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C(79) 10th
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CABINET

CONCLUSIONS of a Meeting of the Cabinet
held at 10 Downing Street on
THURSDAY 19 JULY 1979
at 10.30 am

PRESENT

The Rt Hon Margaret Thatcher MP
Prime Minister

e Rt Hon William Whitelaw MP
cretary of State for the Home Department

e Rt Hon Lord Carrington
cretary of State for Foreign and
mmonwealth Affairs

e Rt Hon Sir Keith Joseph MP
cretary of State for Industry

e Rt Hon Lord Soames
rd President of the Council

e Rt Hon Sir Ian Gilmour MP
rd Privy Seal

e Rt Hon Michael Heseltine MP
cretary of State for the Environment

e Rt Hon Nicholas Edwards MP
cretary of State for Wales

e Rt Hon Patrick Jenkin MP
cretary of State for Social Services

e Rt Hon John Nott MP
cretary of State for Trade

The Rt Hon Lord Hailsham
Lord Chancellor

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

The Rt Hon Francis Pym MP
Secretary of State for Defence

The Rt Hon James Prior MP
Secretary of State for Employment

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

The Rt Hon George Younger MP
Secretary of State for Scotland

The Rt Hon Humphrey Atkins MP
Secretary of State for Northern Ireland

The Rt Hon Norman St John-Stevas MP
Chancellor of the Duchy of Lancaster

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 John Biffen MP
Chief Secretary, 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 John Hunt
Mr R L Wade-Gery (Items 2 and 3)
Mr M D M Franklin (Items 2 and 3)
Mr P Le Cheminant (Item 4)
Mr P J Harrop (Item 1)
Mr P Mountfield (Item 4)
Mr D E R Faulkner (Item 1)

CONTENTS

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. It was now intended that the House should reassemble after the Summer Recess on Monday, 22 October.

THE PRIME MINISTER said that the proposed date for Parliament's return from the Summer Recess had been advanced from 29 October to enable the House of Commons to make earlier progress with the important Bills which should by then be ready for introduction. Bills could not be read a second time until they had been before the House for two weekends; the earlier date for reassembly after the Recess would enable a number of Bills to receive their Second Readings in the first half of November. This was essential if the Government's programme were not to be put at risk, and if the advantages of the long Session were not to be lost. Ministers sponsoring Bills should ensure that instructions were sent to Parliamentary Counsel in good time to enable this objective to be met.

The Cabinet -

Took note.

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2. THE FOREIGN AND COMMONWEALTH SECRETARY said that President Carter's major speech on energy policy represented an important advance, provided he could carry the policies outlined therein, on the promises he had made at the Tokyo Summit. It also seemed to have led to some improvement in his domestic popularity. The contrived mass resignation of his senior advisers had the air of a political gimmick. Mr Vance, Dr Brown and Dr Brzezinski had already been reappointed. Mr Schlesinger might not be.

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THE FOREIGN AND COMMONWEALTH SECRETARY said that Parliament had now been informed of the Government's decision on Vietnamese refugees. He would be attending the Geneva Conference on 20 July. Both Vietnam and the Soviet Union would also be represented there and might try to blame the United States for the present refugee problem as being a consequence of the Vietnam war. Western speakers would be able to rebut this firmly. But it might have some effect on Asian attitudes.

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THE FOREIGN AND COMMONWEALTH SECRETARY said that during Bishop Muzorewa's visit to London the Prime Minister had made clear to him both that we were trying to help him and that there would have to be some movement on the constitutional front. The next steps on Rhodesia would be considered by the Defence and Oversea Policy Committee on 23 July. Meanwhile Kenya's statement on the Muzorewa Government had been helpful though heavily qualified; and it might not be to our disadvantage that serious quarrels on other issues had developed at the current Organisation of African Unity Summit in Monrovia.

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THE LORD PRIVY SEAL said that his own visit to Gibraltar, where Spanish restrictions were having an increasingly serious effect, had now been followed by the visit to London of Senor Calvo Sotelo, the leader of the Spanish team negotiating for Spain's entry into the European Economic Community. A paper on our policy on the Gibraltar problem was being prepared for Ministerial consideration.

The Cabinet -

Took note.

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3. THE FOREIGN AND COMMONWEALTH SECRETARY said that the Prime Minister and he had had a meeting earlier in the week with Baron Biesheuvel, M Marjolin and Mr Edmund Dell, who had been appointed by the European Council to consider adjustments to the machinery and procedure of the Community institutions particularly in the light of enlargement. It seemed unlikely that they would make any radical proposals.

