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E(79) 14th Meeting

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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

MINUTES of a Meeting held at
10 Downing Street on
TUESDAY 30 OCTOBER 1979 at 10.45 am

PRESENT

The Rt Hon Margaret Thatcher MP
Prime Minister

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

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

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

The Rt Hon Lord Soames
Lord President of the Council

The Rt Hon James Prior MP
Secretary of State for Employment

The Rt Hon 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
Chief Secretary, Treasury

THE FOLLOWING WERE ALSO PRESENT

The Rt Hon Nicholas Edwards MP
Secretary of State for Wales
(Items 2 ~~and 3~~)
\- 4

The Rt Hon Patrick Jenkin MP
Secretary of State for Social Services
(Items 1 + 2
and 4

The Rt Hon Mark Carlisle QC MP
Secretary of State for
Education and Science
(Items 2 ~~and 3~~)
4

Mr Paul Channon MP
Minister of State,
Civil Service Department

Earl of Mansfield
Minister of State
Scottish Office

Sir Kenneth Berrill
Head of Central
Policy Review Staff

SECRETARIAT

Sir Robert Armstrong
Mr P Le Cheminant
Mr P Mountfield

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CONTENTS

1. GAS AND ELECTRICITY PRICES AND PUBLIC EXPENDITURE, 1981-82 TO 1983-84

Previous Reference: E(79) 13th Meeting, Item 2

The Committee considered a memorandum, E(79) 61, by the Secretary of State for Energy about the timetable for price increases over a 3 to 4 year period designed to correct the present level of underpricing of electricity and domestic gas supplies.

THE SECRETARY OF STATE FOR ENERGY said that the Committee had already accepted, in principle, the case for a return to economic pricing on the basis described in his earlier papers E(79) 51 and 52. The Cabinet had since decided that there should be two price increases during the financial year 1980-81, one in April and one in October. His paper, which had been agreed with the Chief Secretary, Treasury, concerned the increases to be sought in later years, given the need to restore economic pricing and make a contribution to reducing public expenditure totals in those years. It also dealt with the related question of medium term financial targets for the industries. He proposed, with the support of the Chief Secretary, Treasury, that gas and electricity prices should be increased in April 1981, April 1982,and April 1983, by amounts above the increases necessary to cover rising costs. The real annual price increase for gas would be 10 per cent and for electricity 1½ per cent. However, since the Public Expenditure Survey in the summer, the financing prospects for the gas and electricity industries had deteriorated, and the combined effect of the new proposals compared with the Chief Secretary's bids in the summer, was to leave a shortfall of £360 million in 1981-82 and of £168 million in 1982-83. There would however be an improvement, compared with the Chief Secretary's bid, of £260 million in 1983-84. In addition, in each year there was likely to be a significant and rising extra income from Corporation Tax which would assist the Public Sector Borrowing Requirement (PSBR) though it would not score for public expenditure purposes. It was for consideration whether the price increases in 1981-82 should be further increased to make good some or all of this shortfall.

In discussion, it was argued that increases of at least the size proposed were needed to help improve the public expenditure position. The increases required for the electricity industry were not particularly large and raised no special problems - indeed it was possible that the Scottish Electricity Boards might need a smaller increase than that proposed for England and Wales. The Committee had already agreed that gas was seriously underpriced, in particular by reference to its main competitor, oil. This was demonstrated by the willingness of industrial consumers to pay much more for new gas supplies than the current domestic tariffs. Moreover the increased cost of additional gas supplies bought from the Northern North Sea or from the Norwegian side of the dividing line would inevitably push up the cost of gas to the British Gas Corporation (BGC). It was essential that domestic gas consumers should be given the right price signals as a basis for their decisions on fuel use and economy. The present unrealistically-low level of gas prices was inducing additional demand, which would lead to more rapid exhaustion of our gas reserves and meanwhile require substantial additional investment in distribution by the BGS.

