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CABINET

CONCLUSIONS of a Meeting of the Cabinet
held at 10 Downing Street on

THURSDAY 30 OCTOBER 1980

at 9.30 am

PRESENT

The Rt Hon Margaret Thatcher MP
Prime Minister

Hon William Whitelaw MP
ry of State for the Home Department

The Rt Hon Lord Hailsham
Lord Chancellor

Hon Sir Geoffrey Howe QC MP
llor of the Exchequer

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

Hon Francis Pym MP
ry of State for Defence

The Rt Hon Lord Soames
Lord President of the Council

Hon James Prior MP
ry of State for Employment

The Rt Hon Sir Ian Gilmour MP
Lord Privy Seal

Hon Peter Walker MP
r of Agriculture, Fisheries and Food

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

Hon George Younger MP
ry of State for Scotland

The Rt Hon Nicholas Edwards MP
Secretary of State for Wales

Hon Humphrey Atkins MP
ry of State for Northern Ireland

The Rt Hon Patrick Jenkin MP
Secretary of State for Social Services

Hon Norman St John-Stevas MP
llor of the Duchy of Lancaster

The Rt Hon John Nott MP
Secretary of State for Trade

Hon David Howell MP
ry of State for Energy

The Rt Hon Mark Carlisle QC MP
Secretary of State for Education and Science

Hon John Biffen MP
ecretary, Treasury

The Rt Hon Angus Maude MP
Paymaster General

THE FOLLOWING WERE ALSO PRESENT

The Rt Hon Norman Fowler MP
Minister of Transport

The Rt Hon Michael Jopling MP
Parliamentary Secretary, Treasury

SECRETARIAT

Sir Robert Armstrong	
Mr M D M Franklin	(Items 2 and 3)
Mr P Le Cheminant	(Item 5)
Mr R L Wade-Gery	(Items 2 and 3)
Mr W N Hyde	(Items 1 and 4)
Mr D J L Moore	(Item 5)
Mr L J Harris	(Items 1 and 4)

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AMENTARY
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1. The Cabinet were informed of the business to be taken in the House of Commons during the following week.

2. THE LORD PRIVY SEAL said that, although the Polish leaders were putting a brave face on it, their sudden summoning to Moscow seemed a sinister development, reminiscent of the similar summoning of the Czech leaders at a critical stage of events in Czechoslovakia in 1968. The Foreign and Commonwealth Secretary, who was on a visit to Poland, had seen the leaders before their departure. Among Britain's major allies, the French remained surprisingly optimistic that there would be no Soviet military intervention, but the Americans were less so and the Germans much less. Concern was mounting in Eastern Europe, as had been clear for example during the Foreign and Commonwealth Secretary's recent visit to Hungary. In the German Democratic Republic there had been a sharply worded Press commentary, and the Government had announced new restrictions on travel to Poland. The Poles were expected to resist if invaded. Any invasion would be likely to be preceded (as in the Czech case) by sizeable Soviet troop movements, of which there was so far no sign.

THE LORD PRIVY SEAL said that the United Nations (UN) Secretariat team had now persuaded the South African Government to set a date for the beginning of the process leading to Namibian elections and independence. This was subject to satisfactory agreement on the composition of the proposed UN force and also to the holding of an international meeting attended by the Namibian internal parties as well as others concerned. On this latter issue it was disappointing that the UN Secretary General, Dr Waldheim, had not been more skilful in his handling of the leaders of the Front Line States; and there was a danger that President Nyerere of Tanzania might again play an unhelpful role, as he had done over the Rhodesian negotiations.

THE LORD PRIVY SEAL said that the fighting between Iraq and Iran continued without major developments. There was no further news of the release of the United States hostages in Iran. But this remained a real possibility. The Foreign Ministers of the European Community had agreed that formal sanctions against Iran would be terminated if the hostages were released, but that it would be for each Government to decide nationally on how to proceed thereafter. In Britain's case a complicating factor would be the four British subjects under arrest in Iran.

THE SECRETARY OF STATE FOR TRADE said that everything possible was being done to persuade the owners of the one British ship caught in the Khorramshahr area of the Shatt-al-Arab that it would be dangerous for the ship to attempt to break out. Such an attempt might nevertheless be made before long: morale was declining among the ship's remaining crew, nine of whom, including the captain, were British.

