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CABINET

CONCLUSIONS of a Meeting of the Cabinet
held at 10 Downing Street on
THURSDAY 6 NOVEMBER 1980
at 10.00 am

PRESENT

The Rt Hon Margaret Thatcher MP
Prime Minister

[The Rt] Hon William Whitelaw MP
[Secret]ary of State for the Home Department

The Rt Hon Lord Hailsham
Lord Chancellor

[The Rt] Hon Lord Carrington
[Secret]ary of State for Foreign and
[Comm]onwealth Affairs

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

[The Rt] Hon Sir Keith Joseph MP
[Secret]ary of State for Industry

The Rt Hon Francis Pym MP
Secretary of State for Defence

[The Rt] Hon Lord Soames
[Lord] President of the Council

The Rt Hon James Prior MP
Secretary of State for Employment

[The Rt] Hon Sir Ian Gilmour MP
[Lord] Privy Seal

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

[The Rt] Hon Michael Heseltine MP
[Secret]ary of State for the Environment

The Rt Hon George Younger MP
Secretary of State for Scotland

[The Rt] Hon Nicholas Edwards MP
[Secret]ary of State for Wales

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

[The Rt] Hon Patrick Jenkin MP
[Secret]ary of State for Social Services

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

[The Rt] Hon John Nott MP
[Secret]ary of State for Trade

The Rt Hon David Howell MP
Secretary of State for Energy

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Rt Hon Mark Carlisle QC MP
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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 Robert Armstrong
Mr P Le Cheminant (Items 3-5)
Mr D M Elliott (Item 2)
Mr R M Hastie-Smith (Item 2)
Mr W N Hyde (Item 1)
Mr D J L Moore (Items 3-5)
Mr L J Harris (Item 1)

CONTENTS

AMENTARY
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1. THE CHANCELLOR OF THE DUCHY OF LANCASTER informed the Cabinet of the business to be taken in the House of Commons during the following week. He expected Parliament to be prorogued at the end of business on Thursday, 13 November. The State Opening of the new Session would be on Thursday, 20 November.

Prison
Strike

THE SECRETARY OF STATE FOR NORTHERN IRELAND said that there was likely to be increasing Parliamentary interest over the coming weeks in developments in the hunger strike in the Maze Prison and in the consequences of the strike for the political and security situation in Northern Ireland. He would keep the Cabinet informed on these matters.

The Cabinet -

Took note.

2. THE FOREIGN AND COMMONWEALTH SECRETARY said that the fighting between Iraq and Iran was continuing. The Iraqis were still trying to capture Abadan and there was little immediate prospect of peace. The International Red Cross were now trying to help to get the ships caught in the Khorramshahr area of the Shatt-al-Arab freed. In regard to the United States hostages in Iran, the Iranians seemed to have missed the most opportune time for striking an advantageous bargain. There might now be some delay before any further developments occurred. More attention was now being focussed on the four British subjects under arrest in Iran. It might be possible to do something to help them, using the Algerians as intermediaries. The release of Mr Sparkes in Iraq was largely due to the intervention of King Hussein. It was likely to prove more difficult to obtain the release of the other British subject imprisoned in Iraq, Mr Smith, because of the strong probability of his guilt of the charge of which he was accused.

In a brief discussion it was noted that oil prices were rising on the spot market as a result of the Iraq/Iran conflict. Although the position was confused, it seemed possible that the French Government were encouraging their suppliers to hold higher stocks and to buy on the spot market. It was improbable that France had succeeded in replacing more than half of the oil supplies which she had previously received from Iraq. The International Energy Agency had so far been successful in persuading its members to hold off the spot market; but, if those countries which had been heavily dependent on Iraqi and Iranian oil supplies lost their nerve, there was a possibility of spot market prices rising very sharply with a consequential effect on term prices. Such a development could have unwelcome consequences for the sterling exchange rate.

THE FOREIGN AND COMMONWEALTH SECRETARY said that during his recent visit to Hungary he had met Mr Kadar, First Secretary of the Communist Party Central Committee and a figure of great authority in the country. He was clearly very anxious about the present situation in Poland and worried in case the West should give the Russians some reason for invading that country. He had also stated that the longer Mr Brezhnev remained in office in the Soviet Union the better this would be for the West.