Against this, it was argued that the consumer would not understand a highly-profitable industry should be required by the Government to raise its prices still further. There was no necessary justification for pricing gas up to the level set by the World oil price. This might simply invite the miners to take advantage of the situation by increasing their wage demands and pricing coal up to the same level. The Cabinet had already decided on the price increases for gas required in 1980-81. The speed of adjustment in later years must be subject to political acceptability and to the immediate impact on the consumer. In any case, April 1981 would be a bad time at which to seek a substantial further increase in gas prices.

In further discussion, it was argued that it would be better to have a single large price increase each year, and face the inevitable public reaction, rather than to spread out the misery by having two increases. Against this, it was urged that two smaller increases a year, more closely tailored to movements in costs, would avoid the heavy concentration of price and charge increases in April each year, while still avoiding too heavy an impact at the beginning of the wage round in October. It was noted that increases in gas and electricity prices worked through slowly to the retail price index, in line with the three-monthly billing cycle of the suppliers. It was also suggested that, while some general indication needed to be given to consumers, of likely future movements in gas prices there was no need for the BGC to be too specific about the expected size of price increases. Against this, it was argued that the whole point of the price increases was to encourage greater economy in the use of the fuel, and that this effect would be lost if the message were obscured. Moreover a reasonably clear pattern of price increases needed to be established if the gas industry was to be provided with meaningful financial targets for the years ahead.

In further discussion, it was suggested that the consumer would find it easier to understand the price increases if the very large profits of the gas industry were reduced, by increasing the costs it had to face. There were a number of ways in which this essentially presentational task might be tackled, including a special Exchequer charge on gas. It was also argued that additional revenue, whether from taxation or from the ploughing-back of gas industry surpluses, would permit a more generous scheme of assistance to the poorer consumer, by extending the scheme already announced for the winter of 1979-80 into later years in a more extended form.

THE PRIME MINISTER, summing up the discussion, said that the Committee agreed with the Secretary of State's proposals for electricity price increases in 1981 and subsequent years. Accordingly, the price of electricity in England and Wales would be allowed to rise in line with the increase in electricity costs in April 1981, together with a further 1½ per cent increase in real terms as a move towards more economic levels of pricing. There would be similar real term increases in April 1982 and April 1983. The Secretary of State for Scotland should agree with the Chief Secretary, Treasury, the appropriate pattern of price increases for the Scottish Electricity Boards. The Committee would resume its discussion of gas prices at a subsequent meeting but was disposed to favour a pattern of two price increases a year in the particular circumstances of the industry. The Secretary of State for Energy should circulate a paper, agreed with the Chief Secretary, Treasury, showing the effects of such a pattern of price increases from April 1981 onwards, as public expenditure, the Retail Price Index (RPI) and the impact in cash terms on the typical consumer. The papers should also illustrate the shape of a twice yearly price increase pattern if total revenue from the increases was to be maintained at the levels proposed in E(79) 61. The Chancellor of the Exchequer should bring forward a parallel paper, agreed with the Secretary of State for Energy, setting out alternative ways of reducing the excessive profits of the Gas Corporation, whether by an Exchequer charge on gas, or in any other suitable way. Meanwhile, the Secretary of State for Energy and the Secretary of State for Scotland, should agree with the Chief Secretary, Treasury, cash limits for 1980-81 for the gas and electricity industries (including the Scottish Electricity Boards) so that these could be announced with the other nationalised industry cash limits in the middle of November. They should also open negotiations with the electricity industry over 3 year financial targets for the English and Scottish Boards. Negotiations with the gas industry over long term financial targets could also begin in general terms though final decisions would have to wait until the Committee had reached an agreed view on the preferred course of gas prices in the years after 1980/81.

The Committee -

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

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2. FUTURE OF THE STANDING COMMISSION ON PAY COMPARABILITY AND RELATED MATTERS

Previous Reference: E(79) 7th Meeting, Item 1

The Committee considered a note by the Chancellor of the Exchequer (E(79) 49) dealing with a number of matters left over from their previous discussion about pay comparability in the public sector.

THE CHANCELLOR OF THE EXCHEQUER said that his paper, which was based upon work done at official level, had been discussed with the Ministers most directly concerned and broadly agreed with them, although there were some differences of emphasis. Its purpose was to suggest ways in which Government policy on the Standing Commission and on related matters could evolve sensibly and naturally from the present positions.

