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CABINET

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

THURSDAY 3 JULY 1980

at 9.30 am

PRESENT

The Rt Hon Margaret Thatcher MP
Prime Minister

Hon William Whitelaw MP
Secretary of State for the Home Department

The Rt Hon Lord Hailsham
Lord Chancellor

Hon Lord Carrington
Secretary of State for Foreign and
Commonwealth Affairs

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

Hon Sir Keith Joseph MP
Secretary of State for Industry

The Rt Hon Francis Pym MP
Secretary of State for Defence

Hon Lord Soames
President of the Council

The Rt Hon James Prior MP
Secretary of State for Employment

Hon Peter Walker MP
Secretary of State for Agriculture, Fisheries and Food

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

Hon George Younger MP
Secretary of State for Scotland

The Rt Hon Nicholas Edwards MP
Secretary of State for Wales

Hon Humphrey Atkins MP
Secretary of State for Northern Ireland

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

Hon Norman St John-Stevenson MP
Governor of the Duchy of Lancaster

The Rt Hon John Nott MP
Secretary of State for Trade

Hon David Howell MP
Secretary of State for Energy

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

Hon John Biffen MP
Secretary of State for the Treasury

The Rt Hon Angus Maude MP
Paymaster General

SECRET

THE FOLLOWING WERE ALSO PRESENT

The Rt Hon Norman Fowler MP
Minister of Transport

The Rt Hon Michael Jopling MP
Parliamentary Secretary, Treasury

Mr Douglas Wass
Treasury (Item 5)

Mr T Burns
Treasury (Item 5)

Mr J R Ibbs
Central Policy Review Staff
(Item 5)

SECRETARIAT

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

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PARLIAMENTARY
AFFAIRS

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

FOREIGN
AFFAIRS
-
North Atlantic
Treaty
Organisation

2. THE FOREIGN AND COMMONWEALTH SECRETARY said that a useful meeting of the Foreign Ministers of the member states of the North Atlantic Treaty Organisation (NATO) had taken place in Ankara in the previous week; but there was still no sign of any agreement being reached between Greece and Turkey which would lead to the Greeks coming back into the NATO military structure.

Previous
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Chancellor
Schmidt's
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show

THE FOREIGN AND COMMONWEALTH SECRETARY said that the visit of the Chancellor of the Federal Republic of Germany, Herr Schmidt, to Moscow seemed to have followed the line which had been forecast. Chancellor Schmidt had taken up a firm position in regard to the Soviet invasion of Afghanistan but had not made any impact. Indications had emerged from his discussions that the Soviet Union might be willing to talk bilaterally to the United States about the deployment of their SS-20 theatre nuclear weapons and the North Atlantic Treaty Organisation's modernisation plans for its theatre nuclear weapons, but the prospect of such talks still seemed to be a long way off.

The Cabinet -

Took note.

COMMUNITY
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3. THE FOREIGN AND COMMONWEALTH SECRETARY said it now seemed likely that Monsieur Gaston Thorn would be appointed as the new President of the Commission of the European Communities, the French having withdrawn their objection. Monsieur Thorn would be presiding over the Commission during an important period for the future of the Community.

THE SECRETARY OF STATE FOR EDUCATION AND SCIENCE said that Education Ministers of the European Community had recently met for the first time since 1976. The meeting had been a satisfactory one and had not involved commitments to additional expenditure.

THE SECRETARY OF STATE FOR THE ENVIRONMENT reported that, following a British initiative, the Council of Ministers (Environment) had now agreed to a Community ban on the import of primary whale products. This had been well received by the British Press and could be publicised as a success for the Community.

The Cabinet -

Took note.

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4. The Cabinet considered a memorandum by the Secretary of the Cabinet (C(80) 37) on the 14th and 15th Reports of the Top Salary Review Body dealing respectively with the pay of the Higher Civil Service, senior officers of the Armed Forces, the ^{Higher Civil} Judiciary and Nationalised Industry Chairmen and Board Members and of Ministers and Members of Parliament.

The Cabinet's discussion and conclusions are recorded separately.

