E(79) 19th Meeting

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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

MINUTES of a Meeting held at
10 Downing Street on
WEDNESDAY 12 DECEMBER 1979 at 4.00 pm

PRESENT

The Rt Hon Margaret Thatcher MP
Prime Minister

The Rt Hon William Whitelaw MP
Secretary of State for the Home Department

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer

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

The Rt Hon James Prior MP
Secretary of State for Employment

The Rt Hon Peter Walker MP
Minister of Agriculture, Fisheries and Food

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

The Rt Hon John Nott MP
Secretary of State for Trade

The Rt Hon David Howell MP
Secretary of State for Energy

The Rt Hon John Biffen MP
Chief Secretary, Treasury

THE FOLLOWING WERE ALSO PRESENT

The Rt Hon George Younger MP
Secretary of State for Scotland

The Rt Hon Nicholas Edwards MP
Secretary of State for Wales

The Rt Hon Humphrey Atkins MP
Secretary of State for Northern Ireland
(Item 2)

The Rt Hon Sir Michael Havers QC MP
Attorney General
(Item 3)

The Hon Nicholas Ridley MP
Minister of State, Foreign and Commonwealth Office
(Item 3)

Sir Kenneth Berrill
Central Policy Review Staff

SECRETARIAT

Sir Robert Armstrong
Mr P Le Cheminant
Mr P Mountfield (Items 2-3)
Mr D R Instone (Item 1)

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1. BRITISH STEEL CORPORATION

The Committee had before them a minute dated 11 December from the Secretary of State for Industry to the Prime Minister, together with a minute dated 6 December from the Secretary of State for Wales to the Prime Minister and related correspondence, about the plant closure plans and pay negotiating position of the British Steel Corporation (BSC).

THE SECRETARY OF STATE FOR INDUSTRY said the BSC Board had issued a statement the previous day confirming their intention to reduce plant capacity by about 5 million tonnes in 1980/81. This would be achieved by closing the Consett works in Durham and a small plant at Hallside in Scotland, and by reducing operations at Scunthorpe. In addition they proposed to begin consultations with unions at Port Talbot and Llanwern in South Wales on ways of achieving a capacity reduction in South Wales of some 2¼ million tonnes, and reducing costs through demanning. The aim was to achieve manpower reductions of about 50,000, including the 12,000 already due to become redundant at Shotton and Corby. BSC were also taking a tough line in their pay negotiations, offering a 2 per cent increase (which represented the narrowing of commitments from earlier pay negotiations) together with the opportunity for further increases through local productivity schemes. In his view there was no case for Government intervention to slow down the rate of closures or to increase BSC's cash limit. To do so would undermine the discipline of the cash limit; would be against the Government's stated aims of avoiding unnecessary interference in nationalised industry management; and would be likely to result in surplus steel production relative to demand.

THE SECRETARY OF STATE FOR WALES said that he did not challenge BSC's proposed closures on the grounds that they were taking too pessimistic a view of demand. But there was some reason to doubt the practicability of BSC's achieving their proposed closures within the short timescale they intended. When account was taken of BSC's proposals for demanning as well as closures, their plans implied a job loss of 16,000 in steelmaking in South Wales; if account was also taken of the expected job losses in coal and 'knock-on' effects, there was an implied reduction of 36,000 jobs in the area. There could well be a strong and combined reaction from the steel and coal unions.

BSC's presentation of the reasons for closures should make it clear that the main reason was the fall in the market rather than Government cash limits; otherwise the Government would be blamed unfairly. BSC's proposals implied that substantial Government expenditure on measures to offset the resulting increase in unemployment would be needed. There seemed no possibility of this expenditure being met within his Department's existing allocation, particularly in 1980/81 when the Welsh Development Agency's budget was already fully committed. When BSC's intentions were known with greater precision, he would wish to raise the issue again.

The following points were made in discussion -

a. It would be wrong to intervene to prevent the implementation of the BSC's proposals. It was partly because of excessive intervention by previous Governments that over-capacity was now as large as it was.

b. The only alternative to backing the BSC management was to replace it; yet there was no obvious alternative management in sight, and even if there was, it would still have to face the same fundamental problems.

c. BSC might have some flexibility in the phasing of closures within their cash limit, since the cash limit itself contained a substantial provision for closure costs, and these costs would be saved if closures were delayed.

d. It was a matter of some concern that the management had still not reached any very precise view about how to implement the proposed capacity reductions, particularly in South Wales. The effects on unemployment of the proposals would be very severe. Consett would be particularly hard hit. It was important that everything possible was done by way of remedial measures, including seeking assistance from the European Communities.

