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CABINET

CONCLUSIONS of a Meeting of the Cabinet
held at 10 Downing Street on
WEDNESDAY 15 NOVEMBER 1989
at 9.30 am

P R E S E N T

The Rt Hon Margaret Thatcher MP
Prime Minister

he Rt Hon Sir Geoffrey Howe QC MP
ord President of the Council

he Rt Hon Douglas Hurd MP
ecretary of State for Foreign and
ommonwealth Affairs

he Rt Hon David Waddington QC MP
ecretary of State for the Home
epartment

he Rt Hon Norman Fowler MP
ecretary of State for Employment

he Rt Hon Nicholas Ridley MP
ecretary of State for Trade and
ndustry

he Rt Hon Kenneth Clarke QC MP
ecretary of State for Health

he Rt Hon Malcolm Rifkind QC MP
ecretary of State for Scotland

he Rt Hon John Wakeham MP
ecretary of State for Energy

he Rt Hon Antony Newton MP
ecretary of State for Social Security

he Rt Hon Peter Brooke MP
ecretary of State for Northern
reland

The Rt Hon The Lord Mackay of Clashfern
Lord Chancellor

The Rt Hon John Major MP
Chancellor of the Exchequer

The Rt Hon Peter Walker MP
Secretary of State for Wales

The Rt Hon Tom King MP
Secretary of State for Defence

The Rt Hon Kenneth Baker MP
Chancellor of the Duchy of Lancaster

The Rt Hon John MacGregor MP
Secretary of State for Education
and Science

The Rt Hon Cecil Parkinson MP
Secretary of State for Transport

The Rt Hon The Lord Belstead
Lord Privy Seal

The Rt Hon Christopher Patten MP
Secretary of State for the Environment

The Rt Hon John Selwyn Gummer MP
Minister of Agriculture, Fisheries
and Food

The Rt Hon Norman Lamont MP
Chief Secretary, Treasury

SECRET

ALSO PRESENT

The Rt Hon Timothy Renton MP
Parliamentary Secretary, Treasury

SECRETARIAT

Sir Robin Butler	
Mr R T J Wilson	(Item 5)
Mr L V Appleyard	(Items 3 and 4)
Mr D A Hadley	(Items 3 and 4)
Mr G W Monger	(Item 5)
Mr P J C Mawer	(Items 1 and 2)
Mrs J M Bailey	(Items 1 and 2)

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PARLIAMENTARY AFFAIRS

1. THE LORD PRESIDENT OF THE COUNCIL said that Parliament would prorogue the following day. The successful completion of this session's programme was satisfying, although there were a number of lessons to be learned from the experience of the session which he asked colleagues to take into account in the handling of Bills in the new session. These included avoiding extending the scope of Bills beyond that originally agreed by QL and Cabinet, and avoiding adding to Bills as they went through Parliament unless this was strictly necessary to secure their satisfactory passage. The problems encountered in handling business in the Commons towards the end of the present session had owed much to the objections of MPs from mining constituencies to the Associated British Ports (No 2) Bill, but had also raised the whole question of the procedure followed by Private Bills. The business managers were considering what steps could be taken to avoid similar difficulties at the start of the new session, and in the longer term were looking at whether any changes were needed to Private Bill procedure.

A successful seminar on the implications of the televising of the proceedings of the House of Commons had been held for Cabinet Ministers the previous week, and two further seminars for junior Ministers were planned. One point which had emerged strongly was that Ministers adjacent to a colleague who was speaking must take particular care not to do anything which would distract the television viewer from the Minister speaking or appear out of keeping with the occasion. The suggestion that it would help Ministers and Opposition Front Bench Spokesmen if lecterns could be provided at the Dispatch Box would need to be approved by the Speaker and the Commons Services Committee as well as the Select Committee on Televising of the Proceedings of the House. It was already clear that the Select Committee on televising was opposed to the suggestion because it would involve adapting the traditions of the House to suit the needs of television. For the time being therefore no early moves in this direction were likely and Ministers would need to devise their own pragmatic solutions to the problem.

THE PRIME MINISTER, summing up a brief discussion, said that previous as well as present Business Managers were to be congratulated on the successful completion of the Government's business for the session and the necessary conclusions should be drawn up for the drafting of future Bills. In the forthcoming Debate on the Address, it would be important to ensure that there was a range of good backbench speakers ready to participate on each day of the debate.