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THE LORD PRESIDENT OF THE COUNCIL said he had represented the Government at the inaugural session of the directly elected European Parliament in Strasbourg on 17-18 July. This had been an uneventful occasion apart from interjections by the Reverend Ian Paisley.

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THE CHANCELLOR OF THE EXCHEQUER said that the Council of Ministers (Finance) on 16 July had had a characteristically unproductive discussion based on reports from subordinate committees about the economic situation. It now appeared that the review of the intervention mechanism of the European Monetary System (EMS) would take place in October rather than in September. He had been able to lift the United Kingdom reserve on the Regulation to grant interest rate subsidies to Italy and the Irish Republic. It had been agreed that if and when the United Kingdom also participated in the exchange rate mechanism of EMS, our entitlement to interest rate subsidies would be decided upon by the Council in accordance with the same criteria as had been adopted in the case of Italy and the Irish Republic. The sums involved were not large in relation to our net budgetary contribution and our readiness to settle this long-standing argument had been much appreciated by the Irish. We had continued to insist that the Commission's reference paper on the budgetary problem should be ready for discussion in September so that consideration of possible solutions - the second phase of the procedure decided upon by the European Council in Strasbourg - could begin in October. It now appeared that work on possible remedies by the Commission and other member States was proceeding faster than had been at first thought and, if we were to inject our own views at the appropriate time, it would be necessary to accelerate the timetable originally envisaged by the Defence and Oversea Policy Committee.

In a brief discussion the importance of losing no chance to influence the Commission and other member States over the gravity of the Budget problem was stressed. We would need to be clear both on our objectives and on what were the most appropriate modalities. We should talk both to our partners and to the Commission.

The Cabinet -

Took note.

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4. The Cabinet's discussion and the conclusions reached are recorded separately.

Cabinet Office

19 July 1979

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CABINET

LIMITED CIRCULATION ANNEX

CC(79) 10th Conclusions Minute 4

Thursday 19 July 1979 at 10.30 am

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The Cabinet resumed its discussion of public expenditure on the basis of two memoranda by the Chancellor of the Exchequer: one (C(79) 30) set out the consequences of failure to achieve the £6.5 billion cut which he had proposed in expenditure for 1980-81; the other (C(79) 31) covered the report of a group of Ministers (MISC 11) established to review the proposed reductions in Departmental expenditure programmes. The Cabinet also had before them previous papers on public expenditure (C(79) 25, 26, 27, 28 and 29).

THE CHANCELLOR OF THE EXCHEQUER said that decisions were needed before the Recess on the levels of expenditure in 1980-81, including finance for the nationalised industries. Substantial reductions would be needed. The Gross Domestic Product (GDP) had grown by less than 1 per cent a year in the previous 5 years and half of this growth had come from North Sea oil; there was little prospect of significant growth in the coming year; pay increases in the private sector were accelerating; there was a substantial trade deficit; the money supply was growing by 13 per cent annually; and the latest oil price increases would have a deflationary effect on the world economy as well as on Britain. The decisions taken at the time of the Budget held the level of expenditure in 1979-80 unchanged from that of 1978-79. The programmes announced by the previous Government would have increased expenditure in 1979-80 by some 2 per cent to 3 per cent over 1978-79 and in 1980-81 by some 5 per cent over 1978-79 on the false assumption of a growth rate of between 2 per cent and 3 per cent a year in GDP. The cuts imposed in 1976 at the time of the International Monetary Fund (IMF) loan would have been more than reversed by these plans. If they had continued unaltered the plans would have involved expenditure of a further £5 billion in 1980-81 as compared to this year, to be financed out of a stagnant GDP. The situation was made worse by the rate of increase of pay in the public sector, which was forecast to rise by 18 per cent, amounting to a further £4.5 billion in cash terms. To offset all this, it was necessary to make reductions of £6.5 billion in expenditure plans for 1980-81 in order to maintain the public sector borrowing requirement (PSBR) in that year at £9 billion. He had proposed that £750 million of this should be found from the Contingency Reserve, £500 million from the borrowing of the nationalised industries and further reductions in Civil Service manpower and yet a further £500 million from the disposal of assets. This left £4.75 billion to be found from Departmental programmes. The Ministerial Group (MISC 11) had set itself this target. It had discussed the plans with all the major spending Ministers. The results were set out in Annex B of their report, circulated with his paper C(79) 31. They recommended cuts totalling about £4 billion, leaving him still £800 million short of the target which was necessary to avoid the risk of higher interest rates or higher taxation. However, it was necessary to reconcile these economic objectives with what was politically practicable. The group had also raised the question of presentation: those cuts which fell in the local authority area could be announced separately, or they could be presented as a single global cut, within which the local authorities would be free to vary their expenditure. However, legislative changes would be necessary in any case, and some indication of the Government's wishes would be inevitable.