The Cabinet -

Took note.

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3. THE PRIME MINISTER said that Monsieur Thorn had visited London on Monday 27 October in his dual capacity as President of the Council and President designate of the Commission. There had been some discussion about the distribution of portfolios in the new Commission. Many of the present Commissioners seemed likely to remain and would wish to retain their existing portfolios. In particular, if Monsieur Cheysson remained, it would be difficult for Mr Ivor Richard to secure the development portfolio, for which he was well qualified. As regards the forthcoming meeting of the European Council, Monsieur Thorn had reported that President Giscard wished the meeting to concentrate on international affairs. In her view, however, the Heads of Government could not ignore problems facing the Community including the Common Agricultural Policy and the Budget. There should also be discussion on commercial policy matters, including trade with Japan and the problems facing eg the chemical industry from low cost American competition. The outgoing President, Mr Roy Jenkins, might be invited to give some account of his stewardship and an indication of how he thought the Community should tackle the problems it was facing.

In a brief discussion it was noted that the French had held the development portfolio since the beginning of the Community and it was time for a change. Herr Haferkamp had not been effective as the Commissioner responsible for external relations. It should not be accepted that incumbents had a right as a matter of course to retain their portfolios and should press for a more general reallocation. Attention was also drawn to the fact that detailed talks were taking place between the Germans and the French on how to avoid creating difficulties for the French in advance of the forthcoming French Presidential Elections. It would be advantageous, following the successful Anglo-French consultations in September, for the British Government to show itself equally sensitive, perhaps through the medium of discreet contacts between the Prime Minister and the President of the Republic. There were a number of industrial and commercial areas where the United Kingdom had interests in common with France.

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THE SECRETARY OF STATE FOR INDUSTRY said he was hopeful that, at the Council of Ministers meeting that day, it would prove possible to resolve the outstanding difficulties over the introduction of mandatory quotas to regulate steel production in the Community. The German Government had sought to protect the interests of their producers of special steels, but some compromise on this point should be possible.

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THE MINISTER OF AGRICULTURE, FISHERIES AND FOOD said that at the recent meeting of the Council of Ministers (Fisheries) agreement on enforcement measures had been reached. At its next meeting the Council would tackle the difficult questions of quotas and access. The new French Minister responsible for fisheries was being co-operative.

The Cabinet -

Took note.

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4. The Cabinet considered a note by the Home Secretary (C(80) 63) to which was attached a revised draft of The Queen's Speech on the Opening of Parliament. They also had before them a letter from the Chancellor of the Duchy of Lancaster to the Home Secretary dated 28 October 1980 reporting on his consultations about the possible deletion of references to specific Bills from the draft Speech.

THE HOME SECRETARY said that the revised draft of The Queen's Speech attached to C(80) 63 took account of changes agreed by the Cabinet at their previous meeting. The Chancellor of the Duchy of Lancaster had subsequently consulted four Ministers responsible for Bills mentioned in the draft Speech, to see whether they would be prepared for the relevant references to be dropped, on the understanding that this would not necessarily imply that the Bills concerned would not find a place in the legislative programme. The Chancellor of the Duchy of Lancaster's letter of 28 October set out the position reached. The Secretary of State for Scotland had agreed to the deletion of the reference to civic government in Scotland on page 5 of the draft Speech, and the Secretary of State for Social Services had agreed to the deletion from the same page of the reference to legislation to enable improvements to be made in the health and social services. It had not been possible to reach agreement on the three remaining Bills mentioned in square brackets on page 5 of the draft Speech. After further discussion it was proposed not to excise from the Speech the references to the Education (Special Needs) Bill and the Education (Scotland) Bill. The reference to the Royal Visit to Sri Lanka had still to be confirmed. The reference to unemployment might have to be amended in the light of discussions later that morning, while the passage on Northern Ireland might also have to be revised to reflect subsequent decisions. He suggested that on both these subjects the final text should be settled between the Prime Minister, himself, and the Ministers directly concerned. Subject to these points, he invited the Cabinet to approve the revised draft Speech, and to agree that it should be submitted to The Queen in the course of the following week.