The Cabinet -

Took note.

HOME AFFAIRS

Industrial Action in the Ambulance Service

Previous Reference: CC(89) 33.2

2. THE SECRETARY OF STATE FOR HEALTH said that there had been relatively few developments in the industrial action by ambulance workers during the previous week. The Armed Forces, together with the police and voluntary services, had been remarkably successful in providing an accident and emergency service in London. There had been no serious problems, and public and press interest in the dispute had therefore waned. He remained pessimistic about the prospects of an early settlement to the dispute. The action was likely to spread over the next few days to the West Midlands and other regions: the Armed Forces were on standby to be called in there if necessary. He had spoken to regional Chairmen to encourage them to react in a consistent way to increased Union action in different ambulance services. At a press conference the previous day he had sought to move matters forward by indicating that pay talks could resume if the Unions agreed to operate the 999 emergency service normally in London and the rest of the country. He had also said that local pay additions might be available for ambulance workers with paramedical skills. The Unions showed no sign of moving their position, however, and continued to press for a substantial increase with movements in their pay to be linked in future to those of other emergency service workers. These demands should continue to be resisted. Accepting them would have damaging consequences for future pay negotiations in the National Health Service, and elsewhere.

Contaminated Animal Feed

Previous Reference: CC(89) 33.4

THE MINISTER OF AGRICULTURE, FISHERIES AND FOOD said that the problems caused by the import of contaminated animal feed had now been contained. It was not expected that the price of milk would rise because of the restrictions which had had to be imposed. Lower levels of lead were now being found in milk. There would therefore be growing pressure to remove the restrictions, which presently covered some 1,400 farms. The pressure would be greater because the farmers involved had no means of gaining swift compensation from the feed merchants. A longer term problem lay in deciding whether the animals who had eaten the contaminated feed could be slaughtered for human consumption. Testing for lead in meat was very complicated and the processes for doing it were only just being established. The decision would therefore not be easy to reach, and could be controversial.

The Cabinet -

Took note.

FOREIGN AFFAIRS

German Democratic Republic

Previous Reference: CC(89) 33.3

3. THE FOREIGN AND COMMONWEALTH SECRETARY said that events in East Germany had moved very rapidly, particularly following the measures taken to introduce freer travel between East and West Berlin. The key question now was whether the East German government would agree to hold free elections. Their intentions were still obscure. The new Prime Minister, Herr Hans Modrow, the former Party Secretary in Dresden, had been elected on 13 November. He had the reputation of a reformer. The Party Congress had been brought forward to 15/17 December. This was bound to be a crucially important occasion. The opposition groups were pressing for free elections, but did not want these to take place immediately since they were not yet ready. There had been intensive diplomatic activity as events in East Germany unfolded. The Prime Minister had been in close touch with other allied leaders. Despite excessive press speculation, allied governments had reacted steadily and with caution. This had emerged clearly at the Western European Union Ministerial meeting on 13/14 November. The French President, M. Francois Mitterrand, had organised a meeting of European Community (EC) leaders on 18 November. It was to be hoped that EC leaders would express their support and welcome for the changes taking place in Eastern Europe while agreeing on the need for a careful and steadfast approach, based on existing well-tried institutions. Account had to be taken of the position of the Soviet President, Mr Mikhail Gorbachev. He faced a difficult situation but it was very much in the interests of Western governments that he should remain in power. The question of German reunification was extremely sensitive. Given the German Constitution and political life in West Germany, it was inevitable that there should be some discussion of reunification. All the allied governments had been committed to this general principle for many years. At the same time no-one in a position of influence in the West or East believed that reunification was likely to happen rapidly, or that this would be desirable in the near future. This view was also shared by reformers inside East Germany. President Mitterrand's purpose in organising the meeting on 18 November was probably to try to dispose of developments in Eastern Europe before the European Council meeting in Strasbourg on 8/9 December. This was unrealistic. Much was likely to happen in the intervening period before the European Council. Moreover, the issues were so important for the future of the EC that they would need to be discussed again in depth at the European Council. Nevertheless, on the whole the allied response to events in Eastern Europe had been sensible and prudent.