In discussion, it was suggested that the forecasts made insufficient allowance for the potential increased revenue from North Sea oil. Oil price increases this year meant that the oil companies would be declaring very large profits, and these would be bound to rise further. The British Government, like other host Governments, should insist on increasing its share of the total 'take' when oil prices rose faster in real terms than oil company's costs. Some changes in the tax regime had already been made in the last Budget. On the other hand it was important not to discourage the development of smaller fields and the forecast already allowed for the Budget tax changes and the most recent increases in oil prices. The effect of any further changes in the tax regime in 1980-81 would not be very large. The effects on the PSBR would be more than offset by the deflationary effect of further oil price increases, working through the British economy through its effects on our overseas trade. In any case, there were other claimants than public expenditure on any additional revenue receipts. It was important to keep the PSBR down to the lowest practicable level in order to relieve interest rates. It was also essential to finance other tax reforms, for example in the structure of corporation tax and capital gains tax, to which the Government was committed by its Manifesto. In addition, various 'accelerator' schemes, which could cost another £500 million by way of tax forgone, were already under study. The forecasts already assumed indexation of excise duties. There was no real scope for other major tax increases. And no room for further real reductions in personal taxation unless public expenditure could be reduced further.

The Cabinet then considered the expenditure reductions proposed in Annex B of the report circulated with C(79) 31.

MISC 11 recommended a reduction of £115 million, compared with a bid for an increase of £13 million. In favour of the reduction, it was argued that the Defence Budget had risen by 4.6 per cent from the previous year's outturn and that the additional bid represented a further increase of 4.7 per cent to 1980-81. The MISC 11 suggestion would still allow for an increase in Defence expenditure of 6 per cent over the two years taken together, which in real terms more than met the commitment to the North Atlantic Treaty Organisation (NATO). The Ministry of Defence was very staff intensive, particularly in the Royal Dock Yards and Ordnance Factories, and there should be room for substantial savings. By comparison, the cuts being sought in other, politically much more sensitive programmes, were far more damaging. Other North Atlantic Treaty Organisation members (especially Germany) had failed to meet their commitment to increase defence expenditure by 3 per cent. The terms of the agreement in NATO allowed for exemption for countries in economic difficulties.

Against this, it was argued that the present Government was committed, both domestically and internationally, to increasing the level of defence expenditure. Internationally, it was important to persuade other NATO members to increase the total NATO defence effort, and to do so it was necessary that the United Kingdom should itself be seen to meet the obligations which it had urged on others. Domestically, it was desirable that the Government should be able to show an increase in the defence budget, compared with the plans inherited from its predecessors.

In further discussion, there was general agreement that, in view of the large reductions in expenditure demanded of other Departments, the Defence Budget should be reduced by £115 million as proposed by MISC 11. It would be important however to present this decision in the least damaging way.

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It was agreed that the aid programme should be reduced by £115 million, and that the provision for other Foreign and Commonwealth programmes should be reduced by £13 million, noting that in the latter case the reductions would not necessarily fall in the areas suggested by MISC 11.

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No reductions were possible to these figures at this stage though they underlined the necessity of the successful outcome to the negotiations now under way.

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Savings of £43 million were agreed; it was noted that the £20 million originally proposed to be found from a reduction on capital grants might be met by alternative savings, including disposals of agricultural land. Any shortfall in the share of the Scottish and Welsh Agriculture Departments would be made good by the Ministry of Agriculture, Fisheries and Food.

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Net savings of £5 million were agreed on the understanding that, provided the savings were achieved, the Forestry Commission would be allowed to retain for their own purposes up to half of the proceeds of any assets they might sell.

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Savings of £187 million were agreed.

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Savings of £17 million were agreed, although it was noted that the makeup would be different from that considered by MISC 11.