THE FOREIGN AND COMMONWEALTH SECRETARY said that during his recent visit to Poland he had been struck by the realistic approach of the Polish leadership to their social and economic problems. These were very real and were likely to grow acute over the next six months. There was a major shortage of potatoes. There were already long food queues. Nevertheless the Polish leadership seemed confident that they would be able to achieve some kind of political solution to their difficulties, if only in the short term. Contrary to the general belief he had gained the impression that Mr Kania, the Polish Communist Party leader and Mr Pinkowski, the Prime Minister, had gone to Moscow at their own suggestion to explain and obtain clearance for their intentions, rather than in response to a Soviet summons. From Poland's point of view it was important that the countries of the West should avoid open speculation about the likelihood of a Russian invasion. Such speculation could make the event more probable.

THE FOREIGN AND COMMONWEALTH SECRETARY said that the size of the landslide in Mr Reagan's support had been a surprise to everybody. So had the Republican capture of the Senate. British interests now depended heavily on the calibre and experience of the people whom Mr Reagan would choose to form his Administration. It was likely that over the next few months relations between the United States and the countries of Western Europe would go through a difficult period, as the Americans felt that recently Western Europe had been taking advantage of them in a number of respects. It was also possible that Mr Reagan's relative inexperience would lead to considerable difficulties in regard to the Arab/Israel dispute.

The Cabinet -

Took note.

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3. The Cabinet considered a memorandum by the Chancellor of the Exchequer on the pay and price factors to be included in the 1981-82 cash limits and votes (C(80) 60); a memorandum by the Chancellor of the Exchequer on certain ancillary questions on pay related to the 1981-82 cash limits and votes (C(80) 65); and a letter from the Lord President of the Council to the Chancellor of the Exchequer dated 31 October 1980.

The Cabinet's discussions and conclusions are recorded separately.

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4. The Cabinet considered a memorandum by the Secretary of State for the Home Department (C(80) 61) on the Rate Support Grant (RSG) settlement for 1981-82.

THE SECRETARY OF STATE FOR THE HOME DEPARTMENT said that, under his chairmanship, a Group (MISC 21) of the Ministers directly concerned with local authority expenditure had considered the RSG settlement for 1981-82. In England and Wales this would be the first year of the new system of Block Grant, and of separate grant settlements for the two countries. The Group had agreed on the option for the method of grant distribution, described in detail in his memorandum, which was the preferred choice of the Association of County Councils. They had looked at the options against the background that, under the last Administration, there had been a major and deliberate shift of grant from shire counties to London, and to outer London in particular. The option now recommended would start to reverse this trend and would lead to a net average gain of 1.5p, in terms of the rates, to non-metropolitan ratepayers and an average net loss of 1.2p for outer London ratepayers. The possibilities for further improvements in the system would be considered during the next year. The arrangements in Wales would be different in detail, though similar in their broad effect, to those in England. The division of overall grant between England and Wales would remain in 1981-82 on the same percentage basis as in previous years, but a study would be made before next year in the hope that the 1982-83 grant could be divided more satisfactorily. The Cabinet had now agreed that the cash limit should be based on a pay factor of 6 per cent and a prices factor of 11 per cent, and on the procedure for dealing with the 'overhang' effect of staged settlements. The pay of the police and of firemen would depend on the level of earnings through the year, and decisions on them could be taken later. If the Cabinet accepted the Group's recommendations on the method of grant distribution, the remaining issue for decision was whether the overall grant percentage for England and Wales should be 61 or 60 per cent.

THE SECRETARY OF STATE FOR THE ENVIRONMENT said that he recommended a grant percentage of 60 per cent. This would be highly unpopular, but it was essential to continue to exert the strongest pressure on the local authorities to cut their current expenditure. This applied both to those authorities which had overspent this year and also to those which had kept to target but which might otherwise be tempted to relax in 1981-82. There was a risk that this decision would lead to higher rates than otherwise. His officials judged that a 60 per cent grant, taken with the other changes decided for local authority expenditure, might lead to rate increases averaging 22 per cent, with much higher increases in some individual authorities. This was on the assumption that local authority treasurers would assume $13\frac{3}{4}$ per cent for inflation and would budget for 3 per cent more in volume terms than the Government were assuming. He intended, however, to challenge those assumptions vigorously while they were still under discussion, and in this way to influence the local authorities to make lower rate increases.

