMOS. If the negotiations failed, final approval should be given to the IDC at Bristol.

In discussion the following were the main points made -

a. The new developments described by the Secretary of State for Industry called in question not only the location of the first production unit, but also whether the Government should advance a further £25 million to INMOS. This sum should not be committed until the Government were satisfied that GEC would not invest instead. If INMOS were to decide that they did not want to go ahead in the United Kingdom - either with or without GEC - and that they would confine themselves to an American venture, there would be public expenditure savings. The £25 million already committed could be recovered in time by the NEB if the Colorado Springs venture was successful. Commitment of a further £25 million would be avoided, and so would the risks of having to commit more than the planned total of £50 million if INMOS ran into serious difficulties. These sums were significant by comparison with difficult and unpopular public expenditure cuts which had already been made, and with the sums still available for support to industry.

b. The terms of the contract offered to the INMOS entrepreneurs, and approved by the last Government, were unsatisfactory. They had risked only £70,000 of their own money, but appeared to be free to dictate terms on how and where £50 million of Government financed equity should be spent. As it was, £20 million had so far been spent in the USA. The terms of the contract, and this initial commitment to funding in the USA, were the responsibility of the last Government, but the present Government could be open to criticism if they advanced a further £25 million without giving GEC a chance to step in.

c. A decision to grant an IDC to INMOS in Bristol could be defended. If it was the Government's policy to support investment in high technology industries, particularly the micro-electronics sector, it could be argued that companies such as INMOS should be allowed to back their managerial judgement on questions of location. Moreover, unless GEC were to invest quickly, a decision in favour of a Bristol site could be presented as a move necessary to avoid losing the project to the United Kingdom altogether. Finally a decision not to grant an IDC for the Bristol site would now, in the light of the recent social unrest there, seem less perverse than it would have seemed a month ago: indeed, a refusal might expose the Government to considerable criticism.

d. The Committee had previously accepted that there were strong reasons of regional policy for continuing to refuse an IDC for the factory in Bristol. While the Government could not direct INMOS to site the plant in Cardiff, or indeed elsewhere, it was important that they should be encouraged to move to an assisted area. If they were to choose South Wales, that would be seen as a major new development offering hope for the future in an area where actual and prospective closures in the coal and steel industries posed particular difficulty.

THE PRIME MINISTER, summing up the discussion, said that the Committee were not yet able to take final decisions on either the INMOS application for an IDC at Bristol or the provision of the second £25 million tranche of NEB finance to the company. They first needed to know whether GEC could successfully negotiate terms with the NEB and the INMOS Board for GEC participation in the venture. The Secretary of State for Industry should press for an early resolution of this uncertainty and should report back to the Committee within a month. The Committee would also need, before its renewed discussion, to have further information about the terms of the contractual arrangements made with INMOS, and approved by the previous Government.

The Committee -

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

2. Invited the Secretary of State for Industry -

a. to report back within one month on whether GEC participation in INMOS could be arranged;

b. to provide the Committee before then with detailed information on the terms of the contractual arrangements with INMOS.

2. ELECTRICITY (ENGLAND AND WALES) - EFL, 1980-81

THE COMMITTEE considered a memorandum by the Secretary of State for Energy (E(80) 34) on the domestic tariff increases and cost savings necessary for the electricity supply industry, in England and Wales, to keep within its External Financing Limit (EFL) for 1980-81.

THE SECRETARY OF STATE FOR ENERGY said that the Industry's EFL for 1980-81 had been set at £187 million last November. It was then thought that this would involve domestic tariff increases of 17 per cent in April and 5 per cent in October 1980. But since then the estimated costs of the industry had increased by £290 million - mainly because of higher fuel costs, higher salary settlements, and a more pessimistic view of sales revenue. To deal with this the Electricity Council had decided at their meeting on 17 April that there should be an increase of 10 per cent on domestic tariffs in August, yielding £150 million in 1980-81; further capital investment cuts of £52 million; and further economies to find the balance of £88 million. It was unsatisfactory that they had not yet identified how these £88 million savings should be found but one element could be reductions in fuel stocks. This would be risky and could have an adverse effect on the financial position of the National Coal Board. The full effects on the Retail Price Index (RPI) of a 10 per cent tariff increase in August would be 0.29 per cent, but this would not work through to the index until December. In view of the over-riding importance of not breeching the EFL he invited the Committee to endorse the proposed tariff increase.