e. BSC might be able to improve their financial position through greater disposals of existing operations; if this resulted in plants obtaining more efficient management, there could be economic benefits. There might be merit in encouraging BSC to proceed with promising proposals, such as disposal of the Lanarkshire steel works. On the other hand it would be wrong for the Government to intervene to encourage disposals against BSC's commercial judgement, particularly when these might result in further under-utilisation of BSC's capacity elsewhere, or might be feasible only at the cost of a substantial Government subsidy to the potential buyers.

f. BSC could run into a great deal of union opposition over both pay and closures. BSC's proposal for local productivity schemes was likely to be particularly strongly opposed by the Iron and Steel Trades Confederation who were strongly in favour of national bargaining. BSC might eventually have to agree to a higher level of pay increases, not wholly or securely based on higher productivity, in order to win union acquiescence to the closures.

g. The effects of strike action on the national economy should not be underestimated particularly if unions in the coal, rail and ports industries took sympathetic action. It was important that any necessary contingency arrangements should be made in good time.

THE PRIME MINISTER, summing up the discussion, said that the balance of the argument came down against Government intervention to prevent or slow down BSC's closure proposals, or any adjustment to BSC's existing cash limit. A close watch should be kept on progress in BSC's pay negotiations and any necessary contingency arrangements should be made to cover the effects of strike action. Opportunities for disposal of assets should be examined seriously. Consideration should be given to possible remedial measures to deal with the consequences of closure; and Ministers would need to consider in due course arrangements for their financing insofar as this could not be met from existing provisions.

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The Committee -

1. Agreed that the Government should not intervene to prevent or slow down British Steel Corporation's closure proposals.

2. Invited the Secretary of State for Industry to arrange for officials to examine the effects of strike action in the steel industry and make arrangements for any necessary contingency planning.

3. Invited the Secretary of State for Industry to ensure that opportunities for disposals of assets were seriously examined.

4. Invited the Secretary of State for Industry, in consultation with the Secretary of State for Wales and other Ministers as appropriate, to consider remedial measures to deal with the consequences of closures.

2. ENTERPRISE PROPOSALS

CONFIDENTIAL

The Committee considered a memorandum by the Chancellor of the Exchequer (E(79) 77) covering two reports from an Interdepartmental Group of Officials dealing with fiscal action to encourage enterprise and the growth of the small firms sector; and memorandum by the Secretary of State for Industry (E(79) 83) and by the CPRS (E(79) 82) arguing for differing approaches to the small firms problem.

THE CHANCELLOR OF THE EXCHEQUER said that his paper considered a number of proposals which had been put forward, either in the context of the 'Strategy Exercise' or separately, for the encouragement of enterprise generally and the small firms sector in particular. It was important to place these proposals in context. The changes already made in income tax, and those he hoped to make in capital taxation, would significantly increase the incentives to investment, both by firms and by individuals. There was however a limit to what could be afforded in the next budget. In his memorandum he proposed a package of five small measures specifically to help the small firms, at a total cost of £55 million, noting that the CPRS thought that one of these (a decrease in the rate of Corporation Tax for small firms) would not be cost-effective. He had also considered two bigger schemes to help small companies: the so called 'losses scheme' which he recommended should be further studied, and which was supported by the CPRS; and the equity investment or 'start-up' scheme, which would be expensive and potentially open to abuse; despite the support of the Secretary of State for Industry, he did not think this scheme should be pursued. He intended to call for further study of a scheme to fill the 'equity gap' by creating a Small Firms Investment Company, and of the possibility of relieving small firms from VAT on bad debts. The reports also considered a number of other proposals, including a tax-holiday for new businesses, proposed by the Secretary of State for Industry; an investment rebates scheme, and a scheme involving the transfer of investment allowances from companies to individuals, recommended by the Secretary of State for the Environment. He did not recommend that any of these should be pursued further.

The following points were made in discussion -

a. While the package of the four or five small measures might be useful, it was not politically exciting and could be expected to have only a marginal effect on enterprise. A scheme limited to relief on losses was not very attractive. It would be preferable to use any money that might be available for a single, positive and more ambitious scheme which could be expected to have more impact. There was much to be said for the scheme designed to encourage start-ups. If such a scheme generated even a small increment in national output, it could well repay the potential loss of tax revenue. It should be limited in time, so that there was an incentive not to delay decisions to take advantage of it. Similar provisions in the United States had undoubtedly encouraged the growth of investment in small companies, particularly by senior employees. It was important not to be too obsessed with the potential scope for evasion.

b. Any money available should be concentrated on measures which would lead to new job-creation. The two proposals put forward by the Secretary of State for the Environment, for an investment rebate and for transferability of investment allowances, were designed with this in mind. But there were serious practical and presentational objections to both schemes.

c. The proposal for a new investment institution to bridge the 'equity gap' should be studied further.

d. The idea of a tax holiday was attractive, particularly in Northern Ireland where competition from the Republic (where there was such a scheme) had to be faced. But there were objections to this course. While it might be necessary to revise it later, it would be better to seek alternative ways of attracting new industry, for example with the use of funds from the European Communities.