THE CHANCELLOR OF THE DUCHY OF LANCASTER said that he was grateful to the Secretary of State for Scotland and the Secretary of State for Social Services for agreeing to drop references to two of their Bills from the draft Speech. He accepted that this did not imply any decision about whether the Bills themselves were to remain in the programme. The Secretary of State for Trade had been unwilling to agree to drop the provisions of the Companies Bill dealing with the implementation of European Community commitments, but had promised to consider whether the same objectives could be achieved with less primary legislation. The Secretary of State had also been reluctant to agree to the deletion of the reference to the Insurance Companies Bill from the draft Speech, on the grounds that there had already been a considerable delay in honouring our Community obligations in this area, and that its provisions would be of benefit to the British insurance industry. This was however a long Bill which was not an essential part of the Government's domestic strategy, and he hoped that it might be possible to avoid a specific reference in The Queen's Speech to this Bill, or to the Jurisdiction and Foreign Judgments Bill, which was also designed mainly to meet European Community commitments and was not essential to the programme. The overloading in the present Session's programme had made it evident that it was better at this stage to err on the side of caution in judging the prospects for next Session's legislative programme.

In discussion, the following main points were made -

a. The Companies Bill would not be ready for introduction until early in the new year. If it was then clear that the legislative programme was running into difficulties, it might be possible to consider dropping some of its less essential provisions so as to facilitate its passage through both Houses.

b. The harmonisation of laws governing activities of insurance companies was one of the areas where developments in the Community were to our advantage in encouraging cross-frontier business. If no commitment to the Insurance Companies Bill were given in The Queen's Speech, it would be disappointing to our own insurance interests, and attract criticism from our Community partners.

c. The Jurisdiction and Foreign Judgments Bill was a non-controversial measure which would fulfil an overdue Community obligation. It was suitable for introduction in the House of Lords, and could probably be handled in the House of Commons under the Second Reading Committee procedure. It would not take up much Parliamentary time and there seemed little point in dropping the reference to the Bill, which was one of the very few law reform measures provided for in the legislative programme, from the draft Speech. On the other hand, the drafting of the Bill had not yet been completed, and it was unlikely to be ready for introduction until shortly before Christmas. The Bill was not a major item in next Session's programme, and any reference to it would not be likely to attract public interest; on balance it might be better to omit such reference from the Speech.

d. Dates for the Royal Visit to Sri Lanka had been agreed, but the reference to the Visit in the Speech must depend on whether an official invitation was received in time.

THE PRIME MINISTER, summing up the discussion, said that the Cabinet agreed to the deletion of the references to civic government in Scotland and to the health and social services on page 5 of the draft Speech. In view of the advantages which would accrue to the British insurance industry from the European Community Directives on insurance services, the reference to the Insurance Companies Bill should remain in the draft Speech, but the reference to the Jurisdiction and Foreign Judgments Bill should be deleted.

The reference to the Royal Visit to Sri Lanka should remain in square brackets for the time being, and would be deleted if no formal invitation had been received by the time of the State Opening. She would settle final texts on Northern Ireland and unemployment in consultation with the Home Secretary and the Ministers directly concerned, and would arrange for the draft Speech, as revised, to be submitted to The Queen in the course of the following week.

The Cabinet -

1. Noted that the Prime Minister would determine final texts of the references to unemployment and Northern Ireland after consultation with the Home Secretary and Ministers directly concerned.

2. Subject to 1, invited the Home Secretary to prepare a final draft of the Speech, taking acount of the points made in the Prime Minister's summing up of their discussion.

3. Noted that the Prime Minister would submit the draft Speech to The Queen.

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5. The Cabinet discussed a memorandum by the Chancellor of the Exchequer (C(80) 59) on the economic prospect and implications for policy. They also had before them a table summarising public expenditure totals from 1974-75 to 1981-82 and the prospects for the Public Sector Borrowing Requirement (PSBR) in 1981-82; memoranda by the Chancellor of the Exchequer (C(80) 60 and 65) on the pay and price factors to be included in the 1981-82 cash limits and votes; memoranda by the Chancellor of the Exchequer and the Chief Secretary, Treasury (C(80) 58 and 64) and by the Secretary of State for Scotland (C(80) 62) on public expenditure programmes; and a memorandum by the Secretary of State for the Home Department (C(80) 61) on the Rate Support Grant settlement in 1981-82.

