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CABINET

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

THURSDAY 29 OCTOBER 1987

at 9.15 am

P R E S E N T

The Rt Hon Margaret Thatcher MP
Prime Minister

The Rt Hon Viscount Whitelaw
Lord President of the Council

The Rt Hon Sir Geoffrey Howe QC MP
Secretary of State for Foreign and
Commonwealth Affairs

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer

The Rt Hon Lord Mackay of Clashfern
Lord Chancellor

The Rt Hon Douglas Hurd MP
Secretary of State for the Home Department

The Rt Hon Peter Walker MP
Secretary of State for Wales

The Rt Hon George Younger MP
Secretary of State for Defence

The Rt Hon Norman Fowler MP
Secretary of State for Employment

The Rt Hon Tom King MP
Secretary of State for Northern Ireland

The Rt Hon Nicholas Ridley MP
Secretary of State for the Environment

The Rt Hon Lord Young of Graffham
Secretary of State for Trade and Industry

The Rt Hon Kenneth Baker MP
Secretary of State for Education and Science

The Rt Hon Kenneth Clarke QC MP
Chancellor of the Duchy of Lancaster

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

The Rt Hon Malcolm Rifkind QC MP
Secretary of State for Scotland

The Rt Hon Paul Channon MP
Secretary of State for Transport

The Rt Hon John Moore MP
Secretary of State for Social Services

The Rt Hon John Wakeham MP
Lord Privy Seal

The Rt Hon Cecil Parkinson MP
Secretary of State for Energy

The Rt Hon John Major MP
Chief Secretary, Treasury

ALSO PRESENT

The Rt Hon David Waddington QC MP
Parliamentary Secretary, Treasury

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SECRETARIAT

Sir Robert Armstrong
Mr C L G Mallaby (Item 4)
Mr R T J Wilson (Item 5)
Mr R G Lavelle (Item 4)
Mr A J Langdon (Items 1-3)
Mr G Monger (Item 5)
Mr S S Mundy (Items 1-3)

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MEMBERSHIP
OF THE
CABINET

1. THE PRIME MINISTER said that the Cabinet would wish to congratulate Lord Mackay of Clashfern on his appointment as Lord Chancellor and to welcome him to his first meeting as a member of the Cabinet.

Appointment
of the Lord
Chancellor

The Cabinet -

Warmly endorsed the Prime Minister's congratulations and welcome to the Lord Chancellor.

PARLIAMENTARY
AFFAIRS

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

Criminal
Justice Bill

Previous
Reference:
CC(87) 1.1

THE LORD PRESIDENT OF THE COUNCIL said that in the Committee Stage in the House of Lords of the Criminal Justice Bill the Government's proposals on lenient sentences had been approved by a majority of 43 votes. This very satisfactory result had been achieved with the assistance of useful interventions in the debate by the Lord Chief Justice, Lord Ackner and Lord Roskill. The proposals for abolishing the prima facie rule in extradition proceedings had, however, faced a good deal of opposition. He understood that the Home Secretary intended to stand firm on the principle but was considering some minor modifications that might help to secure the passage of this part of the Bill. There was a risk also that the Government would face defeat on its proposals for abolishing the peremptory challenge of jurors. This had been recommended by Lord Roskill's fraud trials committee and it would be helpful if Lord Roskill could be persuaded to take part in the debate. It appeared that the Opposition might succeed in carrying an amendment at Report Stage to change the present law on life sentences for homicide. It should be possible to reverse in the House of Commons any defeats on major issues of principle.

THE SECRETARY OF STATE FOR NORTHERN IRELAND said that it would be helpful if the Government's position on extradition could be settled as quickly as possible. If it were decided to press ahead with the abolition of the prima facie rule, an early announcement of this could help to ease the ratification of Irish accession to the European Convention on the Suppression of Terrorism.

The Cabinet -

Took note.

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HOME AFFAIRS

British
Petroleum
Share Offer

3. THE CHANCELLOR OF THE EXCHEQUER said that the underwriters of the fixed price underwriting agreement for the sale of Government shares in British Petroleum had made formal representations to him earlier that week seeking consultations with a view to terminating the offer of sale. He expected to reach a decision later that day on whether or not the offer should proceed. This decision would need to be communicated to the underwriters and to the market as soon as practicable and the House of Commons would expect to be informed at the earliest opportunity. He would consult the Lord Privy Seal about the timing of an announcement in the House of Commons.