In discussion, the following points were made:

a. A clear framework for dealing with the changes in Eastern Europe had been laid down, most recently in the Prime Minister's speech at the Lord Mayor's Banquet on 13 November. It was essential to maintain existing institutions, especially the North Atlantic Treaty Organisation. Ministers should not raise the issue of German reunification, which was not an immediate issue. Progress had already been achieved on strengthening the EC's economic relations with East European countries. The EC had signed trade agreements with Poland and Hungary, and an association agreement with Yugoslavia. In due course Poland and Hungary might want to negotiate association agreements. Such a development was unlikely to cause major problems for the Soviet leadership. If events moved too quickly or Western governments did not continue to take a measured and prudent attitude, there was a risk that President Gorbachev might be swept away. This would cause grave damage to the broader Western objective of promoting democracy throughout both parts of Europe, and ultimately from the Atlantic through the Soviet Union to the borders of China. The EC could not ignore these crucially important processes of historic change which would have a profound effect on developments within the Community.

b. The West German Finance Minister, Herr Waigel, had made clear both in the formal and informal meetings of the Economic and Finance Council on 13 November that West Germany saw its future as remaining an integral member of the EC and Western Europe. Herr Waigel had emphasised that West Germany was not seeking reunification at the present time. The same line had been taken by the West German Foreign Minister, Herr Genscher, and the Defence Minister, Herr Stoltenberg, at the Western European Union Ministerial meeting. Nevertheless, these statements contrasted with the greater attention paid to the theme of reunification by Chancellor Kohl in recent speeches, though it should be remembered that he had always been one of the foremost advocates of reunification among German political leaders.

c. Against this background, the West German government was likely to show an increasing tendency to examine new proposals for greater integration within the EC in the light of the implications for closer relations between East and West Germany and eventual reunification. In certain cases this tendency might be helpful to Britain's own interests.

d. In reality there were already close economic links between East and West Germany. West German companies were able to take advantage of cheap labour in East Germany in their manufacturing processes. Goods from East Germany were admitted to West Germany, and hence into the EC, without tariffs or quotas. Hitherto West German companies had been deterred from major investment in East Germany because of the political situation there. The recent changes were likely to stimulate a significant flow of new West German investment in East Germany. The Polish and Hungarian governments had stressed recently that they attached importance to securing increased investment from Britain and other EC countries to match the preponderant weight of West German trade and investment flows. On the other hand, East Germany and the other reforming East European countries would have great difficulty in practice in implementing the structural changes necessary to create genuine market economies based on private enterprise. This was likely to be a long process.

e. West Germany had a trade surplus of £35 billon with the rest of the EC in 1988. Closer economic links between East and West Germany would present a formidable challenge to the other members of the EC. With a combined population of nearly 80 million people this economic entity would have a major distorting effect on EC projects for closer economic and financial unity and the concept of the Single Market. The EC could not afford to ignore this emerging reality. The process would also affect the EC's relations with the European Free Trade Area (EFTA). The EC's import standards would need to be maintained both in relation to East Germany and EFTA.

THE PRIME MINISTER, summing up the discussion, said that it was of cardinal importance for Western governments that all these complex questions should be handled carefully and prudently. Allied governments should remain in close touch, especially Britain, France and the United States who had Four Power rights and obligations. Although Western governments had taken a formal position since 1955 in favour of East German self-determination, German reunification should not be treated as an immediate issue. Governments should take due account of the implications of the present turn of events for President Gorbachev's position. A change in the Soviet leadership would inflict major damage on the prospects for the further spread of democracy in the Soviet Union and Eastern Europe. The EC would need to discuss these issues in depth both at President Mitterrand's dinner and at the European Council in Strasbourg. EC member states could not simply concentrate on internal developments within the Community without taking account of trends in Europe as a whole. A single European currency was no answer to these wider changes. Although events were moving in a favourable direction, Europe faced a difficult decade ahead.