THE CHANCELLOR OF THE EXCHEQUER said that the decisions which the Cabinet was now called upon to reach had to be considered against a very difficult international and domestic economic situation. Throughout the industrialised world there had been a sharp reduction of growth in the 1970s, as a result of the increase in oil prices and general inflationary tendencies. This had been particularly marked in the United Kingdom, where the average annual rate of growth between 1973 and 1979 had fallen to 1 per cent as compared with 3 per cent over the previous twenty years. Gross Domestic Product in the United Kingdom was expected to fall by about five percentage points between 1979 and 1981, because of the world recession, and the high exchange rate accentuating the long-term decline in the international competitiveness of British industry. The underlying problems of the British economy were rooted in the increase of earnings and prices and not in a deficiency of demand. The right course was to stick to the policy objective of containing the aggregate totals of public expenditure at the levels agreed earlier in the year - which because of the recession would imply an increase in the ratio between public expenditure and Gross Domestic Product, and to bring the PSBR to a level which would permit the possibility of a reduction in the level of interest rates, which was among the factors keeping the exchange rate high and was creating severe liquidity problems for industry.

The reductions in public expenditure proposed by the Treasury did not represent an overall reduction in public spending: they represented a redistribution within the total, so as to make room for the increases (to a considerable extent the unavoidable result of recession) detailed in Table 1 attached to C(80) 58. Even if all the reductions proposed by the Treasury were agreed, that would leave the PSBR in 1981-82 slightly higher than that forecast in July. It would not in present circumstances be appropriate to try to bring the forecast PSBR back to the level implied by the centre of the range indicated for money supply increases in the medium term financial strategy, but it would be necessary to bring the PSBR some way back towards that level, if it was to become compatible with any prospect of reducing interest rates. That meant that he was bound to be thinking in terms of a considerable increase in taxation in his next Budget, over and above the reductions in public expenditure now proposed.

In discussion there was general agreement with the objectives of the Government's economic strategy, but reservations were expressed by some Ministers about the scale and timing of the measures proposed. It was suggested that the increases in nationalised industry financial requirements and in the cost of unemployment benefit as a result of the recession should not be regarded as a reason for cutting other public spending programmes. Most countries did not include nationalised industry investment in their public expenditure, or include it in their PSBR. It was necessary to have regard to what was happening in the economy. The Treasury papers did not provide the Cabinet with adequate forecasts of the consequences of their proposals for interest rates, industrial output or unemployment, and Treasury forecasts of unemployment had in the past tended to be over optimistic. Manufacturing output had fallen by 11 per cent this year. Unemployment was continuing to rise. British goods were increasingly uncompetitive in world markets because of the high exchange rate. The volume of exports had so far held up as order books were worked through, but manufacturers could not continue indefinitely to export at a bare profit or even a loss, and export orders were likely soon to decline. There was a risk that the measures now proposed by the Treasury might merely serve to aggravate the decline in output and the rise in unemployment now occurring. If this happened, it could make inevitable higher expenditure on unemployment benefits, larger financing requirements for nationalised industries and a larger PSBR, and could force out of business not just inefficient and badly managed companies but some of the best companies in the country on whom the prospects of recovery would depend. On the monetary side, bank lending to the private sector was likely to begin to come down, and it should be possible to finance a PSBR consistent with a money supply increase of the order of 10 per cent in 1981-82 at lower interest rates than those now ruling. The Cabinet should also have regard to the political implications of what was being proposed. The right course for the Cabinet was, while supporting the general strategy, not to go as far as now proposed in reducing public expenditure, to make a modest reduction in the level of interest rates as the rate of inflation came down, and to review the situation again in a few months' time.

On the other hand, though there was general recognition that the decisions facing the Cabinet were very difficult and painful, both on public expenditure and perhaps also on taxation, it was argued that the decisions would not become less necessary or less disagreeable with the passage of time, and should not therefore be postponed. The measures proposed were themselves likely to have only a marginal effect on the level of industrial activity and unemployment; it would be idle to suppose that the Government could find some easy way of significantly increasing the level of activity, which was determined by world recession and other circumstances not within the Government's ability to determine in the short term. The Cabinet should continue to set its course in relation to the longer-term requirements for the reduction of the rate of inflation and the recovery of the economy. That necessitated doing whatever was possible to create the climate for a revival of investment. It was essential to bring the PSBR in 1981-82 back to a level that was compatible with a fall in interest rates. This would entail a massive budgetary switch, with reductions in public expenditure of the aggregate amount proposed by the Treasury and increases in taxation of the kind foreshadowed by the Chancellor of the Exchequer. In deciding which public expenditure programmes to cut, the Cabinet should concentrate as far as possible on those programmes that were not wealth-creating. From the point of view of the credibility of the strategy and of offering some prospect of hope for industry it was arguable that the changes of taxation required should be brought forward from next year and included with the public expenditure changes in an early announcement. In this way the total impact of the Government's proposals on the PSBR would be seen, and the full extent and gravity of the problem demonstrated; but there would be some ground for hoping that this could complete what was required and hold out the prospect of a reduction in interest rates.