In discussion it was agreed that the primary consideration in deciding upon the timing of an announcement must be compliance with legal requirements and with the legitimate needs and interests of the underwriters and the market, even if the timing indicated by those considerations was not ideal from the Parliamentary point of view.

Prisons

Previous
Reference:
CC(87) 29.2

THE HOME SECRETARY said that he had spoken to representatives of the Prison Officers' Association (POA) as he had been authorised at the previous meeting of the Cabinet. All prisons were now receiving prisoners although prison officers at Wandsworth had merely suspended their industrial action. A national delegate conference of the POA had been called for the following day. While the situation in the prison service had improved over the previous week, with the numbers of prisoners in police cells having fallen, it was too early to be certain of the final outcome.

The Cabinet -

Took note.

FOREIGN
AFFAIRS

Ministerial
Meeting of
Western
European
Union

4. THE FOREIGN AND COMMONWEALTH SECRETARY said that he and the Secretary of State for Defence had that week attended the Meeting of Foreign and Defence Ministers of the seven member countries of Western European Union. The meeting had adopted a document entitled "Platform of European Security Interests", which set out clearly the main conditions of European security. It declared unambiguously that European security was founded on deterrence and on the presence of United States forces in Europe. During the meeting there had been useful discussions about the situation in the Persian Gulf. The Defence Ministers of the five European countries with a naval presence in the area had been able to consult directly, for the first time, about the co-ordination of minesweeping in the Gulf. The Federal Republic of Germany was now contributing indirectly, by moving minesweepers to the Mediterranean to compensate for the departure of Italian minesweepers from that area to the Gulf. Luxembourg was helping to pay for Belgian

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and Netherlands minesweepers' operations in the Gulf. The European presence in that area was an effective contribution.

The Cabinet -

1. Took note.

Nuclear Arms
Control

Previous
Reference:
CC(87) 29.3

THE FOREIGN AND COMMONWEALTH SECRETARY said that he had seen the United States Secretary of State, Mr George Shultz, at a meeting of the North Atlantic Council on 24 October, after Mr Shultz's visit to Moscow. Mr Shultz had at first been puzzled by the Soviet hesitation, after major progress had been made towards an agreement on intermediate range nuclear forces (INF), about proceeding to a summit meeting between the United States and Soviet leaders. In retrospect, it seemed that significance should be accorded to the remark by the General Secretary of the Communist Party of the Soviet Union, Mr Mikhail Gorbachev, to Mr Shultz to the effect that he had to consider the question of a summit as a politician as well as a human being; in other words, there might have been political constraints in Moscow on Mr Gorbachev's freedom of action with regard to a summit. The Soviet Foreign Minister, Mr Eduard Shevardnadze, was now to visit Washington on 30 October, apparently with a view to fixing the date of a summit. The Government's position was that an agreement on INF should be concluded and that the question of a summit could be treated separately from that. It was possible that there would be a summit in December 1987 without any significant change beforehand in the United States position on the Strategic Defence Initiative. During Mr Shultz's visit to Moscow there had been progress towards an INF agreement; the period for withdrawal of short range INF had been set for 12-18 months and that for long range INF at three years. The details of verification of the proposed agreement were now being discussed.

In discussion, the question was raised whether deployments of United States INF in Europe should continue after the signature of an INF agreement. There were arguments on both sides, but the main point was that such deployments might serve no purpose. It might therefore on balance be preferable for an announcement to be made, on signature of an agreement, that further moves on deployment would be suspended. The suspension should probably be for a stated period, in case the agreement for any reason should not enter into force. Meanwhile, the Government's line should be that there would be no change in the deployment arrangements before signature of an agreement, and existing arrangements for exercising with Cruise missiles should continue. Mr Shultz had rightly rejected a suggestion by Mr Gorbachev that INF deployment should be suspended from 1 November 1987.