THE ECONOMIC
PROSPECT

5. The Cabinet considered a memorandum by the Chancellor of the Exchequer (C(80) 35) on recent developments in the economy and the outlook ahead.

MR BURNS, the Chief Economic Adviser to the Treasury, presented an analysis of the Government's economic strategy. He concluded that the growth of the money supply was now under control and that there were signs of a slow down in the rate of inflation as we moved through 1980 and into 1981. To maintain progress it would be vital for the Government to keep control over the Public Sector Borrowing Requirement (PSBR) and Government spending. Unemployment was rising rapidly because of excessive pay settlements. Only when the increase in average earnings was brought within the range of figures for the growth of money supply would there be the basis for a sustained reduction in the rate of inflation, the resumption of growth and a reduction in unemployment. None of the alternatives, such as relaxing the monetary targets or reducing the exchange rate, was attractive or offered any hope for a sustained improvement in the outlook.

MR IBBS, Head of the Central Policy Review Staff, said that there was a basic question why, compared with other industrialised countries, money supply and hence inflation had repeatedly risen more strongly in the United Kingdom. One reason was that a belief in "cost of living" entitlements was deeply embedded, while management had failed to insist on improved productivity so that unit labour costs could remain stable, or fall, even though wages rose. Within a tightly controlled money supply there would be considerable damage to the industrial structure if high wage settlements and increased unit costs persisted. It was essential to back up the economic policy with explanation and education aimed at changing attitudes. Companies had to be persuaded to stand out for pay settlements at lower levels rather than to buy time and avert strikes by the apparently easy route of higher settlements. Thus the Government's aim in implementing the economic strategy should be to do everything possible to modify the general attitude on pay and productivity and to keep down the cash requirements of the public sector.

THE CHANCELLOR OF THE EXCHEQUER said that current developments in the economy were not substantially different from what had been expected at the time of the Budget. But there were two important qualifications to this. First, pay increases had been significantly bigger than had been hoped; second, there were difficulties in containing the PSBR in 1981-82. The PSBR problems arose not from the revenue side of the account but from the problems of controlling expenditure and borrowing by central Government, the local authorities and the nationalised industries.

SECRET

If the economic strategy were to succeed, it was crucial for Government Departments and local authorities to stay within their cash limits and the nationalised industries within their External Financing Limits. There were different views among forecasters about the likely depth and duration of the United Kingdom economic recession; and a good deal would turn on our cost competitiveness at a time of world recession. But the prospect was that the company sector might remain in substantial financial deficit through the period to 1983; that unemployment would rise steeply, and exceed the level of 1.8 million by autumn 1981 which had been previously assumed; and that, while inflation would decelerate, this would not happen as quickly as had been hoped. Nevertheless, after a tight budgetary position in 1981-82, there should be some scope in the later years for tax reductions consistent with the overriding objective of bringing down the growth of money supply and inflation. Faced with the difficulties of containing the PSBR and reducing monetary growth in 1981-82, and in the present delicately poised situation, it was more than ever imperative to hold to the economic strategy. It was only by bringing about the needed adjustments in the economy in that period that the Government could create the conditions for sound and sustainable growth in the medium term.

In discussion it was argued that in looking at the economic strategy it was very important to take account of the political and social consequences of following it through. The prospect was of unemployment rising to over 2 million. At the same time the squeeze on company liquidity was much more severe than had been expected and this was affecting investment. There was a danger of widespread and lasting damage to the country's industrial base. It was not just a matter of individual firms going out of business; there was a risk that whole lines of production would disappear, and open the British market to foreign firms who were not necessarily better or more efficient. If the strategy were to succeed, it was necessary to look for some palliatives. There was a case for more expenditure to keep people off the unemployment register. Measures should be taken to encourage older workers to retire earlier and, in particular, it was necessary to tackle the problem of growing unemployment among young people, by additional training and youth employment schemes. The Government should not shrink from the additional public expenditure involved, which was preferable to the alternative of higher expenditure on unemployment benefits. It was also necessary to look for measures to revive investment; perhaps, for example, by adopting Mr Alan Lord's proposals for giving relief to tax-exhausted companies. To resolve the apparent inconsistency between simultaneously stimulating productivity and reducing unemployment, the Government should continue to give fiscal encouragement to the new and expanding industries which would be able to create jobs.

