

SECRET

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Conclusions

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CABINET

CONCLUSIONS of a Meeting of the Cabinet  
held at 10 Downing Street on  
THURSDAY 25 FEBRUARY 1988  
at 10.30 am

P R E S E N T

The Rt Hon Margaret Thatcher MP  
Prime Minister

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 (Items 1 and 2 only)

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 President of the Council

The Rt Hon The Lord Belstead  
Lord Privy Seal

The Rt Hon Cecil Parkinson MP  
Secretary of State for Energy

The Rt Hon John Major MP  
Chief Secretary, Treasury

THE FOLLOWING WERE ALSO PRESENT

The Rt Hon David Waddington QC MP  
Parliamentary Secretary, Treasury

The Rt Hon Peter Brooke MP  
Paymaster General

SECRET

## SECRETARIAT

Sir Robin Butler  
 Sir Christopher Mallaby (Items 3-5)  
 Mr R T J Wilson (Item 6)  
 Mr R G Lavelle (Items 3-5)  
 Mr A J Langdon (Items 1 and 2)  
 Mr S S Mundy (Items 1 and 2)  
 Mr J Neilson (Item 6)

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PARLIAMENTARY  
AFFAIRS

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

Local  
Government  
Bill: Dog  
Registration

THE LORD PRIVY SEAL said that the Local Government Bill would be completing its passage through the House of Lords in the following week. On the previous Thursday, an amendment had been carried by a substantial majority against the Government which would give the Secretary of State for the Environment power to establish a registration system for dogs. He understood that as the powers were merely permissive, the Secretary of State for the Environment doubted whether it was worth seeking to reverse the amendment. The provisions in the Bill abolishing the dog licence remained intact.

Legal Aid  
Bill

THE LORD CHANCELLOR said that the legal aid system was not geared to deal effectively with civil cases involving a large number of plaintiffs and the present arrangements had attracted criticism in cases like that of the drug Opren. He had accordingly tabled amendments to the Legal Aid Bill to enable the Legal Aid Board to contract with a single solicitor to provide representation for all the plaintiffs in a group of closely similar cases. The proposed new arrangements had been generally welcomed, although they might not go as far as some people would wish.

The Cabinet

1. Took note.

Rateable  
Value of  
Business  
Properties

THE SECRETARY OF STATE FOR WALES said that the House of Lords had held in a recent case that businesses in areas adjacent to enterprise zones were entitled to a reduction in the rateable values of their properties. The rationale was that the benefits which enterprise zones offered to businesses had had a depressive effect on the notional rental values of properties in surrounding areas. He estimated that Swansea City Council and Glamorgan County Council, the two authorities immediately affected by the judgment, stood to lose around £1.7 million.

THE PRIME MINISTER, summing up a brief discussion, said that the House of Lords ruling could have major implications for the funding of local authorities, not only in respect of areas adjacent to enterprise zones but also, perhaps, areas surrounding simplified planning zones or urban development corporations. The Chancellor of the Exchequer, in consultation with interested colleagues, should consider urgently the implications of the decision and what response to it might be necessary.

The Cabinet -

2. Invited the Chancellor of the Exchequer, in consultation with the Secretaries of State for Wales, for the Environment and for Scotland, and the Chancellor of the Duchy of Lancaster to proceed as the Prime Minister had indicated.

HOME  
AFFAIRS

Industrial  
action in  
the National  
Health  
Service

Previous  
reference:  
C(88) 4.2

2. THE SECRETARY OF STATE FOR SCOTLAND said that Scottish health workers had taken industrial action the previous day in protest against the Government's proposals on competitive tendering in the National Health Service. The action had caused the postponement or cancellation of a significant number of operations, and at some hospitals the emergency cover which had been promised had not been forthcoming. The Opposition spokesman on Scottish Affairs had given the action his unqualified support in the House of Commons, thus demonstrating that the Opposition were prepared to endorse industrial action that inevitably harmed the welfare of patients and increased hospital waiting lists.

Industrial  
action in  
the Motor  
Industry

Previous  
reference:  
C(88) 6.3

THE SECRETARY OF STATE FOR EMPLOYMENT said that employees at Land Rover had begun strike action the previous week which had closed down the plant. The Land Rover management had no intention of going beyond their final offer and no further meetings had been arranged with the trades unions. The willingness of the Ford management to make concessions beyond what they had described as their final offer had had an unhealthy effect on the expectations of workers in other parts of the motor industry and it was important that the Land Rover management should stand firm. Large numbers of protesters had gathered outside the Land Rover plant. The trades unions would no doubt claim that there were no more than six pickets at any one time, that the remainder of the protestors were merely demonstrating, and that the protestors' actions were accordingly consistent with the code of practice on picketing. This was a complex area of law but it was possible that Land Rover would succeed should they decide to mount a challenge in the courts. The pay dispute at Ford had been settled, but there was now a further dispute concerning white collar workers. It was possible that this would lead to renewed industrial action, but any such action would not affect production for three to four weeks.