The Cabinet -

2. Invited the Secretary of State for Defence to explore with the United States and the other

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European countries where intermediate range nuclear forces were being deployed the possibility of an announcement at the time of signature of an intermediate range nuclear forces agreement that further moves in deployment would be suspended for a given period.

Sri Lanka
Previous
Reference:
CC(87) 29.3

THE FOREIGN AND COMMONWEALTH SECRETARY said that the Indian peacekeeping force in Sri Lanka had claimed to have taken control of the town of Jaffna. But the town did not seem yet to have been fully secured; nor had the Indian forces captured any of the leaders of the "Tamil Tigers" guerrilla organisation. The Indian operations in Sri Lanka were clearly taking longer than had been planned. The first Commander of the Indian peacekeeping force had been quietly replaced. The resistance of the Tamil Tigers was likely to continue for some time.

In discussion, it was noted that the events in Sri Lanka could affect the case, awaiting an appeal hearing in the House of Lords of six Tamils seeking political asylum in Britain.

Hong Kong
Financial
Markets

THE FOREIGN AND COMMONWEALTH SECRETARY said that the Hong Kong stock and futures exchange had been closed for four days in the previous week. The underlying reason had been concern about the state of the futures exchange and the risk that speculators on that exchange might default, with repercussions for the stock exchange as well. The stock exchange, after reopening on 26 October, had suffered a fall of 30 per cent. This had been followed by fluctuations both ways, so that the net fall stood currently at 30 per cent. The Hong Kong Government had taken substantial measures to support the markets, providing funds for the restructured Futures Guarantee Corporation. Independent banks and also the Bank of China had contributed largely to the support fund. It seemed that the situation was being managed satisfactorily.

In discussion, it was pointed out that speculation on the Hong Kong futures market amounted virtually to gambling on the future of the stock market index. The Hong Kong Government was looking at the wider question of the future management of the markets. In Britain, many members of the public found it difficult to understand why people who for years had made profits in the financial markets had to be helped as soon as there was a week with serious losses. The Government might need to be ready with an appropriate explanatory line on this.

Airbus
Industrie
Previous
Reference:
CC(87) 28.4

THE CHANCELLOR OF THE DUCHY OF LANCASTER said that the meeting in London on 27 October between the United States Trade Representative, Mr Yeutter, the Commission and the European Airbus Ministers had been reasonably satisfactory. Agreement had been reached on a framework for continued negotiations. The European side had held together but the United States Administration appeared divided and unsure of their objectives. Negotiations might drag on in to 1988. During this period, no airbus orders would be placed by the United States.

Blockade of
French
Channel Ports

THE FOREIGN AND COMMONWEALTH SECRETARY said that French fishing vessels had tried to blockade French channel ports in protest at the extension of British territorial waters under the Territorial Sea Act 1987 which came into force on 1 October. He had discussed the issue earlier that week with the French Foreign Minister, Monsieur Raimond. The present position was that the blockade had been lifted. Further discussions were to take place the following week. Meanwhile on the British side enforcement was not taking place in a heavyhanded way.

The Cabinet -

3. Took note.

1987 PUBLIC
EXPENDITURE
SURVEY

5. The Cabinet considered a memorandum by the Chief Secretary, Treasury (C(87) 16) on the 1987 Public Expenditure Survey. The discussion is recorded separately.

The Cabinet -

1. Endorsed the recommendations in the Chief Secretary, Treasury's memorandum.

2. Took note that the Chancellor of the Exchequer would make his Autumn Statement on 3 November.

Cabinet Office

29 October 1987

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CABINET

LIMITED CIRCULATION ANNEX

CC(87) 30th Conclusions, Minute 5

Thursday 29 October 1987 at 9.15 am

1987 Public
Expenditure
Survey

The Cabinet considered a memorandum by the Chief Secretary, Treasury (C(87) 16) on the 1987 Public Expenditure Survey.