The Committee then considered the various proposals in the Chancellor's paper -

i. Long Term Future of the Clegg Commission. There was general agreement that the Commission should be kept in existence, as the Chancellor of the Exchequer had proposed, to take on appropriate new or repeated references. There was however no need for the Government to commit itself to a public view on the principle of comparability in the public sector on the longer term future of the Commission.

ii. Membership. The Committee noted that the appointment of the present Chairman ran until October 1981, and that decisions would soon be needed about a successor. There was also a strong case for strengthening the Commission, particularly on the private sector managment side.

iii. Candidates for Future References. The Committee noted that although the Commission had a full workload at present, it might be necessary for it to undertake additional work in relation to the groups on which it had already reported, who were due for fresh pay settlements in the next few months. There was a case for taking soundings of the management sides among the Local Authorities and in the National Health Service (NHS), to see whether there was a possible role for the Commission in relation to the 1980-81 pay round.

iv. Form of Future References. There was general agreement that future references should normally include a request for findings which would then be subject to negotiation between the parties, rather than (as in the earliest cases) a request for specific and binding awards. In either case, such references should make it clear that the Government was in no way committed to provide the full finance necessary to implement the ensuing pay settlements without offsetting economies being found. The Commission might therefore be asked not only to provide evidence on pay, but also to indicate the scope for economies, as they have done in some of their earliest reports.

v. Non-Industrial Civil Service. There was general agreement that the process of comparability as applied to the non-industrial Civil Service should be extended to take full account of relative job security in the public and private sectors, and of other labour market factors. To this end, the Pay Research Unit Board might be asked to make an independent evaluation of the weight to be attached to job security, and to include this in its comments on the PRU findings in 1980. The main emphasis should be placed on job security in that year, but in addition the Civil Service Department might be asked to conduct small scale pilot studies of the scope for taking account of regional differences and of relative scarcity or surplus of particular skills, so that a view could be taken of the place such factors might have in future reviews.

THE PRIME MINISTER, summing up the discussion, said that the Committee broadly approved the approach to comparability and the Comparability Commission outlined by the Chancellor of the Exchequer in his paper. The Secretary of State for Employment should bring forward proposals on the chairmanship and membership of the Standing Commission. The Secretary of State for the Environment and the Secretary of State for Social Services should take soundings of the Local Authorities and the NHS management side respectively, about the scope for references to the Standing Commission in the 1980-81 pay round. These should be completed in time for the offer to be made, if necessary, in the course of negotiations on the 1979-80 pay settlements for the groups concerned. The Committee agreed that future references to the Commission should, normally, take the form of requests for findings which would be subject to negotiation between the parties. The alternative of asking for specific recommendations was not ruled out in every case. The Lord President of the Council should invite the Pay Research Unit Board to report, at the time of the 1980 Pay Research Survey, on the weight to be attached to job security in the non-industrial Civil Service. At the same time he should arrange for the Civil Service Department to make small scale pilot studies of the scope for regional and skill differentiation in national pay negotiations.

The Committee -

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

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3. HUNTERSTON IRON ORE TERMINAL

THE PRIME MINISTER, summing up a brief discussion arising out of the previous item on the Agenda, said that the situation which had developed at the Hunterston Iron Ore Terminal illustrated the dangerous extent to which inter-union rivalry could hold up the development of large scale investment projects. It was symptomatic of much that was wrong with present industrial relations. Ministers had hitherto been reluctant to make any public comment about the Hunterston situation for fear of exacerbating delicate negotiations. There was no longer any reason to avoid comment, and indeed Ministers should take every opportunity of drawing public attention to the situation which had arisen.

The Committee -

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

4. CIVIL SERVICE PAY RESEARCH: PENSIONS VALUATION

Previous Reference: E(79) 5th Meeting, Item 4

The Committee's discussion and the conclusions reached are recorded separately.
(E(79)60)

Cabinet Office
31 October 1979

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MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

LIMITED CIRCULATION ANNEX
E(79) 14th Meeting, Minute 4
TUESDAY 30 OCTOBER 1979 at 10.45 am

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CIVIL SERVICE PAY RESEARCH: PENSIONS VALUATION

Previous Reference: E(79) 5th Meeting, Item 4

The Committee considered a memorandum, E(79) 60, by the Lord President of the Council, explaining how deductions for the value of Civil Service pensions were arrived at in pay research, and proposing two changes for the future.