THE PRIME MINISTER, summing up the discussion, said that the Committee could only give the Chancellor a broad indication of its views, and leave him to make the best judgement in the light of available resources nearer the time of the budget. The Committee did not want to rule out the package of small measures to help small businesses, but then it considered that, within the limits of available resources, there was much to be said for larger and more attractive schemes. Despite the difficulties, the Committee saw more attraction in the equity investment or 'start-up' scheme than in the so-called 'losses' scheme. They also considered that the proposal for new institutions to bridge the equity gap should be further studied. They were attracted to the proposal for an investment rebate scheme and for transfer of investment allowances, but recognised the very serious operational and presentational difficulties.

The Committee -

Invited the Chancellor of the Exchequer to take account of the points made in discussion in drawing up his Budget proposals.

3. BNOC: FUTURE STRUCTURE AND PRIVATE SECTOR PARTICIPATION

The Committee considered a memorandum (E(79) 80) by the Secretary of State for Energy, dealing with problems raised in earlier discussion about the introduction of private capital into the British National Oil Corporation (BNOC).

THE SECRETARY OF STATE FOR ENERGY said that the Government had decided to introduce private share capital into BNOC, and he was publicly committed to this course. In previous discussion the Committee had ~~financed~~ FAVOURED maintaining 100 per cent Government control over BNOC's trading operations, but separating the 'up-stream' operating functions, and selling some of the shares in an operating subsidiary. He had also suggested that the Government should keep open the possibility of giving away some of these shares to the public and thus preventing the re-nationalisation of BNOC in due course. No decision was needed at this stage about the precise extent or speed of introduction of private capital. But decisions were needed quickly on the future structure of the Corporation, so that legislation could be prepared and introduced early in the New Year. The Committee had also been concerned about the possibility of legal challenge, under the European Treaties, to the Government's continued control over the disposal of BNOC Oil, but it now appeared that this risk was no greater under his proposals than under the present arrangements.

The following points were made in discussion -

a. Any new trading company, formed from BNOC, should remain wholly in Government ownership, in order to retain control of as much UK oil as possible in Government hands. A new BNOC (trading) would have available oil surrendered in lieu of royalties, and oil secured under participation agreements.

b. It would be for consideration whether the whole of the equity oil which would belong to to a new operating subsidiary should also be dedicated to the trading company. This would detract from the commercial independence, and stock market value, of the new subsidiary. Because such arrangements would be covered by options, rather than by formal sale-back arrangements, they might be somewhat less open to challenge under Community law, though the process of separating the companies would inevitably draw attention to the Government's intention of retaining control over the oil.

c. A separate trading company, at arms length from its operating partner, would be relatively weak. The profits of the operating subsidiary would not be available to cushion any trading losses, and the advantages of consultation would be lost. Against this, it was argued that such cross-subsidisation was wrong in principle, and that the object would be to carry out all trading operations at a profit. It was also argued that the operating subsidiary, once strengthened with the addition of private capital, would be able to explore and develop oil reserves elsewhere than in the United Kingdom continental shelf, and thus acquire other sources of oil which it would not be required to dedicate to the trading subsidiary.

THE PRIME MINISTER, summing up the discussion, said that the information available to the Committee did not enable it to judge the impact on the Public Sector Borrowing Requirement (PSBR) of the various alternatives proposed. The essential choice was between early benefits to the PSBR, from the disposal of shares in the operating company and lessened, or shed responsibility for financing BNOC's investments, and the loss of continuing inflows of funds to the Exchequer. But the scale of the potential gains and losses was not clear, and the assumptions used about the effect on the PSBR were open to challenge. Although the Committee were still disposed to favour the divisions of BNOC into separate operating and trading companies, they did not wish to reach final decisions on this or on the most appropriate scale of timing of introduction of private capital into BNOC without full information about the effects of the various available courses on the PSBR. Officials should clarify these issues urgently before final decisions were taken.

The Committee -

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

2. Invited the Chancellor of the Exchequer to arrange for officials from the Departments concerned and from the CPRS urgently to review the implications for the PSBR of the various options for introducing private capital into BNOC, including delaying such introduction for a period.

3. Noted that the Prime Minister would arrange for the Ministers directly concerned to meet again, if possible before Christmas, to consider the results of this further work.

Cabinet Office

14 December 1979