THE CHIEF SECRETARY, TREASURY said that his paper set out the agreements he had reached with colleagues on their programmes. After allowing for the higher provision for local authority current expenditure already decided, there would be increases in programmes totalling £4.6 billion in 1988-89, £6.1 billion in 1989-90, and £7.7 billion in 1990-91. A large part of these increases reflected estimating changes, and decisions taken before the Survey. On social security the increases, ranging from over £900 million in 1988-89 to over £3 billion in 1990-91, were the result mainly of estimating changes, together with the earlier decision to raise benefits to protect income support claimants against the cost of the 20 per cent rates contribution. On health the increases reflected the cost of the Review Body awards agreed earlier in the year, higher demand on the Family Practitioners Services and the growing cost of AIDS. Home Office expenditure had been increased mainly to cover the expansion and acceleration of the prison building programme agreed in the summer. Launch aid for the Airbus accounted for a major part of the increase in the Department of Trade and Industry programme. The figures also allowed for substantial increases in Britain's net contributions to the European Community.

Because of these pressures for higher spending, it had been possible to hold the totals to acceptable levels only by taking difficult decisions elsewhere. In social security, for example, the Secretary of State had announced that the new income-related benefits would be introduced in 1988 at levels slightly below the illustrative rates given in the 1985 reform White Paper, that Child Benefit would not be uprated in 1988, and that the housing benefit taper would be raised. In the nationalised industries, there would be substantial increases in electricity prices. The Secretary of State for Employment had agreed, in view of the improved prospects for unemployment, to absorb the extra costs of the January employment package.

As to running costs, a total increase of £560 million had been agreed for 1988-89. The target agreed by Cabinet in July of at least halving the bids received had not been met, in part because of the increase in

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market rents and the need to catch up with the backlog of maintenance work on the Government Estate. The outcome was, however, broadly consistent with the other objective agreed by Cabinet of constraining running costs to their present share of the planning total. In the case of ten Departments he had agreed a provision based on suitable management plans. Other Departments were still developing their plans. He hoped that in all cases suitable plans would be in place in time for the next Survey.

THE CHANCELLOR OF THE EXCHEQUER said that the increases agreed in programmes clearly left the reserves at an inadequate level. He proposed that they should be fixed at £3.5 billion for 1988-89, £7 billion for 1989-90 and £10.5 billion for 1990-91. The result would be increases in the planning totals of £2.6 billion in 1988-89 and £5.6 billion in 1989-90. The new figures for the planning totals would then be £156.8 billion in 1988-89, £167.1 billion in 1989-90 and £176.1 billion in 1990-91. The growth in the planning totals was, however, partly offset by minimal growth in debt interest, as a result of low borrowing. The share of national income taken by public spending, without allowing for privatisation proceeds, would be 42 per cent, 41³/₄ per cent, and 41¹/₄ per cent in the three years, meeting the Cabinet's objective of keeping within the percentages in the previous year's White Paper.

He had agreed with the Secretary of State for Social Services the National Insurance Contribution levels to be announced in the Autumn Statement. There would be no change in rates, but the Lower Earnings Limit would rise to £41 a week, and the Upper Earnings Limit to £305, broadly in line with inflation.

The Autumn Statement would also contain the new Industry Act forecast. It was of course especially difficult to make an economic forecast at the present time, and although he had tried to take the effects of the fall in share values into account it might not be until the pre-Budget forecast in the New Year that a proper judgment could be made. His present expectation was, however, that growth in the United Kingdom would be 4 per cent in 1987, and 2¹/₂ per cent in 1988. The 2¹/₂ per cent figure was better than it appeared, since the contribution of North Sea oil in 1988 would be negative, at -¹/₂ per cent. In both years, investment would grow faster than consumers' expenditure, and manufacturing output faster than the economy as a whole. Inflation as measured by the Retail Price Index was forecast to be 4 per cent by the fourth quarter of that year, and 4¹/₂ per cent by the fourth quarter of the following year. The Gross Domestic Product deflator would be 4¹/₄ per cent that year and 4¹/₂ per cent the following year. The balance of payments was especially difficult to predict, but he was keeping to the Budget forecast of a deficit of £2¹/₂ billion that year, and forecasting one of £3¹/₂ billion the following year. The deficit was the product of a faster rate of growth in the United Kingdom than in the rest of the industrial world, for which he estimated growth at 2 per cent the following year. Unemployment would continue to fall. He now expected the Public Sector Borrowing Requirement outturn in 1987-88 to be only £1 billion. This was well below the £4 billion estimated in the

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Budget mainly because of the buoyancy of the revenue, but partly because the planning total would undershoot by £1 billion. This undershoot was largely the result of higher proceeds from sales of council houses and land; other spending in total was broadly in line with plans.

