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CC(81) 23rd
Conclusions

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CABINET

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

WEDNESDAY 17 JUNE 1981

at 9.30 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 Lord Hailsham
Lord Chancellor

The Rt Hon Lord Carrington
Secretary of State for Foreign and
Commonwealth Affairs

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 Francis Pym MP
Chancellor of the Duchy of Lancaster
and Paymaster General

The Rt Hon Lord Soames
Lord President of the Council

The Rt Hon James Prior MP
Secretary of State for Employment

The Rt Hon John Nott MP
Secretary of State for Defence

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 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

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

The Rt Hon John Biffen MP
Secretary of State for Trade

The Rt Hon David Howell MP
Secretary of State for Energy

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

The Rt Hon Norman Fowler MP
Secretary of State for Transport

The Rt Hon Leon Brittan QC MP
Chief Secretary, Treasury

SECRET

ALSO PRESENT

The Rt Hon Michael Jopling MP
Parliamentary Secretary, Treasury

SECRETARIAT

Sir Robert Armstrong
Mr P Le Cheminant
Mr D J L Moore

S U B J E C T

ECONOMIC STRATEGY

SECRET

ECONOMIC
STRATEGY

The Cabinet considered a memorandum by the Chancellor of the Exchequer (C(81) 29) on the Economic Strategy. They also had before them a note by the Secretary of the Cabinet (C(81) 30) covering two further papers by the Chancellor of the Exchequer: a memorandum on the Economic Impact on North Sea Oil and Gas Revenues which had been prepared for the Ministerial Group on Energy Prices (MISC 56), and a memorandum on pay in the coming year which had been circulated for discussion by the Ministerial Committee on Economic Strategy.

The Cabinet's discussion is recorded separately.

THE PRIME MINISTER, summing up the discussion, said that the Cabinet endorsed its broad general support for maintaining the Government's present economic policy, and in particular for giving continuing priority to the reduction of inflation. The successful implementation of this policy was essential if the Government were to achieve its broader political aim of reducing the role of the public sector and of creating a society in which the individual, and private sector companies, had more responsibility and more resources. The Cabinet agreed that, within the framework of the economic policy, further consideration should be given to the options for reducing the level of unemployment, particularly among young people; the Secretary of State for Employment would shortly be making recommendations on this to the Ministerial Committee on Economic Strategy. They further agreed that, to stimulate private sector investment and to help reduce unemployment, it would be necessary to look further at the hindrances to employment which had been identified in their discussion and by the Chancellor of the Exchequer in C(81) 29; she would arrange for further work to be undertaken on these issues. The Secretary of State for Employment would make recommendations in July to the Ministerial Committee on Economic Strategy following consultations on the Green Paper on Trade Union Immunities. The Cabinet's discussion, in July and in the autumn, of the 1981 Public Expenditure Survey would provide the opportunity for further consideration of the balance to be struck between the Government's objectives for taxation and for public expenditure, and of the balance, within the public expenditure programme, between capital and current expenditure. It would be necessary to look at the options for reductions in programmes which had hitherto been generally immune from cuts but which might have to be reduced in the interest of achieving the objective of stimulating private sector activity and so helping to reduce unemployment. The Cabinet had recognised that the achievement of acceptable pay settlements over the next two years was crucial to the success of the economic strategy. She would arrange for the Central Policy Review Staff to consider the options for achieving the Government's pay objectives, in both the public and private sectors, what were the hindrances to the achievement of those objectives, and what changes might have to be made. There was general agreement that this

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discussion of the Government's economic strategy had been useful, and should be repeated. She would arrange for a further discussion in the autumn. In view of the interest taken by the Press in this meeting she would arrange for guidance to be given to the effect that members of the Cabinet were pleased with the outcome of the meeting, that they had confirmed the Government's broad general economic policies, but they were concerned about unemployment, and had under study policies on the employment particularly of young people, but regarded it as important above all, and for the fulfilment of all the Government's political and economic objectives, to keep inflation coming down, and to shift responsibility and resources from the public sector to the private sector from which alone new jobs would come.