On the other hand, while there should be scope for some reordering of priorities within public expenditure totals, it was essential that the Government should stick to the cash limits and to the overall public expenditure plans which had been agreed last year. Otherwise, public sector borrowing would increase, interest rates would stay high, and the present pressures on private sector industry would be unnecessarily and damagingly protracted. All the suggested alternatives to the present economic strategy carried high risks of greater inflation and greater loss of output and employment in the longer term.

In further discussion the following points were made -

- a. While unemployment would rise from its present levels, it should not be assumed that it would do so as much as some commentators expected. To some extent the outcome would depend on the depth of the world recession, from which we could not be isolated. More directly it would turn on how quickly increases in the levels of pay and prices came down.
- b. The squeeze on corporate liquidity might now be at its peak. The position would ease as a result of the running down of stocks and reductions in spending on capital investment, and as interest rates were reduced and companies were able to borrow more easily. For the moment companies were borrowing short term from the banks and waiting for a fall in interest rates. It was crucial that the capital markets should be revived so that they could raise their money there. Any increase in the PSBR now would postpone that day.
- c. There was no doubt that the industrial base was suffering and that major companies were losing customers. This was inevitable in a period of transition. It was desirable, however, that the transition should be as short as possible. Many firms who could survive a short period of difficulty would go under if the period of adjustment were prolonged. In the meantime it was doubtful whether there was much advantage in attempting to pick out particular companies for assistance. Such assistance would be no more than a drop in the bucket. The aim should be to persevere with the present strategy and to correct the fundamental conditions which were causing the damage, in particular the high level of pay settlements, so as to be able to bring down the level of interest rates.

d. It was generally agreed that it would be wrong to reduce the National Insurance Surcharge. This would be indiscriminate in its effects: helping not just manufacturing industry but the banks and oil companies too. Moreover, it would undermine the will of companies to stand up to unrealistic pay claims.

THE PRIME MINISTER, summing up the discussion, said that the Cabinet agreed that the Government should maintain its present economic strategy. For that strategy to succeed it was essential for the Government to keep tight control over those areas for which it was directly responsible. The level of public sector pay settlements had to be reduced, and this would give a lead to the private sector. There could be no increase in the present overall public expenditure totals, and the trend to overspending in 1980-81 which had been identified had to be corrected. If this were not done, borrowing would increase and interest rates would stay high; the private sector would be penalised and the country's industrial base would be damaged. Within the overall public expenditure plans there might well be scope for switching expenditure to enable higher priority to be given to measures to alleviate the problems of unemployment, particularly among young people. The Cabinet would consider this further in the course of their forthcoming discussions of the 1980 Public Expenditure Survey.

The Cabinet -

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

Cabinet Office

4 July 1980

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CABINET

LIMITED CIRCULATION ANNEX

CC(80) 27th Conclusions, Minute 4

Thursday 3 July 1980 at 9.30 am

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The Cabinet resumed their discussion of the 14th Report of the Top Salaries Review Body (TSRB) dealing with the pay of the higher Civil Service, senior officers of the Armed Forces, the higher judiciary, and nationalised industry Chairmen and Board members, and the 15th Report of the TSRB dealing with the pay of Ministers and Members of Parliament (MPs), and considered a memorandum by the Secretary of the Cabinet (C(80) 37) on the options open to them in respect of the salaries of Ministers and of senior public servants.