In discussion it was argued, in support of maintaining the grant percentage at 61 per cent, that the local authorities were already faced with the pressures of a fundamental change in the distribution system, of tight cash limits, and of a further 1 per cent volume cut on current expenditure on top of the 2 per cent announced in August. A 1 per cent cut in the grant percentage would add a further 2.8p on average to the rates in England and 5p to 6p on average in Wales. Faced with this overall package treasurers were likely to rate high and borrow more, so adding to the burdens on ratepayers and to the Public Sector Borrowing Requirement. This would be yet another burden on industry, since 60 per cent of the rates fell on them. High rates, together with the prospect of sharp increases in the water rate, increases in council house rents and increases in gas and electricity prices would coincide in April 1981 to create a climate in which it would become very difficult to contain the pressure for higher wage increases. So far the Government's tough stance in demanding savings and greater efficiency by local authorities had been generally supported. A decision to reduce the overall grant would, however, be seen by the public as direct action by the Government to put up the rates, and criticised as such.

On the other hand it was argued, in support of a grant percentage of 60 per cent, that it could well make little or no significant difference to the level at which rate demands were set, if the grant percentage was fixed at 60 rather than 61 per cent; and it was important to keep up the greatest possible pressure for savings in local authority current expenditure, for which there was certainly scope and which would be less damaging to industry than cuts in capital spending.

THE PRIME MINISTER, summing up the discussion, said that the Cabinet agreed to endorse the method of grant distribution in England and Wales recommended by the MISC 21 Group. They had already agreed in earlier discussion on the allowances to be made in the cash limit for pay and price increases. They further agreed on balance that the overall grant percentage should be 60 per cent. The Secretary of State for Scotland and the Chief Secretary, Treasury, should now reach agreement on the appropriate figures for Scotland in the light of the decisions for England and Wales.

The Cabinet -

1. Approved the method of distribution of the Rate Support Grant in England and Wales, and the share of grant between the two countries, summarised in paragraphs 3-8 of C(80) 61.

2. Agreed that the overall grant percentage for England and Wales should be 60 per cent.

3. Invited the Secretary of State for Scotland and the Chief Secretary, Treasury, to agree appropriate figures for Scotland in line with those selected for England and Wales.

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5. The Cabinet briefly resumed their discussion of public expenditure and the Public Sector Borrowing Requirement in 1981-82. The discussion is recorded separately.

The Cabinet -

Agreed to resume their discussion of public expenditure on Thursday 13 November.

Cabinet Office

6 November 1980

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CABINET

LIMITED CIRCULATION ANNEX

CC(80) 39th Conclusions, Minute 3

Thursday 6 November 1980 at 10.00 am

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The Cabinet considered a memorandum by the Chancellor of the Exchequer on the pay and price factors to be included in the 1981-82 cash limits and votes (C(80) 60), and a memorandum by the Chancellor of the Exchequer on certain ancillary questions on pay related to the 1981-82 cash limits and votes (C(80) 65); they also had before them a letter from the Lord President of the Council to the Chancellor of the Exchequer dated 31 October 1980.

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Limits
81-82

THE CHANCELLOR OF THE EXCHEQUER said that the Cabinet needed to set cash limits for pay covering numerous public service groups including the Armed Forces, doctors, nurses, National Health Service staff, teachers, local authority staff and civil servants. In his view a single pay cash limit of 6 per cent should apply to all these groups. He would like to announce this pay cash limit later in the day, so that the Government's view could be available to influence expectations in current wage negotiations and as a reassurance to the Confederation of British Industry (CBI) whose annual conference was about to begin. The private sector was bearing the brunt of the present recession and attached a good deal of importance to the Government holding down the increase in public service pay. An announcement of a 6 per cent cash limit would give a clear indication of the Government's intention of doing so. Apart from the main decision on the figure, there were a number of technical points, relating in particular to the treatment of staged increases, to be decided. His impression from preliminary discussions was that his proposals on these points would be acceptable to the Cabinet.

In discussion, the following main points were made -

a. It was essential that the Government's pay assumption for cash limit purposes should be realistic. A cash limit set too low which encouraged confrontation could be more expensive than one set a little higher which had a chance of acceptance. These were matters of fine judgment, but it was relevant that by next April when the bulk of the public service pay settlement dates would have been reached, the retail price index (RPI) might still be about 13 per cent up on the year before, and private sector pay settlements might well be averaging out at 10 per cent or more. It should be possible to achieve public service settlements in single figures, but 6 per cent would be likely to be, at best, at the limits of acceptability and might well prove to be too severe. A figure in the range of 7 to 8 per cent would be likely to reduce considerably the risks of confrontation. Against this it was argued that expectations were falling against a background of sharply rising unemployment and numerous liquidations in the private sector. Moreover, there were conspicuous examples of low settlements being sought in the trading public sector, eg. BL's "final offer" of 6.8 per cent and Rolls-Royce's decision to offer no pay increase other than on the grounds of improved productivity, which would increase the likely acceptability of 6 per cent in the public services. It was relevant also that public service employees enjoyed job security in a difficult period, and that higher settlements would involve yet further increases in taxation and the further weakening of the private sector.