In discussion the following were among the other points made:-

a. Of the proposed increases in expenditure, over £1 billion was for the nationalised industries. This was a major reason for the substantial cuts which were now being demanded from other programmes. If, however, loss-making nationalised industries, such as the British Steel Corporation (BSC) had been put into liquidation, the costs to the PSBR would have been considerably higher.

b. There was strong pressure from industry to reduce the burden on them of energy prices, and there might be some scope for limited selective action in this direction. On the other hand any substantial slowing down of the move to economic energy pricing would have a further and major adverse effect on the finances of the nationalised industries.

c. It was necessary to provide for further increases in the Contingency Reserve for realism, in the light of experience over the last year and to guard against likely further demands for financing of, for example, British Leyland and BSC.

d. In considering the options it would be necessary to be clear whether priority should be given to the aim of reducing the PSBR or to reducing the public expenditure totals. In the health service, for example, it would be possible to avoid public expenditure cuts by the alternative of an increase in the National Insurance Health Contribution which would benefit the PSBR. A balance would have to be struck between these objectives. It was suggested that, while in 1981-82 the primary objective must be to reduce the PSBR, the Government should not lose sight of its commitment to bringing down the level of public expenditure as a proportion of Gross Domestic Product.

e. It would be of prime importance to present a united front in defending the Cabinet's decisions. Press speculation which sought to portray Cabinet discussion in adversary terms was particularly damaging and members of the Cabinet should avoid saying anything which fed such speculation.

THE PRIME MINISTER, summing up the discussion, said that it was clear that the Cabinet endorsed the Government's economic strategy, and accepted the need to pursue the objective of keeping the totals of public expenditure in 1981-82 and later years broadly at the levels set out in the March White Paper (Cmnd. 7841). To this end, and as a contribution to reducing the PSBR in 1981-82, it would be necessary to achieve aggregate reductions of public expenditure of the order of magnitude proposed by the Treasury. Even with these reductions, the Chancellor of the Exchequer would be faced with the need to increase taxation in order to bring the PSBR down to a level compatible with a reduction in interest rates. The only alternative course - that of allowing the PSBR and the money supply to rise - was not likely to provide significant relief for industry in the short term and would have incalculable consequences for the levels of inflation, output and unemployment in the longer term. The Cabinet would meet again on Tuesday, 4 November to discuss the detailed proposals for reductions in spending programmes to achieve the total required. It had to be accepted that, if some programmes were reduced by less than was proposed, the shortfall would have to be offset by larger reductions than those proposed in other programmes, if the total reduction required was to be realised. If the Cabinet did not agree upon reductions adding up to the total required, the shortfall would have to be made up by increases of taxation additional to those which would be required in any case.

The Cabinet -

1. Endorsed the Government's economic strategy as set out by the Chancellor of the Exchequer in C(80) 59 and in discussion.

2. Endorsed the objective of keeping the totals of public expenditure in 1981-82 and later years broadly at the levels set out in the White Paper of March 1980 (Cmnd. 7841).

3. Endorsed the objective of reducing the total of public expenditure programmes by the aggregate amounts indicated in C(80) 58 and 64.

4. Agreed that, in so far as the agreed reductions in public expenditure fell short of the aggregate amounts indicated, it would be necessary for the Chancellor of the Exchequer to impose additional increases of taxation, over and above those which would be required even if the reductions indicated were achieved in full, in order to bring the PSBR in 1981-82 down to a level compatible with the prospect of a significant reduction of interest rates.

5. Agreed to meet on Tuesday, 4 November for detailed discussion of the reductions in public expenditure programmes proposed in C(80) 58 and 64.

Cabinet Office

31 October 1980