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MPs

THE PRIME MINISTER, summing up a discussion of the pay of MPs and of Ministers, said that the Cabinet confirmed the agreement which they had provisionally reached in their earlier discussion that the Government should recommend that the increase for MPs should be reduced from 14.6 per cent as recommended in TSRB 15 to 9.6 per cent, to produce a salary of £11,750 from 13 June 1980. The Cabinet also confirmed its agreement to bring into effect from 13 June 1980 the second stage salary levels for Ministers and other paid office holders. The Cabinet further agreed that the second stage salaries of Cabinet Ministers should be increased by 5 per cent, and of all other Ministers and other paid office holders of the House of Lords and House of Commons (including the third Opposition Whip for whom TSRB 15 had inadvertently failed to make recommendations) by 9.6 per cent. The Cabinet were not persuaded that any additional payment, beyond the 9.6 per cent, should be made to junior Ministers in the Lords by way of increase in their salary. They should, however, be made eligible for the normal expenses allowances for Peers. Secretarial and research assistance allowances for MPs and the secretarial allowance for Ministers and other paid office holders in the House of Lords would be increased by 9.6 per cent. Pensions would be based on salaries actually paid except where, as in the case of MPs, the Government had already undertaken to base them on a higher notional salary. No

further entitlement to a higher notional salary for pensions purposes would arise from present decisions. Following the proposed changes the basis for the third stage increase in MPs' pay due on 13 June 1981 would be £13,025 rather than £12,000. The Order necessary to implement the staged salary increases in Ministers' pay should cover both the second and third stages.

Groups

In discussion of the groups covered by TSRB 14 the following main points were made -

a. Some Ministers argued that the average increase for the groups as a whole should be 9.6 per cent, as for MPs. Whichever of the alternatives suggested in C(80) 37 was adopted, it would arouse great resentment in the groups affected. As far as the Civil Service was concerned, it would probably make it impossible to agree with the Staff Side the proposed modifications to pay research, and would put at risk the possibility of agreeing new pay scales based on pay research within cash limits next year. These difficulties would not be much greater if the Government decided upon the more drastic of the two alternatives, and if the other alternative averaging 12.5 per cent, as set out in C(80) 37, was implemented, it would be very difficult to persuade MPs to accept 9.6 per cent. Moreover, while the average was 12.5 per cent, the Under Secretaries and their equivalents in the Armed Forces would get 13.9 per cent and similar increases were envisaged for people at lower levels in the other groups concerned. These figures would be picked on by the press, and the Government would fail to convince public opinion that they were in earnest in seeking to influence public sector pay settlements.

b. Other Ministers considered that there was a strong case for approving the range of increases averaging 12.5 per cent. This would represent a reduction in the general level of increases recommended by TSRB 14 (that is, excluding the additional increases recommended to restore differentials) in the same proportion as that proposed for MPs. Anything lower would mean that senior public servants were being treated more severely than were MPs, and this would be inequitable. It would add to the problem of compressed differentials and would mean setting aside the results of pay research not only for Assistant Secretaries but for Senior Principals too. Moreover, it would suggest that the Government was trying to establish a pay norm of 9.6 per cent. The emphasis should be on the range of increases involved; and in the case of the higher Civil Service, and of the senior Armed Forces, it could be

emphasised that the range was from 8.1 per cent to 9.6 per cent with 13.9 per cent as an exception necessary to deal with the problem of differentials. While the average for nationalised industry Board members should similarly be set at about 12.5 per cent, the increases for each of the Chairmen should be less than 10 per cent.

c. Acceptance of the proposals in column C of Table 2 annexed to C(80) 37 for senior military officers would result in a particular problem about the pay of medical Brigadiers and their equivalents and medical Major Generals and their equivalents. This could be overcome by giving a special salary of £21,500 to medical Major Generals and their equivalents.

d. The suggested rates of pay for the senior judiciary in column C of Table 3 annexed to C(80) 37 were a little on the high side. In particular the proposed increase of 15.9 per cent in the pay of Masters and Registrars of the Supreme Court and equivalent judicial appointments should be shaded to around 13 per cent and the increase in pay of the judicial group as a whole should be held to around $12\frac{1}{2}$ per cent.

e. If the proposed rates of pay for Chairmen and Board members of nationalised industries were to be based broadly on the suggestion in column C of Table 4 annexed to C(80) 37 it would be necessary to modify them so that no Chairman received more than 10 per cent. It would also be necessary to adjust downwards the increases proposed for members of nationalised industry Boards where these showed increases significantly above 13 per cent as in the case of the British Transport Docks Board and the National Water Council.