b. Even if the Cabinet decided to accept 6 per cent as its objective for the pay factor in cash limits for the public services, it would be prudent only to announce figures for particular limits as it was operationally necessary to do so, and not to make an announcement now that would commit the Government to 6 per cent as of universal application in the public services. There were many uncertainties about particular settlements, and many links between settlements which could put a single universal objective at risk. For example, one of the earliest settlements due in the present pay round was that for local authority manual employees, whose employers had recourse to their own sources of finance through the rating system, were able to borrow, and had significant possibilities for cutting staff. A 6 per cent cash limit applied to them might well be tenable so far as their wage bill was concerned, whilst still allowing higher settlements for the individual employee. The negotiations for the National Health Service (NHS) manuals which would follow closely on those for local authority manual workers would, however, be wholly constrained by the cash limits set, because there was no alternative source of finance and only limited opportunities to reduce staff or save money in other ways. Moreover in the case of the Civil Service the existence of a separate cash limit for pay, the decisions already taken and announced on staff cuts and the Cabinet's decision against staging gave virtually no flexibility at all. The water workers, too, represented a difficult case, lying as they did between the nationalised industries and the public services. They had considerable industrial power, but the industry was generally acknowledged to be over-manned. The actual outcome of negotiations in terms of the pay increase gained could not therefore be predicted with any confidence. The water workers' settlement would cast its own shadow over other public sector negotiations. Given these complexities it would be sensible to limit announcements about the pay element in cash limits to those which were operationally necessary, and thus to preserve a degree of flexibility to respond to changing circumstances.

c. It could be argued that there ought to be a single pay cash limit figure for the whole of the public services and the nationalised industries. Such a universal limit, by appearing fair, might lead some groups to settle within the limit who would not otherwise do so. On the other hand a single limit covering so wide a field was not reconcilable with the facts of pay bargaining, particularly in the nationalised industries, would appear as a "norm" to be challenged, and would almost certainly be broken by significant groups, thus discrediting the policy as a whole.

d. The Government's firm commitments on the pay of the Armed Forces and the police were complicating factors. In the case of the police, it would probably be enough to say that the settlement due in September 1981 would depend on the movement of earnings during the year and would fall for decision at the time. The pay settlement due for the Armed Forces next April would need to be considered by the Cabinet when the report of the Armed Forces Pay Review Body (AFPRB) was to hand. The Government's commitment to the Armed Forces stood, but it might be possible to influence the review body through the evidence to be given to them by the Chancellor of the Exchequer and the Secretary of State for Defence. The more immediate problem here was the extent to which and the way in which any excess in the Armed Forces pay bill over that provided by the standard pay cash limit factor should be accommodated. The Cabinet would need to return to this point at a later stage in its discussion of public expenditure.

e. It was for consideration whether the local authority employers should be given a single cash limit covering pay and prices or a separate cash limit for pay. The second course was to be preferred for its demonstration effect; the combined figure, being higher, might be misunderstood.

f. Another complicating factor could arise from the existence of arbitration arrangements in various parts of the public services. This question was already under consideration in the Ministerial Committee on Economic Strategy.

g. In fixing cash limits for 1981-82 it would be necessary to make some assumption about the figure to apply in respect of settlements in the pay round starting in August 1981. The Chancellor of the Exchequer had proposed a figure two percentage points below the figure decided upon for the current pay round, in order to emphasise the need for the level of settlements in the next round to be below the level in this; but it was generally felt that this would unduly tie the Government's hands too far in advance of events, and that it would be preferable simply to carry forward the figure agreed for 1981-82, adjusting later on (for instance, by means of clawback on the Rate Support Grant) if events justified or required doing so.