The Cabinet -

1. Endorsed the objective of maintaining the Government's present general approach to the economy.
2. Took note that the Prime Minister would arrange for:-
 - i. the Ministers concerned to consider ways of further reducing the hindrances to employment identified in their discussion and in the Chancellor of the Exchequer's memorandum C(81) 29;
 - ii. the Central Policy Review Staff, in consultation with Departments as necessary, to examine what action should be taken to achieve the Government's objectives for pay settlements in the public and private sectors.
3. Agreed to consider further, in the course of their discussions of the 1981 Public Expenditure Survey, the balance to be struck between the Government's taxation and public expenditure objectives and the balance, within the public expenditure programme, between capital and current expenditure.
4. Took note that the Secretary of State for Employment would make recommendations to the Ministerial Committee on Economic Strategy before the summer Recess on:-
 - i. action to reduce unemployment, particularly among young people;

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- ii. the action to be taken in the light of consultations on the Green Paper on Trade Union Immunities.

Cabinet Office

18 June 1981

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CABINET

LIMITED CIRCULATION ANNEX

CC(81) 23rd Conclusions

Wednesday 17 June 1981 at 9.30 am

ECONOMIC
STRATEGY

The Cabinet considered a memorandum by the Chancellor of the Exchequer (C(81) 29) on the Economic Strategy. They also had before them a note by the Secretary of the Cabinet (C(81) 30) covering two further papers by the Chancellor of the Exchequer: a memorandum on the Economic Impact of North Sea Oil and Gas Revenues which had been prepared for the Ministerial Group on Energy Prices (MISC 56), and a memorandum on pay in the coming year which had been circulated for discussion by the Ministerial Committee on Economic Strategy.

THE CHANCELLOR OF THE EXCHEQUER said that his memorandum (C(81) 29) was intended to help the Cabinet to take stock of the Government's first two years of office and to identify the key issues to be faced in the remainder of the present Parliament and in preparation for the next. The main objectives of the economic strategy were to continue to control and to reduce inflation, and in particular to reduce interest rates, and to restore a sustainable growth of output, employment and living standards. In the last year inflation had been reduced from 22 to 12 per cent. The recent fall in sterling against the United States dollar, and recent increases in oil prices, would make it more difficult to maintain this progress in the immediate future, and the timing of further progress in reducing inflation was uncertain; there was no reason, however, to revise the present forecast of 10 per cent inflation in the year ending in the fourth quarter of 1981. Interest rates in the United Kingdom were now substantially below those in the United States of America and in France, and lower than those of other major industrialised countries generally. Industrial production had now ceased to fall, though it was uncertain how quickly it would increase. If these improvements were to be maintained, it was essential to avoid short term expedients which could incur the risk of a further increase in inflation. The rate of increase in unemployment was now slowing down, but he recognised the political and social importance of checking and reversing this increase. It might be possible to make some contribution to dealing with this by more effective use of expenditure on present employment and training measures. There were,

however, no easy general solutions. It had been estimated, for example, that a £4 billion stimulus to the economy would reduce unemployment by only 100,000, but such a measure would lead to substantial increases in inflation and in interest rates which would be damaging to private sector industry and, in turn, to employment prospects. It might be possible to give more priority, within existing public expenditure totals, to capital investment offering a good economic return, if other expenditure were reduced; any increase in the overall public expenditure totals for this purpose would, however, have to be financed either by higher taxation or by increased public sector borrowing leading to increases in interest rates. He had set out in paragraph 43 of C(81) 29 a number of suggestions for changes which might stimulate a real growth of output. First, it was necessary to change the patterns of economic behaviour and, in particular, to secure a sustained change in the attitudes of pay bargainers, in the public and private sectors, leading to pay increases below the expected rate of inflation in the coming year. Secondly, he had suggested measures for improving the supply side of the economy. Thirdly, he had raised the question of the balance of the Government's fiscal policy, as between its taxation and public expenditure objectives. On present spending plans the Government would enter the Election with an overall tax burden much heavier than that inherited in 1979; in his view, this was not tolerable either politically or economically. The Government had already recognised, and said publicly in the Public Expenditure White Paper (Cmd 8175), that the present public expenditure programmes were higher than it would wish in relation to financial and economic objectives. The need now was to reduce the public expenditure totals for the years ahead below those in the White Paper. Unless this was done it would be very difficult to raise income tax thresholds or to respond to the pressure from private sector industry for reductions in the burdens on them; it would not be practicable to secure again next year the benefits from the 1981 Budget from higher taxes on oil and from taxes on the clearing banks. He invited the Cabinet to take note of the need to maintain the Government's present general approach to the economy; and to consider how best to promote the changes in patterns of economic behaviour and in the working of the markets which were essential to improving economic performance, and to adapt the Government's fiscal and other policies to contribute to those objectives.

