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COPY NO 79

CABINET

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

THURSDAY 12 JULY 1979

at 10.30 am

PRESENT

The Rt Hon Margaret Thatcher MP
Prime Minister

e Rt Hon William Whitelaw MP retary of State for the Home Department	The Rt Hon Lord Hailsham Lord Chancellor
e Rt Hon Lord Carrington retary of State for Foreign and mmonwealth Affairs	The Rt Hon Sir Geoffrey Howe QC MP Chancellor of the Exchequer
e Rt Hon Sir Keith Joseph MP retary of State for Industry	The Rt Hon Francis Pym MP Secretary of State for Defence
e Rt Hon Lord Soames d President of the Council	The Rt Hon James Prior MP Secretary of State for Employment
e Rt Hon Sir Ian Gilmour MP d Privy Seal	The Rt Hon Peter Walker MP Minister of Agriculture, Fisheries and Food
e Rt Hon Michael Heseltine MP retary of State for the Environment	The Rt Hon George Younger MP Secretary of State for Scotland
e Rt Hon Nicholas Edwards MP retary of State for Wales	The Rt Hon Humphrey Atkins MP Secretary of State for Northern Ireland
e Rt Hon Patrick Jenkin MP retary of State for Social Services	The Rt Hon Norman St John-Stevas MP Chancellor of the Duchy of Lancaster
e Rt Hon John Nott MP retary of State for Trade	The Rt Hon David Howell MP Secretary of State for Energy

Rt Hon Mark Carlisle QC MP etary 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

Rt Hon Norman Fowler MP ister of Transport	The Rt Hon Michael Jopling MP Parliamentary Secretary, Treasury

SECRETARIAT

Sir John Hunt
Mr M D M Franklin (Items 3 and 4)
Mr P Le Cheminant (Item 5)
Mr P J Harrop (Items 1 and 2)
Mr R L Wade-Gery (Items 3 and 4)
Mr P Mountfield (Item 5)
Mr D E R Faulkner (Items 1 and 2)

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1. THE LORD CHANCELLOR said that he had been concerned to read an article in the previous weekend's Sunday Telegraph which purported to quote verbatim remarks made by a number of senior Ministers. If the remarks were accurately reported they were in breach of the conventions of public life.

THE PRIME MINISTER, summing up a brief discussion, said that the article had been a matter of serious concern to many members of the Cabinet. If such reports were repeated they would destroy all trust between Ministerial colleagues and undermine the basis of Cabinet Government. She had emphasised at the Cabinet's first meeting the importance of maintaining the strictest standards of confidence in Cabinet and between members of the Cabinet: Ministers should remind themselves of the minutes of that meeting and of the relevant paragraphs of Questions of Procedure for Ministers.

The Cabinet -

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

ENTARY

2. The Cabinet were informed of the business to be taken in the House of Commons during the following week and of the business proposed for the remainder of the period up to Friday 27 July. It was intended that the House should rise for the Summer Recess on 27 July and return on Monday 29 October.

THE HOME SECRETARY said that he intended to speak early in the debate on capital punishment which was to take place on Thursday 19 July. In doing so he would be departing from the practice of his predecessors, who had spoken at the end of previous debates on this subject. Unlike them however he would not be seeking to influence the House towards a particular conclusion. He would set out as fairly as possible the considerations which should affect the decision in principle and the questions which would arise in drafting new legislation. Finally he would say that, having again considered the arguments, he would himself vote against the Motion to restore capital punishment, but that if it were carried he and his Department would do everything possible to give effect to the wishes of the House and to ensure that any subsequent Bill was soundly drafted. The debate would take place on the very general Early Day Motion which had been tabled in the name of Mr Eldon Griffiths and others; it would be open to amendment but its sponsors would probably try to persuade other Members against tabling amendments or pressing them to a division.

