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CC(81) 8th
Conclusions

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CABINET

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

TUESDAY 24 FEBRUARY 1981

at 11.00 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 Sir Ian Gilmour MP
Lord Privy Seal

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 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 Carriisle 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 M D M Franklin (Items 3 and 4)
Mr P Le Cheminant (Items 5 and 6)
Mr R L Wade-Gery (Items 3 - 5)
Mr W N Hyde (Items 1 and 2)
Mr D J L Moore (Item 6)
Mr L J Harris (Items 1 and 2)

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ENGAGEMENT OF
THE PRINCE OF
WALES

1. THE PRIME MINISTER informed the Cabinet that the engagement of the Prince of Wales to Lady Diana Spencer was being announced in a statement issued on behalf of The Queen that morning. The marriage was expected to take place in July. She would take the opportunity of an Audience arranged for that evening to express to Her Majesty the Cabinet's great pleasure at the announcement, and to offer their warmest congratulations.

The Cabinet -

Took note, with warm approval, of the Prime Minister's statement.

PARLIAMENTARY
AFFAIRS

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

The Strategic
Nuclear Deterrent

Previous
Reference:
CC(80) 29th
Conclusions,
Minute 1

THE PRIME MINISTER, summing up a brief discussion, said that the Cabinet noted that the Secretary of State for Defence would make both the opening and the closing speeches for the Government in the debate on nuclear defence policy arranged for Tuesday, 3 March. There would be considerable advantages if the Government Motion for the debate were drafted in such a way that the differing factions within the Parliamentary Labour Party could not all vote against it. The Motion should therefore emphasise the need for the United Kingdom to continue to maintain an effective strategic nuclear deterrent, and should not refer to the deployment of Cruise missiles. A reference to the proposed purchase of Trident missiles would enable the Government to obtain the specific approval of the House of Commons for the Trident programme, though the Cabinet recognised that such a reference might be exploited to unite the Parliamentary Labour Party in a vote against the Government. The Secretary of State for Defence should consider the precise wording of the Motion further in consultation with the Chancellor of the Duchy of Lancaster and Paymaster General and the Chief Whip.

The Cabinet -

Invited the Secretary of State for Defence, in consultation with the Chancellor of the Duchy of Lancaster and the Chief Whip, to consider further the form of the Motion for the debate on Tuesday, 3 March, as indicated in the Prime Minister's summing up.

FOREIGN
AFFAIRS

Spain

Previous
Reference:
CC(81) 2nd
Conclusions,
Minute 2

3. THE FOREIGN AND COMMONWEALTH SECRETARY said that the attempted coup d'état in Spain appeared to have failed. The Army in the Valencia military region had been involved, as well as the members of the paramilitary Civil Guard who had seized the Parliament building in Madrid. But the King had stood firm and seemed to have the support of the rest of the Army. The episode was a major set-back for Spain, coming as it did at a time of serious difficulty on both economic and regional affairs. The new Government under Senor Calvo Sotelo might not now take office. The effect on Spanish policy, eg towards the European Community or the North Atlantic Treaty Organisation or Gibraltar, remained to be seen.

Namibia

Previous
Reference:
CC(81) 4th
Conclusions,
Minute 2

THE FOREIGN AND COMMONWEALTH SECRETARY said that in view of the deadlock in the Namibian negotiations the member governments of the Organisation for African Unity, who were at present meeting in Addis Ababa, might decide on precipitate action at the United Nations. A General Assembly debate on the subject in early March might now be difficult to avoid, and there might well be pressure for an early Security Council vote on sanctions against South Africa. Some African Governments, including the Nigerians, privately recognised that it would be unwise to press forward before the new United States Administration had been able to consider their policy. But public African attitudes remained uncompromising. If a sanctions vote took place, it would almost certainly be vetoed by the United States, and Britain would be bound to support the veto. Even if France also vetoed, as was possible in the present climate of Franco-American relations, serious damage would be done to British economic interests in Black Africa, notably in Nigeria where British visible exports alone had been worth £1,200 million in 1980 and were still rising. The Prime Minister and he would need to discuss the problem urgently with the United States Government during their forthcoming visit to Washington. One possible device for heading off an early crisis might be if the new American Administration offered to send a high-level fact-finding mission to the area, comparable to the Rhodesia-related mission which Lord Harlech had undertaken for the British Government soon after they took office in 1979.