Elections in Namibia

THE FOREIGN AND COMMONWEALTH SECRETARY said that elections in Namibia had taken place in a peaceful atmosphere. The South West African People's Organisation (SWAPO) had obtained 57 per cent of the votes counted. This was likely to be sufficient to persuade SWAPO to accept the outcome of the elections though they did not obtain the two-thirds majority needed for constitutional changes. The United Nations Special

Representative had certified that the elections were free and fair. Although Namibia was entering a period of continuing difficulty, the outcome of the elections had been as favourable as might have been hoped for Western interests.

The Cabinet -

Took note.

COMMUNITY AFFAIRS

Economic and Finance Council 13 November

4. THE CHANCELLOR OF THE EXCHEQUER said that the Economic and Finance Council on 13 November had had a crowded agenda. Two legal texts needed to launch Stage One of Economic and Monetary Union had been agreed without much difficulty and on a satisfactory basis. He had then presented the United Kingdom's paper on what should follow Stage One, and there had been lengthy discussion on that and on the Delors Report. It had been generally agreed that the paper raised important issues which merited proper consideration. The German, Dutch and Luxembourg Ministers had spoken in favour of a measured and cautious approach. Herr Waigel, in particular, had warned against trying to build the roof before the foundations were in place. Even so, there seemed to be a general expectation on the part of other Ministers that the European Council in December would call an Inter-Governmental Conference to consider Treaty change. It had been agreed that the United Kingdom's paper would be on the table at that meeting, along with the Delors Report and the Report from Officials setting out a list of questions to be addressed. He had, however, been obliged to intervene to prevent the French Chairman concluding that the Council had agreed to give the two latter documents superior status. The fact that, in the recent House of Commons debate, members of the opposition parties had also uniformly spoken out against the Delors prescription for achieving economic and monetary union appeared, from conversations outside the Council, to have been registered by the advisers of other Ministers.

The Council had adopted satisfactory conclusions on the abolition of fiscal frontiers. The destination principle for applying VAT would be retained, but the importance of avoiding burdens on industry had been accepted. There was ample opposition to wording suggested by the Presidency on the need to harmonise rates of VAT. Limits on travellers' allowances were to be abolished by 1993 subject to possible derogations for certain member states with high tax rates: but the whole subject would need further discussion.

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Health Council 13 November

THE SECRETARY OF STATE FOR HEALTH said that the Council had, as expected, adopted the Directive on tobacco labelling despite United Kingdom objections. He would need to make regulations prescribing this labelling in due course. The Council had similarly reached a common position on the Directive on the maximum tar content of tobacco: among other things, this might eventually contribute to reducing the cost of the Common Agricultural Policy.

Social Charter

THE SECRETARY OF STATE FOR EMPLOYMENT said that the Commission was expected, that morning, to agree and announce its action programme of measures to implement the Social Charter. Indications were that 47 separate actions would be proposed including 19 Directives. So the proposed Charter would go far beyond a non-obligatory declaration. It seemed that there would be no attempt to regulate industrial relations and the only action envisaged on minimum pay was a non-binding recommendation. This was helpful. But the Commission would probably seek to regulate work patterns through measures on such matters as hours of work, part-time work, holidays, and rest periods, which could not fail to increase labour costs if they were enacted. The programme would be on the agenda of the Social Affairs Ministers for their meeting on 30th November.

The Cabinet -

Took note.

1989 PUBLIC EXPENDITURE SURVEY

Previous Reference: CC(89) 25.6

5. The Cabinet considered a memorandum by the Chief Secretary, Treasury (C(89)13), on the 1989 Public Expenditure Survey.

THE CHIEF SECRETARY, TREASURY, said that at the start of the bilaterals the bids he had received totalled some £13 billion for 1990-91, rising to £17 billion and £23 billion for the two later years. The Government was already committed to increases in 1990-91 of over £4 billion, and there was less scope for savings than there had been the year before. The room for manoeuvre had therefore been limited. Nevertheless, with the help of colleagues, he had had a satisfactory round of bilaterals and had agreed significant reductions in the bids. The additions to programmes which he now proposed totalled £7.5 billion in 1990-91, £9.7 billion in 1991-92 and £13.2 billion in 1992-93. There would in particular be extra spending on the priority services. For example, spending on the National Health Service would rise by £2.4 billion between 1989-90 and 1990-91. Expenditure on roads would double between 1988-89 and 1992-93, and there would be an extra £1/2 billion a year to upgrade services and relieve congestion on the railways. Similarly, there would be an increase in planned capital spending, by central Government and the nationalised industries, of £1 1/2 billion a year, representing a real increase of 10 per cent on a year ago. Support for Housing Associations would more than double from £800m this year to £1.7 billion in 1992-93. There would be extra spending on capital investment on prison refurbishment and hospitals and a £1/4 billion package to alleviate homelessness. There would be significant extra help for the disabled. The number of police would rise by 1100. There would also be a big rise in expenditure on higher education. Civil Service running costs would rise by just under 10 per cent between this year and next: this implied a substantial reduction in the bids although it still meant higher growth than in previous years to accommodate cost rises and expansion in key areas.