In discussion the following main points were made -

a. The Electricity Council should be told that in looking for their further savings of £88 million they should rule out the possibility of further reductions in their fuel stocks. It was essential that stocks should be maintained in order to sustain endurance in the peak winter months when there were great uncertainties over demand and the risk of industrial disruption affecting fuel supplies.

b. Maintenance of the electricity and other nationalised industry EFLs were essential if the Government were to achieve its public expenditure objectives between now and 1983-84; and already the improvement in nationalised industries' financing had been identified as the most vulnerable area of the Government's public expenditure plans. Even if the proposed increase of 10 per cent in August went ahead, and the EFL was held to £187 million, the industry would be uncomfortably below the path towards meeting its financial target of an average return on their net assets, in current and accounting terms, of 1.8 per cent a year over the next three years. This, together with a decision not to allow further stock reductions, meant that it could be prudent to go for a higher or earlier price increase than that proposed. This could be achieved either by advancing the proposed 10 per cent increase from August to July or by seeking a 12 per cent price increase in August.

c. The objective of maintaining EFLs, and of meeting medium term targets for public expenditure, had to take into account the short term effects on the RPI and the repercussions of this on public expenditure in later years. The proposed increase would have an unwelcome effect on the RPI towards the end of 1980. Because of index linking this would lead to increases in some public expenditure costs, such as social security benefits, next year. This pointed to accepting the Electricity Council's proposal of 10 per cent rather than 12 per cent. The yield in 1980-81 would be increased if the timing could be advanced into July. But this was now probably impracticable because of the statutory requirement to consult Consumer Consultative Councils before bringing a price increase into effect.

d. There should be an urgent inquiry into the efficiency of the industry, with particular reference to its control of costs. This could be undertaken by the Monopolies and Mergers Commission who were keen to make an inquiry into the costs of a fuel industry. They could probably complete such an inquiry within about six months.

e. The Secretary of State for Energy was already reviewing the possibilities for legislation to increase competition in the electricity supply industry. He was also considering the organisation of the electricity industry in England and Wales whose management deficiencies were highlighted by the present situation. He hoped to achieve useful changes here without legislation in the first instance.

THE PRIME MINISTER, summing up the discussion, said that the Committee agreed that the Electricity Council should go ahead with their proposed 10 per cent increase in domestic tariffs. If it was no longer practicable for the increase to take place in July, it should take place as early as possible in August. The Council should be informed that they should exclude fuel stocks from their search for further savings. Both the quality of the management and the organisation of the industry were unsatisfactory, and the Committee would wish to consider proposals from the Secretary of State for Energy to deal with this when he was ready to bring them forward. In the meantime there should be a reference as soon as possible to the Monopolies and Mergers Commission on the efficiency of the industry - perhaps confined to the generating side - with particular reference to its control of costs. The Secretary of State for Energy should consult the Secretary of State for Trade on the precise terms of reference and coverage of such an inquiry and then clear his proposals with members of the Committee.

The Committee -

Invited the Secretary of State for Energy -

a. to encourage the Electricity Council to advance their proposed 10 per cent increase in domestic tariffs from August into July if that were practicable;

b. to inform the Electricity Council that in formulating proposals for further savings in 1980-81 they should not seek savings by reducing their fuel stocks;

c. to consult the Secretary of State for Trade on the terms of reference and coverage for an early inquiry by the Monopolies and Mergers Commission into the efficiency of the industry, with particular reference to cost control, and to clear the resulting proposals with members of the Committee;

d. to bring proposals to the Committee in due course for reducing the monopoly enjoyed by, and for re-organising, the electricity supply industry in England and Wales.

Cabinet Office

25 April 1980