In discussion the following were the main points made:-

- a. The Public Expenditure White Paper (Cmd 8175) had assumed unemployment in the United Kingdom of 2.8 million in 1981-82 rising to 3.03 million in 1982-83 and remaining at that level in 1983-84. These figures were annual averages; the surge of school leavers would take the totals well over 3 million in the late summer and early autumn of 1982 and 1983. The impact on particular groups would be greater than the totals suggested: with 3 million unemployed, two-thirds of

those aged under 18 could be without a normal job; by 1983, around 800,000 people could have been out of work for more than a year; many areas would have overall unemployment rates of 20 per cent or more which, with a few recent exceptions, would be the worst figures in Great Britain since the last war; and, within the totals, unemployment would tend to be concentrated on the unskilled and on ethnic minorities. It was possible that, with reasonable growth in output, there could be a modest fall in unemployment, of perhaps a quarter million, in the course of 1983; but even that small fall could be wiped out by a faster growth in productivity - which in other respects was a highly welcome result of action taken by firms in the present recession - or by further growth in the labour force. If the economic strategy were not to succeed, the figures would be worse and there would be a continued rise in unemployment.

b. The continuing rise in unemployment, particularly among young people, was deeply disturbing. As was already evident in some areas, it produced increasing social disorder and crime. Although it was unrealistic to look for substantial reductions from the levels of unemployment projected for 1983, it was essential, if the Government were to continue to command support for its policies, that by then the trend should be reversed and unemployment should be seen to be coming down. It might well be possible to make better use of existing resources by switching funds to new employment and training measures and by making present schemes, such as the Youth Opportunities Programme, more effective. There were, however, limits to what the Government could do to create jobs. The Government's main role should be to create the conditions in which private sector industry could prosper and provide jobs; this would be achieved by continuing to bring down inflation and interest rates, and by further action to remove constraints on private sector initiatives.

c. The prospective level of pay settlements was a major threat to the economic strategy. In order to avoid a renewed surge in prices and unemployment, the aim for the next round of pay settlements in 1981-82 should be to see settlements below the rate of inflation, perhaps in the range of 5 to 7 per cent. This might be achieved, but it would then be very difficult to continue, as was necessary if the strategy were to succeed, with a third year of restraint during which settlements were below increases in the cost of living. There was little doubt that the unions would exert strong pressure for higher increases, particularly in the winter of 1982-83. It would be easier to deal with this problem, and with that of unemployment, if within the broad overall economic strategy some measures could be taken to bring forward, or to strengthen, growth in output.

d. In the meantime, considerable further thought needed to be given to how the Government should deal with pay claims in 1981-82. The timing of these claims, and their interaction on each other, should be analysed; their relative importance, and the relative strength of the unions concerned, assessed; and a strategy and tactics for handling the pay round worked out.

e. It would be politically very difficult to withhold "Rooker-Wise" increases in personal tax thresholds in the next Budget. It was, however, possible that, perhaps with the exception of "Rooker-Wise" indexation of allowances, the public now attached more importance to stimulating private investment than to cutting personal taxation; already public opinion was near the point of giving greater priority to dealing with the problems of unemployment rather than to reducing taxation. If private sector industry were to earn the profits which were a pre-condition of a revival in investment leading to reductions in unemployment, it was essential to take steps to bring down the burden of taxation, including that of the rates and of National Insurance Contributions.

f. While some sensible savings might be found, there were considerable objections to looking for yet further major savings from those public expenditure programmes which had already been repeatedly and substantially cut. Some savings on capital programmes, such as the housing programmes, could be made if necessary, but this would be highly damaging to private sector activity. Some programmes had already been cut to such an extent that to look for further cuts was politically unrealistic: measured as a percentage of Gross Domestic Product, the health and social service programmes in the United Kingdom were significantly smaller than those in all other member countries in the European Community. Although the Government would continue to put pressure on the local authorities to achieve savings, it was unrealistic to assume that large savings, beyond those already in prospect, could be achieved: under present powers, it was not in the gift of the Ministers concerned to deliver them.