As to the outturn for this year, there now seemed likely to be an overspend. On the old definition of the Planning Total he expected an excess of £1.1 billion. This was, however, more than accounted for by overspending by local authorities, which confirmed the need for the new arrangements for local authority finance which the Government was introducing.

Cabinet had agreed that the Government's objectives in the Survey were to maintain the downward trend in general government expenditure (GGE), excluding privatisation proceeds, as a proportion of Gross Domestic Product (GDP) and to stick as closely as possible to existing plans. The outcome was that the ratio of GGE to GDP would be the same in the first two years of the Survey period as in last year's Autumn Statement. There would be some additions to the existing plans, but he believed that they were fully justified. He thanked colleagues for their co-operation in the Survey exercise.

THE CHANCELLOR OF THE EXCHEQUER said that the Chief Secretary was to be congratulated on the skilful conduct of this year's Survey, which had been a difficult one from the outset. In the economy as a whole, it had become apparent by July that demand had continued to grow more quickly than had been expected at Budget time. More recent events had confirmed this buoyancy of demand. He now expected that, as a result, the current account deficit for this year would be £20 billion as against the £14 1/2 billion forecast in the Budget and that Retail Price Index (RPI) inflation in the fourth quarter would be 7 1/2 per cent compared with the forecast of 5 1/2 per cent. Those figures were clearly higher than was desirable, but they would not come as a surprise to the markets, who accepted that the economy was fundamentally in a sound position. Business investment would probably grow by over 9 per cent this year, giving a total of 40 per cent over the last three years. This worsened the trade gap in the short-term but would improve it in the long term. Exports had risen strongly and growth in non-oil goods was expected to be over 11 per cent, the highest rate since 1973. Unemployment had continued to fall, although a rise was more likely than a fall over the next few months. He now estimated debt repayment over the year at £12 1/2 billion compared with the £13 3/4 billion forecast earlier. The shortfall was the result of lower privatisation proceeds and higher than expected national insurance rebates due to the uptake of personal pensions, which was in itself a considerable success story.

As to next year, it was clear that the recent very high growth in domestic demand and output could not be sustained. It was essential to damp down demand if inflation was to be reduced. This was the pre-requisite for a resumption of steady growth. He expected the economy to slow down during 1990, with an increase in GDP of 1 1/4 per cent, compared with the Budget forecast of 2 per cent. Domestic demand would be flat: consumer expenditure and investment would continue to grow, but more slowly than this year, and stockbuilding was likely to be reduced. The current account deficit should fall, by over 1 per cent of GDP, to £15 billion. Inflation would also fall, by the RPI measure, to 5 3/4 per cent by the fourth quarter of 1990, although less distorted measures such as producer price increases were likely to be at around 4 per cent. The level of inflation should continue to fall after the end of 1990, but it was clear that policy must remain tight if inflation was to be brought down as quickly and as substantially as the Government wanted.