The cause of the current market turmoil was lack of confidence in United States policy. Some international agreement was needed to minimise the damage and he was in continual contact with Finance Ministers in the other major countries. The key to restoring confidence was effective action by the United States Government to reduce its budget deficit. If such action were taken, other countries could help by cutting interest rates. The United Kingdom would be affected less than most by the collapse of market confidence. But it could not expect to be immune, not so much to the direct effect as the indirect effect, through the slow-down in the United States growth. There was however, no need, if appropriate policies were followed, for the slow-down to become a recession.

In discussion the following main points were made -

- a. The increase in the proceeds now expected from sales of housing and land by local authorities and new towns had made a major contribution to easing the problems of the Survey. It showed the success of privatisation in the local authority area also. Since the undershoot in 1987-88 was largely attributable to those receipts, it would not be appropriate to increase other expenditure to offset it.
- b. The electricity industry had accepted the need for a higher financial target. A rise in prices was necessary to finance the big increase in electricity investment required over the next few years. It was important in public presentation to stress that higher prices were needed to provide adequate and efficient capacity, so as to rebut the charges that their purpose was to make the industry more attractive for privatisation.
- c. The figures for the Department of Trade and Industry's programme provided for a restructuring of regional assistance which would have an initial cost but produce increasing savings by the end of the Survey period. Corresponding changes would be made in Scotland and Wales.
- d. Any downturn in world growth would complicate the management of the United Kingdom economy over the next two years. The level of real interest rates was important. They had reached excessive levels throughout the world and if they could now be brought down, prospects for renewed growth would be much enhanced.
- e. The Treasury Secretary and many others in the United States Administration were well aware of the need to cut the budget deficit. Action would have to be taken to reduce spending or increase taxes, or probably both. It would have to be on a substantial scale over a period of years, and the longer it was

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postponed the more substantial it would have to be. But it would not be easy to get the necessary decisions made, because of the structure of decision-making in the Administration, the political difficulty of raising taxes especially with an election the following year, and the failure so far of American opinion generally to recognise the gravity of the situation. Other Governments would need to do all they could to ensure that the right decisions were taken. Another important task was to stiffen the Administration's resistance to the pressure for protectionism.

f. It could be argued that the international markets should be allowed to work by letting the value of the dollar fall. Certainly there was no case for trying to maintain exchange rates if they were clearly wrong, and international co-operation had helped to achieve a substantial devaluation of the dollar over the past two years. But an uncontrolled fall in the dollar at that time would be most damaging for world markets and its short-run effect on the United States trade balance would be a still greater deterioration.

g. At first sight it was surprising that shares in London had fallen faster than those in New York or Tokyo. This was because of the different characteristics of the markets. In New York there were many traders prepared to buy, even at some risk, if they thought prices had fallen too far. The London market was dominated by cautious institutions, who preferred to wait until prospects were clear. The falls in London had resulted in the large part from marking down of prices rather than the high volume of selling seen on Wall St.

THE PRIME MINISTER, summing up the discussion, said that the Cabinet congratulated the Chief Secretary, Treasury on the outcome of the Survey and endorsed his recommendations in C(87) 16. They also endorsed the proposals by the Chancellor of the Exchequer for the new levels for the reserves and planning totals over the Survey period. It was essential that no information about these decisions should become public knowledge before the Chancellor delivered his Autumn Statement on 3 November, particularly in view of the Government's legal position in relation to the British Petroleum flotation. The Lord Privy Seal would tell the House of Commons that afternoon the date of the Autumn Statement. She would arrange for the press to be told that the Cabinet had that day successfully concluded its work on the 1987 Public Expenditure Survey; and that the outcome, together with the Industry Act forecast, would be set out in the Autumn Statement which the Chancellor proposed to make to the House on Tuesday 3 November. Nothing should be said to the press beyond that.

The Cabinet -

1. Endorsed the recommendations in the Chief Secretary, Treasury's memorandum.
2. Took note that the Chancellor of the Exchequer would

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3 November 1987