THE PRIME MINISTER, summing up this part of the discussion, said that the Cabinet agreed on balance that the pay of the higher Civil Service and of the senior Armed Forces should be increased by about 12.5 per cent on average, as proposed in column C in Table 2 annexed to C(80) 37. In taking this decision the Cabinet knew and accepted that it meant refusing arbitration to the Senior Principal and Assistant Secretary grades whose Pay Research Unit (PRU) based settlement was still outstanding. Pay rates below those suggested by the PRU evidence would have to be imposed where necessary. To avoid a problem of differentials medical Major Generals and their equivalents in the Armed Forces should be paid £21,500. The Secretary of the Cabinet would discuss further with the Lord Chancellor's Department the proposals for the higher judiciary. The aim should be to achieve an average increase of about 12.5 per cent for this group as a whole. Within the group the aim should be to restrict the higher rates of increase to around 13 per cent. The Secretary of the Cabinet should also discuss the proposals

for the nationalised industries with representatives of the Departments concerned. The proposals in column C of Table 4 annexed to C(80) 37 should be amended so that all Chairmen received less than 10 per cent. Any consequential changes to the increases for members should take account of the need to pay them more than the executive staff immediately below them; particular attention in this respect should be paid to the problems of the National Freight Corporation in this respect, which she would discuss separately with the Minister of Transport. On the other hand the rates of increase proposed for Board members of the British Transport Docks Board and the National Water Council were unacceptably high and should be reduced to be in line with those proposed for members of the Boards of other nationalised industries. The rates of pay settled on this basis would apply through the coming year to those Chairmen and Board members now in post. In future the TSRB would not be asked to deal with the pay of nationalised industries Chairmen and Board members and the arrangements would be on the basis agreed by the Ministerial Committee on Economic Strategy at their meeting on 20 May. New appointments arising during the year would be dealt with on their merits. As there were no longer any staged increases from past settlements due to any of the TSRB 14 groups the rates of pay actually paid, rather than the TSRB recommendations, would be the basis for assessing pensions. The increases now approved by the Cabinet for the groups covered by the TSRB 14 Report assumed that the House of Commons approved the Government's recommendations for the salaries of MPs. If they did not do so, the Cabinet would need to reconsider the position.

The Cabinet -

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

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THE PRIME MINISTER, summing up a further discussion on the timing, handling and presentation of the Cabinet's decisions, said that she would announce the Government's recommendations for MPs' pay and their decisions on the other groups covered by TSRB 14 and 15, in a statement to the House of Commons on Monday 7 July. She would explain that in view of the economic situation the Government had decided, contrary to their previous intention as announced by the Chancellor of the Duchy of Lancaster, that the recommendations of TSRB 15 could not be implemented in full. She would write in confidence to the Leader of the Opposition before the weekend to inform him of the Government's decisions. On 7 July, and before her statement, she would see representatives of the 1922 Committee; Lord Boyle, the Chairman of the TSRB; and (if he so wished) the Leader of the

Opposition. The Chancellor of the Duchy of Lancaster should see the Deputy Leader of the Opposition at the same time. Representatives of the four groups covered by the TSRB's 14th Report should also be given notice, in confidence, of the contents of her statement as they affected them at noon on Monday 7 July. The Lord Chancellor should make arrangements to inform representatives of the higher judiciary; the Secretary of State for Defence should speak to the Chiefs of Staff; the Lord President of the Council should arrange for the Council of Civil Service Unions and representatives of the Nationalised Industries Chairmen's Group to be informed. Each of the Ministers concerned should inform the Chairmen of the nationalised industries for which he was responsible. She would consider further with the Chancellor of the Duchy of Lancaster the arrangements for meeting the Lobby after the statement. The debate on the proposals for MPs' pay should be arranged to take place on Monday 14 July, after that on unemployment.

The Cabinet -

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

Cabinet Office

4 July 1980