g. If it were accepted that there was a limit to the savings which could be sought from programmes which had been cut previously, and if public expenditure in total were to be reduced to make room for reductions in taxation, it would be necessary to consider the options for cuts in areas which had hitherto been regarded as sacrosanct. Major reductions in the Public Sector Borrowing Requirement could be achieved - far greater than anything in prospect from confining cuts to the programmes which had been reduced so far - if increases in benefits and in taxation thresholds were not indexed to

increases in the cost of living, and if increases in public sector pay were similarly kept below the rate of inflation. It could be that people would be willing to accept reductions in their real earnings if they were persuaded that the sacrifice would lead to a revival of investment which would benefit both those in work and also those at present unemployed. On the other hand, there would be considerable political difficulties if benefits and thresholds were not to be indexed in full. Ministers would need to consider the expenditure options further in their discussion of the 1981 Public Expenditure Survey.

h. In reviewing the overall public expenditure programme, the opportunity should be taken to re-order priorities to make room for some further public sector capital investment where a convincing case could be made that an acceptable rate of return would be achieved. Because of the close connection between the public and private sectors, such projects could be helpful in stimulating the revival of private sector activity. Subject to the further studies of methods of financing which the Chancellor of the Exchequer had recently commissioned, it was possible that some projects might be financed by the private sector outside the Public Sector Borrowing Requirement. There was also a case for considering investment to enable productivity improvements in nationalised industries which were currently performing badly and which could not be de-nationalised in the foreseeable future.

i. The recent and sharp movements in the dollar/sterling exchange rate, the reduction in real interest rates, and the unexpectedly high level of retail sales had not been assumed in the forecasts made at the time of the March 1981 Budget. They appeared to provide a substantial short term stimulus to the economy which was far greater than any stimulus which Ministers might have brought about by deliberate action. If these uncovenanted changes had come on top of reflationary action taken by the Government, the effect would have been inflationary and damaging to interest rates; this reinforced the case for declining to take any significant reflationary measures now. On the other hand, the effects of these recent changes were uncertain. More of the United Kingdom's trade was with Europe than with the United States of America; sterling had not weakened against the European currencies, and it could be that European currencies would weaken further against sterling so damaging the country's trading performance with Europe. There was a case for further work over the next two or three months, during which the effects of these changes might become clearer, on what were the options for some shading of priorities, within the present broad economic strategy but aimed at ensuring that it continued to have public support.

j. It was essential to create the conditions for a revival of profitability in the private sector which would in turn lead to higher investment and reductions in unemployment. To this end, it was essential to reduce inflation, interest rates, and the burden of taxation and of other costs on the private sector. The United Kingdom had not been as successful as other countries in stimulating its private sector and in creating the conditions for a strong industrial base. There was now evidence that other European Community countries were increasing their investment aids, both to the benefit of their domestic industries and in order to attract inward investment; a notable recent example was the measures taken by the French Government to stimulate their food industry. In view of such action by other Governments, it could be necessary to take measures to ensure that British firms remained internationally competitive.

k. The reduction of inflation, and the revival of the economy, could be prejudiced if the unions were to resist necessary changes and to press for pay settlements which would effectively price people out of jobs. If this were to happen, private sector industry would be denied the profits which were essential to investment. This could be dealt with in part by the continuing process of educating public opinion, and in part by further legislative changes in the light of the Secretary of State for Employment's proposals following consultations on the Green Paper on Trade Union Immunities. It would be particularly important to curb excessive union power in industries, in both the private and public sectors, of key importance in the economy.

l. Further measures should be taken to reduce hindrances and impediments to employment. The difficulties and costs of dismissing workers should be reduced: otherwise firms, and particularly small firms, would be reluctant to take on new workers as the economy revived. There were signs that the new Enterprise Zones were not working as well as they should, because of hindrances and delays imposed by bureaucratic procedures. Some local authorities, in operating their planning requirements, appeared to give greater priority to preserving amenities than to helping small businesses and employment.

m. There had been keen Press and public interest in this meeting of the Cabinet. The discussion had demonstrated that there continued to be general support in the Cabinet for the thrust of the Government's economic strategy. It was the more important that, in any guidance given to the Press, the fact that there was this general support should be emphasised: the guidance should give no credence to the myth that there had been a clash between opposing views of the strategy, with one view prevailing over the other.

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