Chad

Previous
Reference:
CC(81) 3rd
Conclusions,
Minute 2

THE FOREIGN AND COMMONWEALTH SECRETARY said that on his recent visit to Nigeria he had found President Shagari very preoccupied over the situation in Chad. The President of Chad, Mr Goukouni, had told President Shagari that when he visited Libya there had been no discussion of a union with Libya; then at the airport he had been presented with a communique in Arabic, which he could not read, and had not been made aware that an agreement on union with Libya was part of its contents. It was a remarkable

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commentary on the policy of the Libyan leader, Colonel Qadhafi, towards Chad that all neighbouring countries now seemed to be united against him.

Belize
Previous
Reference:
CC(80) 43rd
Conclusions,
Minute 2

THE FOREIGN AND COMMONWEALTH SECRETARY said that he had seen the Prime Minister of Belize, Mr Price, on 23 February and had persuaded him to be somewhat more forthcoming in the negotiations which Britain and Belize were conducting with Guatemala. It might now be possible to restart those negotiations, which had recently broken down when the Belize Government failed to respond adequately to an important modification in Guatemala's position. The Guatemalans were no longer demanding the cession of territory and wanted only to be allowed to lease a number of uninhabited Belizean islands. The United States Government, whose support Britain needed if the negotiations were to be successful had shown sympathy with the current Guatemalan position and corresponding impatience with Belize. This was not necessarily helpful, since it remained desirable to keep up the pressure on Guatemala, and the United States Government could have a role in this.

Iran
Previous
Reference:
CC(81) 7th
Conclusions,
Minute 2

THE FOREIGN AND COMMONWEALTH SECRETARY said that the three British detainees who had now been released from prison in Iran were expected to be allowed to leave the country in the near future. The position of the fourth detainee, who was a businessman, remained uncertain. It would be made clear to the Iranians as necessary that British relations with Iran could not be improved until he too was freed. A most helpful role continued to be played by the Swedish Government, who were in charge of British interests in Iran. They would be publicly thanked at an appropriate moment.

Poland
Previous
Reference:
CC(81) 7th
Conclusions,
Minute 2

THE FOREIGN AND COMMONWEALTH SECRETARY said that the situation in Poland appeared to be improving. But it was impossible to know whether this trend would continue.

The Cabinet -

Took note.

COMMUNITY
AFFAIRS

Common
Agricultural
Policy

Previous
Reference:
CC(80) 44th
Conclusions,
Minute 3

4. THE FOREIGN AND COMMONWEALTH SECRETARY said that the Council of Ministers (Agriculture) was currently considering imports of New Zealand butter. If no agreement or a long-term arrangement could be reached, it now seemed likely that the French would agree to a roll forward of the existing arrangements. The Agriculture Ministers would meet again in the middle of March to discuss agricultural prices for 1981-82, with the aim of reaching decisions by the end of the month. The position to be adopted on the level of prices, the green pound and other aspects of the Commission's proposals would need to be considered by Ministers collectively in due course.

Common
Fisheries
Policy

Previous
Reference:
CC(81) 7th
Conclusions,
Minute 3

THE PRIME MINISTER said that she had recently had talks with the President of the Commission, M Thorn, and with Commissioner Tugendhat. She had emphasised to the former the importance of a speedy settlement of the Common Fisheries Policy. The prospects were not good, however, since the French were showing no signs of flexibility. She had urged on Mr Tugendhat the necessity of maintaining the present ceiling of 1 per cent on VAT contributions.

European
Monetary
System

Previous
Reference:
CC(80) 12th
Conclusions,
Minute 5

In a brief discussion, reference was made to a speech the previous day by Mr Tugendhat advocating adherence by the United Kingdom to the exchange rate mechanism of the European Monetary System (EMS). He had not referred to his intention to do so during his recent meetings with the Prime Minister and the Chancellor of the Exchequer. The speech appeared to have had some effect in weakening the pound on the exchange markets. While a number of Government supporters had written to the Chancellor of the Exchequer advocating full British membership of the EMS, there had been no recent discussion of this possibility within the Community. At least until very recently there had been no change in the factors which had led the Government not to join the exchange rate mechanism, particularly the opposing effects of oil price rises on sterling and the Deutschemerk. In these circumstances, the inclusion of sterling might add to the existing tensions within the EMS.