The Cabinet -

1. Took note.

THE SECRETARY OF STATE FOR TRADE said that in his view it was essential for the Competition Bill to receive its Second Reading before the House of Commons rose for the Summer Recess, in order to get the controversy over the abolition of the Price Commission out of the way. It would be damaging to the Government's position to defer Second Reading until the autumn at a time when the Retail Price Index would be reaching a peak and the autumn round of pay negotiations at a critical stage. An early Second Reading would also provide constitutional justification for the disbanding of the Commission which was now going ahead.

In discussion it was suggested that a debate on the Second Reading of the Competition Bill could take the place of the proposed debate on regional policy on 25 July. The arrangements for that debate and for laying the necessary Orders presented serious difficulty in relation to the forthcoming debate in Scottish Grand Committee on unemployment in Scotland, and further problems would arise at the same time from the Government's decisions on dispersal and from redundancies in the shipbuilding industry. It was suggested that the announcement of the Government's new regional policies could be deferred for some weeks without forgoing the expected savings provided the transitional period of one year was shortened, and that the debate on the Orders could be deferred until the autumn. On the other hand it was argued that the announcement must be made in the House of Commons; that any delay in making it could damage business confidence; and that since the proposals were already being negotiated in Brussels an early announcement was needed to anticipate any possible leak from that source. The date of the summer adjournment ought not to be postponed since the House would then have to sit while the Prime Minister and the Foreign and Commonwealth Secretary were at the Commonwealth Heads of Government Meeting in Lusaka.

THE PRIME MINISTER, summing up the discussion, said that the Cabinet agreed that arrangements should be made for the Competition Bill to receive its Second Reading before the Summer Recess and that the date of the summer adjournment should not be postponed. She would consider with the Ministers principally concerned how the business for the last few days before the Recess might be rearranged for this purpose.

The Cabinet -

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

3. THE FOREIGN AND COMMONWEALTH SECRETARY said that during his visit to London the Secretary General of the United Nations, Dr Waldheim, would be informed of the satisfactory appointment of Sir James Murray as the Five Western Powers' special envoy to discuss with the South African Government the difficult search for a settlement on Namibia. On Rhodesia, the Organisation of African Unity meeting in Monrovia had adopted an unhelpful resolution which had, however, stopped short of recognising the Patriotic Front as the sole representatives of the people of the territory. Meanwhile Bishop Muzorewa's Washington talks with United States leaders seemed to have gone fairly well, although he had been non-committal on political changes. During his impending London visit we would be speaking to him along the lines which the Government's spokesman had taken in Parliament on 10 July.

THE PRIME MINISTER, summing up a brief discussion, said that the Cabinet noted what the Foreign and Commonwealth Secretary had said. A question had been raised about the likelihood and nature of Nigerian action against British interests in the Rhodesian context, with particular reference to the position of British Petroleum (BP) since this might affect the Government's plans for disposing of BP assets: this would be considered by the Defence and Oversea Policy Committee. It had also been suggested that private legal proceedings might be taken against Bishop Muzorewa during his visit to London: the Attorney General would be urgently consulted about the possibility of this and whether in that event it would be appropriate to issue a nolle prosequi.

The Cabinet -

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

THE FOREIGN AND COMMONWEALTH SECRETARY said the Defence and Oversea Policy Committee had concluded that on humanitarian grounds we should agree to take over a phased period of three years a further 10,000 Vietnamese refugees, who would include any picked up by our ships at sea but would otherwise come only from Hong Kong; and that £5 million should be made available from the overseas aid budget.

THE PRIME MINISTER, summing up a brief discussion, said that the Cabinet endorsed the Committee's conclusion. We should not announce our decision until next week, and should meanwhile tell Dr Waldheim only that we hoped to be able to agree to the quota proposed by the High Commissioner for Refugees. The announcement need not refer to the fact that the refugees' arrival would be phased, although the Home Secretary would need to make clear (perhaps in answer to an arranged Supplementary Question) that they could obviously not all arrive at once.