THE CHANCELLOR OF THE EXCHEQUER continued that, as to public expenditure, he proposed to leave the estimate of privatisation proceeds unchanged at £5 billion a year. He also proposed to fix the Reserve at £3 billion, £6 billion and £9 billion in the three Survey years. These figures were lower than those fixed in the last Survey, but the Reserve would no longer have to accommodate the risk of overruns in self-financed local authority expenditure. The result was that the Planning Total in the three Survey years would be £179 billion, £192 billion and £203 billion, and general government expenditure £215 billion, £227 billion and £239 billion. Over the next two years this was £5.5 billion and £6.5 billion higher than the figures published in the 1988 Autumn Statement. These figures were probably higher than the markets were expecting, but lower than had seemed possible earlier in the Survey. The ratio of GGE to GDP would be the same over the first two Survey years as forecast in last year's Autumn Statement. It was, however, unexpectedly low this year at 38 3/4 per cent, and would therefore show a rise in 1990-91 to 39 per cent. In the two following years, it would fall to 38 3/4 per cent and 38 1/2 per cent, and at 38 1/2 per cent it would be at its lowest level since 1965-6. The outcome, although satisfactory, would need to be presented with care. The new definitions of the Planning Total would be unfamiliar to the markets and it would therefore be better to concentrate on GGE. This was forecast to grow between 1988-89 and 1992-93 at 1 3/4 per cent a year, the same rate of growth as forecast in last year's Autumn Statement for the period 1988-89 to 1991-92, and much lower than the 3 per cent in the ten years up to 1979. If Cabinet agreed, he would that afternoon make his Autumn Statement announcing this outcome.

In discussion the following were the main points made:

a. The decline in the volume of Government debt had reduced the level of debt repayment and so had allowed some increase in programme expenditure within the Government's objectives. This benefit should be reflected in presentation.

b. One of the most disturbing features of the economy was the growth of credit encouraged by banks and financed partly by the import of capital. It helped to account for the worse than expected deterioration in the current account and in inflation. More direct pressure on the lenders by the Bank of England should be considered. On the other hand, although it was true that the creation of credit was at a higher level than was desirable or had been expected, there was good evidence that it was declining. There were clear signs of this from the housing and retail markets, although occasional indicators like those for new car registrations still went the other way.

c. The prospect of a downturn in private capital investment was highly unwelcome since other countries were likely to continue investing at a high level. One particular concern was that the United Kingdom would fail to get a proper share of the substantial inward investment into the European Community likely over the next few years. Some measures to encourage continued investment might be considered as part of the Budget strategy. But the current prospect was that although capital investment would not continue to increase during 1990 at the very high level of this year, it would still show satisfactory growth.

d. The markets would be interested in the prospects for the monetary aggregates. To retain confidence, it would be necessary to show that the long-term trend for them also was satisfactory. It was expected that M0 would move down towards its target range of 1-5 per cent this year. A target range of 0-4 per cent had been set for next year. Movements in broad money were difficult to interpret, but there were signs of some levelling off in its growth.

e. It would be important in presentation to stress that prospects for the economy were still good. The Opposition would no doubt claim that it was entering a recession. The forecast that RPI inflation would still be at 5 3/4 per cent in the last quarter of 1990 would also attract criticism. However, the continued increase expected in exports and capital investment would help to show the underlying strength of the economy, which would certainly enter the 1990s in much stronger condition than the 1980s. The public would also welcome the extra resources for areas such as transport and higher education which were of high priority because of their importance to the health of the economy in the long term.

f. Some past forecasts had proved in the event to be too optimistic, and the Government had been forced on to the defensive when this became apparent. The new forecasts were the best and most central forecasts which could be made; but inevitably there were considerable uncertainties, especially at an important turning-point for the economy.

THE PRIME MINISTER, summing up the discussion, said that the Cabinet congratulated the Chief Secretary on the outcome of the Survey. They endorsed the recommendations in his memorandum C(89)13. They also agreed with the recommendations made by the Chancellor of the Exchequer as to the content of the Autumn Statement, and noted that he would make an oral statement in Parliament that afternoon, with publication of the full printed version on Wednesday 22 November. She would arrange for the Press to be told that the Cabinet had today successfully concluded its work on the 1989 Public Expenditure Survey, and that the Chancellor proposed to make his Autumn Statement to the

House that afternoon, setting out the outcome of the Survey and the prospects for the economy. It was important that the contents of the Statement should remain confidential until then. Ministers whose Departments had received extra allocations would need to be ready with their own supporting announcements, but should make it clear that these had been agreed within the context of priority for reducing inflation and continuing tight control over public expenditure.

The Cabinet -

1. Endorsed the recommendations in the memorandum by the Chief Secretary, Treasury.

2. Took note that the Chancellor of the Exchequer would make his Autumn Statement later that day.

Cabinet Office

15 November 1989