The Cabinet -

Took note.

INDUSTRIAL
AFFAIRS
Previous
reference:
CC(81) 7th
Conclusions,
Minute 4
Water

5. THE SECRETARY OF STATE FOR THE ENVIRONMENT said that all the unions in the water industry had now rejected the 10 per cent offer. Discussions on the pay of manual water workers in England and Wales were resuming on that and the following days. The outcome was uncertain, though it was possible that the National Water Council (NWC) would make a new offer aimed at an immediate settlement. Most regional Water Councils had now fixed the level of water rate they would charge in 1981-82. As a result of the activities of the accountants whom he had introduced to examine the costs of the industry, the proposed water rate increases over 1980-81 had been brought down from an average of 19 per cent to an average of 13 per cent.

In discussion it was suggested that the striking success in reducing costs achieved by outside accountants in the water industry suggested that the technique might profitably be used more widely, for example in local authorities and the National Health Service. A pilot operation had in fact already been launched in one local authority area in Greater London and would be seeking to extend the technique to other local authorities. He was also examining whether legal obstacles existed to the appointment of private firms of accountants as District Auditors.

THE PRIME MINISTER, summing up a short discussion, said that the Cabinet was not disposed to take any step to influence the outcome of the negotiations in the water industry at this stage; the balance of the argument was against taking such a step.

The Cabinet -

1. Took note.

Civil Service

THE LORD PRESIDENT OF THE COUNCIL said that he had met the Civil Service unions on the previous day. He had told them that the 6 per cent pay factor in cash limits was firm, but that it should be possible, within this limit, to squeeze out a 7 per cent settlement. He had also told them of the Government's willingness in principle to work towards an ordered and, if possible, agreed scheme for settling Civil Service pay in future years. The unions had not accepted the 7 per cent offer but had been very keen to discuss possible longer term arrangements. This latter proposal might well prove to be the means by which serious industrial disruption in the Civil Service could be avoided, though some difficulties were inevitable. In particular, it seemed likely that the one-day strike called for 9 March would take place.

The Cabinet -

2. Took note.

6. The Cabinet considered a memorandum by the Chancellor of the Exchequer (C(81) 10) on the conduct of the 1981 Public Expenditure Survey (PES). They also had before them a letter from the Minister of Agriculture, Fisheries and Food to the Prime Minister dated 23 February 1981.

THE CHANCELLOR OF THE EXCHEQUER said that he proposed changes in the conduct of the 1981 Public Expenditure Survey (PES) designed in part to strengthen control and pressure for economy and efficiency but mainly to enable the Cabinet to see more clearly throughout the process of planning and determining public expenditure programmes the prospective cash costs of expenditure. The need for such changes would be illustrated vividly by the figures about to be published in the Public Expenditure White Paper, which would show total cash expenditure rising from £77 billion in 1979-80 to an estimated £104 billion in 1981-82 - an increase greater than that in the rate of inflation over the same period, and resulting in a sharp rise in the proportion of Gross Domestic Product taken for public expenditure. This increase was in part attributable to the economic recession, to inherited commitments on public sector pay, and to the problems of the nationalised industries and the local authorities; but it was also in part due to the present system of public expenditure planning and to the continued dependence on volume planning at constant prices. Particularly in periods of high, and varying, inflation, it was difficult to know until very late in the process the implications for actual cash expenditure of decisions taken earlier in the course of the Survey discussions. He recommended that in the 1981 Survey all plans and discussions of the principal target year of 1982-83 should be conducted from the outset in terms of the estimated cash costs which would arise in that year. The Cabinet would need to decide in March 1981 what were the provisional inflation assumptions to be used to arrive at 1982-83 prices. This would be on the understanding that these assumptions would be open to revision in the light of developments until the autumn, when they would be finalised. With greater weight given to the constraints on cash costs, there would no longer be a presumption of entitlement to some particular volume or level of services; adjustments of cash provision would be made only if they could be shown to be justified, and not, as at present, largely automatically. The form of revaluation proposed would have the effect that any squeeze or slack which might have emerged from operating within cash limits in one year would normally be carried forward into the next year, unless and until a specific decision was taken to the contrary. As a result of these changes, some of the burden of uncertainty inherent in unpredictable price movements would be transferred to spending Departments. These changes would focus attention on a number of very real and difficult problems, which the present system tended to mask, and would thus provide the opportunity for them to be collectively discussed in good time. He did not, at this stage, wish to propose cash planning for the years beyond the focal year of each Survey; this would raise problems which would need further consideration. For 1981-82 he recommended that, as part of the move towards a greater