The Cabinet -

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

4. THE FOREIGN AND COMMONWEALTH SECRETARY said the Irish had now assumed the Presidency of the Community for the coming six months. He had visited Dublin the previous day for talks with the Taoiseach and the Irish Minister for Foreign Affairs. He had stressed that, if the Irish wished to make a success of their Presidency, they would need to resolve our problems over the budget. He had assured them that we were not trying to solve our problems at the expense of the Irish Republic. The Lord President of the Council would be representing the Government at the inaugural session of the European Parliament on 18 July.

In a brief discussion it was reported that, as a result of discussions between the Chancellor of the Exchequer and Commissioner Ortoli, it might be possible at the forthcoming Council of Ministers (Finance) to find an adequate way to protect our interests in connection with the payment of interest rate subsidies to Italy and the Irish Republic under the European Monetary System. The Council was not expected to discuss the United Kingdom budget problem but Commissioner Tugendhat had been urged to ensure that the Commission's factual analysis was available in time for discussion at the September meeting.

The Cabinet -

Took note.

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

Cabinet Office

12 July 1979

COPY NO 37

CABINET

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CC(79) 9th Conclusions Minute 5

Thursday 12 July 1979 at 10.30 am

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The Cabinet considered a memorandum by the Chancellor of the Exchequer (C(79) 27) about the Economic Background to the Public Expenditure decisions; three memoranda by the Chief Secretary, Treasury, one of which (C(79) 26) covered a report by officials on the scope for reductions in public expenditure in the years 1980-81 to 1983-84, one covered a report by officials on the investment and financing programmes of the nationalised industries for the same years (C(79) 28), and one (C(79) 25) contained his own recommendations for reductions in public expenditure; together with a memorandum by the Secretary of State for Education and Science (C(79) 29) about the scope for reductions in the Education Programme; and a minute dated 10 July from the Secretary of State for the Environment to the Prime Minister, reporting on discussions with the Local Authority Associations about reductions in public expenditure in those years.

THE CHANCELLOR OF THE EXCHEQUER said that, since coming to office, he had made a careful reappraisal of the country's economic prospects. Our performance was deteriorating, and all the indicators were pointing in the wrong direction. Inflation seemed likely to rise fast, and this made it essential to maintain control over borrowing and the money supply. The recent oil price increases made the situation worse. The shape, though not the size, of the problem was in line with what the Party had expected before the Election. They had agreed then that there was no escape through relaxing the money supply and the borrowing requirement. This would merely lead to greater inflation after a short-lived period of false security. Similarly, the tax cuts were crucial to the strategy and should not be forgone. The forecast public sector borrowing requirement (PSBR) for 1980-81 was made much higher by the likely impact of comparability settlements in the public sector and it was necessary to seek off-setting reductions. All of this had led him and the Chief Secretary to propose reductions of £6.5 billion on the inherited plans for that year. This implied a reduction of only

£1.5 billion (or about 2 per cent) on the current year's spending levels. It would reduce expenditure, not to the target level of the out-turn of 1977-78, but about half way to that point, while leaving public expenditure at a constant share of about 42 per cent of the gross domestic product (GDP). All this was necessary merely to recover lost ground. The proposed levels for 1980-81 would not permit any significant reduction in the level of taxation in the next Budget, apart from the indexation of personal allowances, and it would require the revalorisation of specific duties. But it would reduce the PSBR from 4.4 to 4.2 per cent of GDP, which was an essential step in the right direction.

In discussion, it was suggested that the Government faced the most serious dilemma in economic policy of any post-war Government. Inflation was rising fast, against the background of a strong pound, inflows of foreign currency, and a growing money supply. This made it essential to reduce the level of public expenditure and at least to stabilise the present level of taxation if not reduce it. Against this, it was argued that the Government's strategy, as developed in Opposition and exemplified in the first Budget, had been overtaken by events. Expenditure cuts on the scale now proposed, at a time when economic activity was declining and unemployment mounting, were no longer feasible or justified. Massive redundancies were in prospect in many major public and private industries. The Cabinet should take into account the employment consequences of the cuts proposed, which might even wipe out many of the savings by increased social security expenditure. The policy might be wrong in other respects too: by maintaining a high level of interest rates, which merely induced additional inflows into sterling, it deterred investment and increased industrial costs. However, the real rate of return on new investment was still negative, and it was this which made it so difficult to sell more gilt edged stock and thus reduce the growth in the money supply. Moreover, the strong inflows of currency were not solely the result of interest rate differentials, but reflected confidence in the Government's economic policies.