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It was noted that a recalculation of interest rate subsidies, made necessary by rising interest rates, involved an addition of £170 million. If interest rates fell so would the amount of finance required. The Secretary of State for Trade should examine whether a higher proportion of the credit made available by Export Credits Guarantee Department could be financed by the banks.

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Savings of £513 million were agreed.

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Savings of £7 million were agreed; it was noted that there might later be a call on the Contingency Reserve to meet additional expenditure on energy conservation and to finance research and development, particularly in the nuclear field.

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Savings of £250 million were agreed.

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MISC 11 had proposed reductions of £1, 264 million in the housing programme, £54 million in the budget of the Property Services Agency (PSA) and £285 million in the other Department of the Environment services. The Secretary of State for the Environment had offered reductions of £621 million in the housing programme, the full cuts asked for on the PSA and £212 million on other DOE services. The original figures on housing had been derived from a list of cuts considered by the Government when in Opposition. It was argued that since these figures contained errors which had been discovered since then, the reductions to be sought should be reduced. Against this, it was argued that the Opposition cuts had no formal status, and that the proposals of MISC 11 were justified in their own rights. Council house rents were, in general, much too low. In real terms they were still below the level of 1973-74. The benefits of housing subsidies were in many cases going to the wrong people. An increase in rents would encourage the large scale sale of council houses to which the Government was committed. The forecasts already assumed that rents would rise in line with the price inflation in 1980-81. The MISC 11 proposal involved a further £1 per week increase. But the Government had no power to insist on this. To take such powers would involve repeating the mistakes of the 1972 Housing Finance Act, and might lead to another confrontation of the kind that developed at Clay Cross at that time. In 1972, the Government had been able to offer a new rent rebate scheme as an inducement. This time such a possibility was not open though the substantial discounts being made available when council houses were sold might serve a similar purpose. This was in any case a difficult time to increase rents, with a serious impact on the retail price index, and would be likely to add to the pressure for excessive pay increases.

It had been proposed to reduce the provision of £1,285 million for new council house building by £440 million. A further cut in this programme might be preferable to an increase in council house rents, provided it did not hit the provision of special accommodation for disabled people and other priority groups. Other cuts in the programmes of the Department of the Environment, and of the Property Services Agency, might prove possible. The Secretary of State had urgently reviewed the DOE programme as a whole and was ready to offer a further £200 million. But substantial real cuts were needed. Many of those proposed earlier did no more than recognise shortfalls in expenditure which would have occurred anyway. There were also substantial additional bids for expenditure on housing-related programmes which would need further consideration. MISC 11 should re-examine the total DOE/FSA programmes with these points in mind and with a view to making the maximum possible savings.

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Additional expenditure of £24 million was approved.

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Reductions of £4 million were approved.

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The Chief Secretary had originally asked for reductions of £860 million. MISC 11 had recommended cuts of £547 million, against which the Secretary of State for Education had suggested cuts totalling £517 million. These proposals involved substantial reductions in peripheral expenditures on education programmes, in order to avoid attacking educational standards too severely. They would involve, however, considerable reductions in the moneys available for school meals, for school transport, and for nursery education. It was proposed to give local authorities discretion to make charges in these areas and to give them discretion to allocate the available funds as they thought best. Such legislation would be highly contentious and difficult to carry. It would be severely criticised, particularly by Members for rural constituencies which would be badly hit. There was little doubt that most of the Shire counties, though not all local authorities in urban areas, would wish, or have little option but, to take full advantage of these opportunities to increase charges. For example, school transport might cost £2.50 or £3 per week for each child, yielding savings of £40 million.

Charges for nursery education would yield half the savings envisaged in this area of £70 million, at a cost of perhaps £4 per child per week. Authorities would be given discretion to abandon the present school meals service, substituting some cheaper form of refreshment at lunch time. In addition, £20 million would be found from increasing the parental contribution for university and further education. This might prove the most unacceptable of all the proposed cuts.

THE PRIME MINISTER, summing up the discussion, said that the Cabinet had now reached a number of decisions. It would resume its discussion of public expenditure on Monday 23 July, when it would consider the outstanding items starting with the education programmes on which it had not been possible to complete its work. The Chancellor of the Exchequer should arrange for MISC 11 to meet again urgently before then to re-examine the programmes of the Department of the Environment. No general announcement about the reductions in public expenditure would be made before the Recess. It would however be necessary to reach agreement on what might be said to the local authorities about their expenditure in 1980-81 during the summer.

The Cabinet -

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

Cabinet Office

19 July 1979