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emphasis on cash control, any decision taken to increase a cash limit should be a charge on the contingency reserve, regardless of whether it was a volume or pay or price change. If the Cabinet approved these proposals, he would wish to announce them in general terms in his Budget Statement, though without any commitment to the details of the arrangements, and so to demonstrate that the Government were taking positive steps to deal with the cash overruns, which the Public Expenditure White Paper would reveal, and with the widespread criticism of the present dependence on planning in terms of constant prices. After the Budget he would seek the approval of Cabinet to the detailed guidelines for the 1981 PES, including the provisional inflation assumptions to be used in constructing the 1982-83 figures.

In discussion there was general support for a move to greater emphasis on planning public expenditure in the focal year of the PES in cash terms; subject to the following main points which were made on the system proposed by the Chancellor of the Exchequer:-

a. The choice in March 1981 of the general inflation factors necessary to arrive at estimated cash costs in 1982-83 would pose severe problems. If the factors turned out to be too low, that would impose an unintended squeeze on volume plans. Either that squeeze would have to be accepted, possibly at the expense of major policy objectives, or the inflation assumptions would have to be changed with the risk of discrediting the new system. The magnitude of the problem was illustrated by the fact that in recent years Treasury forecasts of the average level of retail prices in any given year made four or five quarters before that year began had been wrong by $4\frac{1}{2}$ - 6 percentage points: that was a measure of the possible effects on volume spending of excessive optimism in inflation assumptions. If the system were to work, it was essential that the inflation assumptions used should be fully realistic. Unlike private sector firms the Government were bound to publish their inflation assumptions, and this could be embarrassing, particularly in any year when the forecasts pointed to a rising rate of inflation.

b. A particular problem would arise from the forecasts for public sector pay. Although these might not be separately identified, they would be bound to become known, with the result that the position of those negotiating public sector pay settlements would be made unnecessarily difficult.

c. There would be a further squeeze on volume plans if all reductions resulting from the application of cash limits were carried through into later years. The system should not provide for it to be axiomatic that cash squeezes were carried through, but rather for the question of carrying through to be considered case by case.

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- d. Even with the emphasis switched to cash planning, volume planning would have to continue both for departmental programmes and for local authority and National Health Service programmes.
- e. Several Ministers shared the view of the Minister of Agriculture, Fisheries and Food that some of these difficulties could be reduced if the conversion to cash were made earlier than at present, but not so early as the start of a Survey exercise. The 1981 Survey, for example, might be carried out initially on the basis of 1981 Survey prices (that is, actual prices in autumn 1980) and early in the autumn of 1981 the resulting volume programmes could be then revalued to 1982-83 prices using inflation assumptions agreed at that time by the Cabinet. Alternatively the survey discussions could be opened on the basis of estimated 1981-82 prices with conversion to 1982-83 prices in the autumn. Either way the problems of forecasting inflation for a long period ahead would be reduced, and the Cabinet would have a clearer and more reliable basis for looking at programmes.
- f. More thought should also be given to the introduction of flexibility between years to ensure that long term equipment and capital expenditure programmes were not unduly disrupted by sudden changes in expectations of inflation. In addition further thought should be given to the problems of controlling the expenditure of the nationalised industries which was a major source of the current difficulties in controlling public expenditure. The implications of the proposed system for the planning of local government expenditure would also require further consideration, and there was a possibility that legislation might be necessary to amend the statutory arrangements for determining the Rate Support Grant.
- g. Whatever the changes made, and particularly if the system proposed by the Chancellor of the Exchequer were to be introduced, there would be a case for other changes at the same time. Given the crucial importance of the collective decision on the inflation factors to be used, and the greater general emphasis on cash planning, it was a corollary of the Chancellor's proposals that the Cabinet should have an opportunity to consider collectively the Chancellor of the Exchequer's view of the prospects and possibilities for revenue alongside those for public expenditure.