THE LORD PRESIDENT said that public discussion of Civil Service and other public sector index-linked pensions had been confused because it had focused on the single figure of 2.6 per cent which was sometimes represented as the charge made for the index-linked element in such pensions. In fact 2.6 per cent was the deduction made from notional salary as revealed by pay research, to take account of the difference between the value of a civil servant's index-linked pension, and the degree of inflation-proofing afforded to the analogues used in the process of pay research. The total contributions made by civil servants for their pensions totalled some 7 per cent of annual salary which was generally a higher contribution than the average in the private sector. The position would be much clearer if public presentation concentrated on this figure. He proposed therefore that the Government Actuary should in future calculate a single combined figure for the value of pensions and that the assumptions and method used in the calculation should be submitted to the Pay Research Unit Board (PRUB) for audit before becoming embodied in pay settlements. He also proposed that a pensions, or insurance, expert should be included in the membership of the PRUB in order to strengthen it and the public acceptability of its findings in this respect.

In discussion, it was argued that some 80 per cent of the analogues on whom Civil Service Pay Research was based were drawn from the private sector and had averaged some 60 per cent inflation protection for their pensions since 1974. If the public sector analogues, where inflation-proofing was widespread, were withdrawn from the comparison the result might well be to drive up the cost of pay settlements because, generally speaking, pay was better in the private sector. Moreover index-linking was now enjoyed by several million employees in the public sector and applied also, of course, to Members of Parliament and to Ministers. There was in any case an Election commitment to maintain index-linking for those who presently enjoyed it. When the system was introduced, under a previous Conservative Government, it had been seen as a way of remedying the unfair treatment of particular groups of pensioners, rather than as the introduction of a new benefit which needed to be offset by abatements from Civil Service pay.

Against this, it was argued that the analogues used in the process of Pay Research were chosen from large firms who had a reputation as good employers. They were not necessarily representative of the whole field of employment, and the self-employed and small companies were excluded. Because many of the analogues came from nationalised industries and other parts of the public sector, the whole process was in danger of becoming circular. The private sector did not and could not afford to protect its pensioners completely against the effects of inflation. Nor would the tax payer be able to do so if inflation continued at anything like its present rate. If index-linking were to be maintained, therefore, there was a strong case for increasing pension contributions, and this would be justified and widely understood. The benefits of inflation-proofing, though strictly incalculable, were obviously very sizeable, and afforded a degree of psychological security to public sector employees going well beyond the acturial calculations. There was therefore a strong case for making some additional deduction from pay to take account of this factor. Existing employees might be given the option of paying this higher contribution, or of continuing at present levels and losing the protection of indexation. Alternatively, indexation might be withheld from future employees or negotiated away in future pay settlements. An internal study within the Treasury had already shown that, within existing policy commitments, these two approaches, of higher contributions for unquantified benefits, and of altering the choice of analogues, were the two main ways in which the problem might be tackled.

THE PRIME MINISTER, summing up the discussion, said that the Committee agreed that the question of pension valuation required further study. Meanwhile, for the purposes of the 1980 Pay Research settlement, the PRUB should be asked to examine the assumptions and method of computation used by the Government Actuary. For this purpose the Board should be strengthened by the addition of a pensions or insurance expert, as proposed by the Lord President of the Council. The Lord President should arrange for these decisions to be announced in reply to a Parliamentary Question already tabled for Answer in the following week by Mr J Bruce-Gardyne MP. The Chancellor of the Exchequer should then arrange for the Minister of State, Treasury, (Lord Cockfield), in consultation with the Lord President of the Council, to carry out a further study of the scope for, and implications of, changes in the system in subsequent years, on the lines indicated in discussion.

The Committee -

Took note, with approval, of the Prime Minister's summing up of their discussion, and invited the Lord President of the Council and the Chancellor of the Exchequer to proceed accordingly.

Cabinet Office

31 October 1979