THE PRIME MINISTER, summing up this part of the discussion, said that the Cabinet agreed that for planning purposes the pay cash limit for the public services in 1981-82 should at this stage be set at 6 per cent. In order to retain as much freedom as possible to respond to changes of circumstances, actual figures should be announced only as and when it was operatively necessary to do so. The figure of 6 per cent should be given to the local authority employers forthwith as a firm decision, so far as they were concerned, for the purposes of the current negotiations about rate support grant. The Cabinet would need to consider further the timing of announcements about the pay cash limits applying to other parts of the public services, and the Chancellor of the Exchequer should provide an early paper on the implications of the Cabinet's decision. If the local authority employers asked whether the Government would apply the 6 per cent factor more widely than to them, they should be told that the Government intended to deal with settlements in the remainder of the public services broadly within the same financial disciplines as were being applied to the local authorities.

The Cabinet -

1. Invited the Secretary of State for the Environment to inform the local authority employers at the appropriate moment that the pay cash limit applicable to the Rate Support Grant settlement for 1981-82 would be 6 per cent.

2. Agreed that announcements of cash limits for other parts of the public services should not be made before they were operationally necessary.

3. Agreed that for planning purposes the objective should be to achieve a 6 per cent pay cash limit for the financial year 1981-82 throughout the whole of the public services, the limit to apply provisionally in respect of settlements in the 1981-82 pay round as well as of settlements in the 1980-81 round.

4. Invited the Chancellor of the Exchequer to circulate a memorandum for discussion at their next meeting on the implications of these decisions.

5. Agreed to consider at a later meeting how to reconcile pay cash limits and the outcome of the next report of the Armed Forces Pay Review Body on the pay of Servicemen and women.

...Factor ...h Limits ...81-82

THE CHANCELLOR OF THE EXCHEQUER said that his recommendation in C(80) 60 was that the cash limits and votes for 1981-82 should be based on an increase in prices of 11 per cent between 1980-81 and 1981-82, this figure being an average over the year as a whole. This number was within the range of realistic expectations, but achievement of an 11 per cent increase over the period would require the recent good performance on prices to be continued, and might therefore imply a small degree of cash limit squeeze on volume. Any such squeeze would be distinct from the general 2 per cent cut in the volume of expenditure which the Cabinet was considering separately.

THE SECRETARY OF STATE FOR DEFENCE said that, even if 11 per cent was realistic as a general factor for price increases, it was not likely to be realistic for expenditure on defence equipment, the level of inflation on which had consistently exceeded the general level of price increases. The question of the cash limit for defence spending should be considered alongside the proposals for the defence programme as a whole which the Cabinet had still to resolve.

THE PRIME MINISTER, summing up a brief discussion, said that the Cabinet accepted the Chancellor's proposal for a general factor of 11 per cent for prices in cash limits for the public services for 1981-82. The allowance for price increases in the defence programme would need to be considered further in the context of the discussion of that programme which was due to take place at their meeting in the following week.

The Cabinet -

6. Agreed that a factor of 11 per cent should apply to the prices element in cash limits in 1981-82 throughout the public services other than to the defence programme.

7. Agreed to resume discussion of the prices cash limit to be applied to the defence programme in the context of the general consideration of defence expenditure at their next meeting.

Cabinet Office

7 November 1980

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CABINET

LIMITED CIRCULATION ANNEX

CC(80) 39th Conclusions, Minute 5

Thursday 6 November 1980 at 10.00 am

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The Cabinet had before them a table circulated at the meeting, summarising the present position on prospects for the public expenditure targets and for the Public Sector Borrowing Requirement (PSBR) in 1981-82.

THE CHANCELLOR OF THE EXCHEQUER said that, in the light of the discussion on 5 November by the Ministerial Committee on Economic Strategy, a further £157 million would be required for the nationalised industries. If this could not be found within the nationalised industries, and if in addition to the changes already agreed full credit were taken for the reductions proposed but not yet agreed on Defence, Scotland, social security, and higher education (on which a reduction of 2 per cent in the cash-controlled programme, totalling £30 million, over and above the $1\frac{1}{2}$ per cent agreed in July, was agreed among the Ministers concerned directly after the meeting of the Cabinet), the total of public expenditure would be £77,592 million by comparison with the target of £76,200 million. Together with the effect of holding all new public service pay increases to 6 per cent, this implied a Public Sector Borrowing Requirement of £12 billion in 1981-82 by comparison with the £$7\frac{1}{2}$ billion implied by the medium term financial strategy. It was not possible both to finance a PSBR of this level and to reduce interest rates. It followed that substantial tax increases would be needed. The position would be worse to the extent that those reductions still under discussion were not approved.

The Cabinet -

1. Took note of the Chancellor of the Exchequer's statement.

2. Agreed to resume their discussion of public expenditure on Thursday 13 November.

Cabinet Office

7 November 1980

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