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THE PRIME MINISTER, summing up the discussion, said that the Cabinet agreed in principle that, in the 1981 Public Expenditure Survey, the discussion of the plans for 1982-83 should be in cash terms, on the broad lines proposed by the Chancellor of the Exchequer. They had identified a number of particular problems in discussion, and the Chancellor of the Exchequer should take these into account in the further memorandum, which he would put to the Cabinet in March after his Budget statement, making his recommendations on the detailed guidelines for the 1981 Survey, including the inflation assumptions to be used. In the meantime, the Chancellor of the Exchequer should announce the proposed change in general terms in his Budget statement, but he should avoid any commitment on the detailed arrangements which the Cabinet had yet to approve.

The Cabinet -

1. Agreed in principle to changes in the conduct of the 1981 Public Expenditure Survey, broadly on the lines of the proposals set out in C(81) 10.
2. Endorsed the proposed changes, in paragraphs 13 - 15 of C(81) 10, on the management of the contingency reserve in 1981-82.
3. Agreed that the Chancellor of the Exchequer should announce in general terms, in his Budget statement on 10 March, their decision to give greater weight to cash planning in the focal year of the Survey period.
4. Invited the Chancellor of the Exchequer to take account of the points made in their discussion in the memorandum which he would be putting to them in March, inviting approval of the detailed guidelines and inflation assumptions for the 1981 Public Expenditure Survey.

Cabinet Office

24 February 1981



From the Minister

MINISTRY OF AGRICULTURE, FISHERIES AND FOOD
WHITEHALL PLACE, LONDON SW1A 2HH

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The Rt Hon Margaret Thatcher MP
10 Downing Street
London SW1A

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CABINET OFFICE
A 581
23 FEB 1981
FILING INSTRUCTIONS
FILE No.

*Mr. 136
Mr. L. Bennett
Mr. Howe
Mr. Ples*

23 February 1981

Dear Prime Minister,

1981 PUBLIC EXPENDITURE SURVEY

My unavoidable attendance at a meeting of the Council of Agricultural Ministers in Brussels will mean that I shall not be present when the Cabinet considers Geoffrey Howe's memorandum on the 1981 Public Expenditure Survey. I would therefore like to let my colleagues have certain comments on the changes proposed.

I fully recognise the force of the considerations behind the aim of enabling the Cabinet to see more clearly the prospective cash costs of expenditure programmes when firm decisions are reached on these. The particular methods for achieving this put forward by Geoffrey Howe would, however, go beyond this. They would in addition carry through into 1982-83 a volume squeeze inherent in the cash limits for 1981-82; and the inflation assumption made for further adjusting to estimated 1982-83 prices could well add a further volume squeeze.

The total impact of these squeezes on departmental programmes could well be substantial. While I fully accept that it is open to the Cabinet to decide on such volume cuts I suggest that this should be a conscious decision, taken in the full knowledge of the implications, and should not flow automatically from inflation assumptions introduced at the outset of the annual Survey.

These difficulties would be avoided if the 1981 Survey were to be carried out initially on the usual price basis, ie actual prices in Autumn 1980, and early in the Autumn of 1981 the resulting volume programmes were then revalued to 1982-83 prices using inflation assumptions agreed at that stage by the Cabinet.

This approach would avoid disrupting from the outset well established Survey procedures. A judgement on inflation assumptions would be made much nearer to the period they concerned. Volume cuts flowing automatically from the Survey procedure would be avoided, without in any way pre-empting a conscious Cabinet decision to make such cuts. More generally the Cabinet would still have before it expenditure proposals expressed in prospective cash terms when reaching firm decisions on programmes for 1982-83.

I suggest that Geoffrey Howe's main aim could be met in this way without the disadvantages carried by his proposals as they stand.

I am copying this letter to other members of the Cabinet and to Sir Robert Armstrong.

Yours sincerely
Kate Timmins

for PETER WALKER

(Approved by the Minister
and signed in his absence)