In further discussion, it was argued that the overall political effects of the cuts proposed would be seriously damaging to the Government, both in the country and in the House of Commons. They would be seen as inconsistent with many of the Manifesto pledges to improve standards of service. Many of the measures proposed would require legislation which would be very difficult to carry through the House of Commons. It was quite possible that the cuts would be much more politically damaging than the alternative of holding or even increasing the level of personal taxation. It was further argued that there were insufficient positive measures to accompany the proposed reductions. The public needed to see the light at the end of the tunnel. Measures to encourage wealth creation, for example by support for small businesses, needed to be included to offset some of the cuts, which would seriously reduce the level of Government support for industry. A number of so-called 'accelerator' schemes of a positive kind were already being studied urgently: these should be considered in the same context as the expenditure cuts.

In continued discussion, it was argued that the economic forecasts on which the cuts were based were necessarily very imprecise. The reductions which Departments had been asked to consider had already been increased three times since the Budget. This made it very difficult for Ministers in the front line of negotiations to go back and ask for more. Past experience suggested that Governments often over-reacted to such predictions, and it was important to avoid making irreversible policy changes which could be politically very damaging.

It was also argued that, even if the overall size of the reductions was about right, the internal balance was wrong, and the speed of change too great. It might be better to spread out the reductions over a longer period. The impact of the cuts varied greatly between Departments. There should be no serious difficulty in achieving the targets in the programmes for the Departments of Trade, Transport or Employment. But in the Defence Budget, where the baseline had changed since the Chief Secretary's paper had been circulated, the cuts he proposed would make it impossible to achieve the 3 per cent growth rate in Defence expenditure which our NATO commitments required. To abandon those now would be strategically and politically damaging, and would undo the morale-building effects of the Government's earlier Defence Budget decisions. However, because Defence and similar areas of public expenditure were largely exempt from cuts, the reductions required in other programmes were correspondingly larger. Moreover, many of the proposed reductions were based upon analysis carried out in Opposition, when access to full information was necessarily limited. In many local authority services, the Government was in no position to impose its will. In the Education programme, the cuts were so substantial, and would require such major legislative changes, that there was no practical way of making them in the time available.

Against this, it was argued strongly that no-one had faulted the Chancellor's analysis of the economic prospects. No Cabinet could afford to gamble on the possibility that things would turn out better than expected. The Chief Secretary's proposals were unpalatable in political terms. But no viable alternatives had been put forward. Without large cuts in public expenditure, or damaging increases in personal taxation, the Government could not bring the growth in money supply under control. The present level of public expenditure was being sustained only at the expense of the wealth-creating sectors of the community, with consequent damage to the level of investment and the prospects for growth in the longer term.

THE PRIME MINISTER, summing up, said that the Cabinet would resume its discussion of public expenditure at its next meeting, and should seek to reach decisions before the Summer Recess on the level of expenditure for 1980-81. She would arrange for a small group of Ministers to discuss with the spending Departments the major changes proposed by the Chief Secretary, reach agreement on as many of them as possible, and report back to the Cabinet at its next meeting. The Chancellor of the Exchequer should prepare a paper for the next meeting, explaining the consequences of failure to meet the target reductions proposed by the Chief Secretary.

The Cabinet -

Took note, with approval, of the summing up of their discussion by the Prime Minister, and invited the Chancellor of the Exchequer and the other Ministers concerned to proceed accordingly.

Cabinet Office

13 July 1979