Industrial  
action in  
the Coal  
Industry  
Previous  
reference:  
C(88) 6.3

THE SECRETARY OF STATE FOR ENERGY said that the industrial action by the National Association of Colliery Overmen, Deputies and Shotfirers (NACODS) was continuing, but both the union and British Coal had now agreed to refer the dispute to the National Reference Tribunal, whose findings would be binding on both parties. NACODS' main outstanding grievance was that British Coal were not prepared to reinstate their exclusive recognition of the union to represent overseers and deputies. It appeared that the NACODS leadership were embarrassed about the continuing dispute and that they were seeking a face-saving device to end it. Coal stocks available to the Central Electricity Generating Board remained unaffected.

The Cabinet -

Took note.

FOREIGN  
AFFAIRS  
---  
Iraq

3. THE FOREIGN AND COMMONWEALTH SECRETARY said that Mr John Smith, a British businessman held for eight years in prison in Iraq, would be released that day, during a visit by the Minister of State, Foreign and Commonwealth Office (Mr Mellor) during which he had delivered a letter from the Prime Minister seeking Mr Smith's release. Another British subject, Mr Ian Richter, was still in prison in Iraq and there was no indication that his release would now follow. Mr Smith's release was good news but the Government's public reaction, given the plight of Mr Richter, should be cautious.

In discussion, it was recalled that the Iraqi authorities had insisted, whenever the United Kingdom had made representations on behalf of Mr Smith, that an Iraqi citizen held in a prison in the United Kingdom should also be released. But the two cases were entirely different: the Iraqi held in this country had been convicted by the courts of murder. It was satisfactory that Mr Smith was being released despite the British refusal to acknowledge any link between the two cases.

Republic of  
South Africa

THE FOREIGN AND COMMONWEALTH SECRETARY said that the South African Government had effectively banned all activity by almost all the black political organisations in the Republic. This had been an unnecessary step. It was hard to see how it could help to promote peaceful reform in South Africa. The South African Government appeared to have been influenced by the prospect of three difficult by-elections in the next two months. The Inkatha movement of Chief Mangosuthu Buthelezi was not covered by the new measures; this was likely to damage Chief Buthelezi by exposing him to being represented as a pawn of the South African Government.

Afghanistan  
Previous  
Reference:  
CC(88) 5.3

THE FOREIGN AND COMMONWEALTH SECRETARY said that the United States Secretary of State, Mr George Shultz, who had visited Moscow that week, had returned with his view that the Soviet Union intended to withdraw its forces from Afghanistan confirmed. Pakistan was continuing its efforts to promote the emergence of an interim Government before the Soviet withdrawal. The United Kingdom should support Pakistan in this. But nothing should stand in the way of the main Western objective - that Soviet withdrawal should begin as soon as possible. The United States shared this view, and was doing everything possible to promote the cessation of Soviet military aid to the Afghan regime before withdrawal began.

THE PRIME MINISTER said that one of the leaders of the Afghan Resistance had suggested to her that, as a matter of military prudence, a country which had decided to withdraw its forces from another country would always do so as rapidly as possible, because of the increasing danger during the process of withdrawal to the diminishing forces that remained. This called into question the motives of the Soviet Union in foreseeing a withdrawal period of nine or ten months. The process of the Soviet withdrawal would not be straightforward and there would be more bloodshed.

Iran/Iraq  
War  
Previous  
Reference:  
CC(87) 29.3

THE FOREIGN AND COMMONWEALTH SECRETARY said that the United States Secretary of State, Mr George Shultz, during his visit that week to the Soviet Union, had followed up the representations which he himself had made in favour of early moves towards adoption in the United Nations Security Council of a resolution imposing an embargo on arms supplies to Iran. With the agreement of the Soviet Union, the Permanent Members of the Security Council had now circulated a draft resolution, originally drawn up by the United Kingdom, to the non-permanent members. The United States Administration believed that it now had a Soviet commitment to adoption of the resolution before the end of February. The price of Soviet acceptance had been a clause in the draft resolution delaying the entry into force of the arms embargo for 30 or 60 days.

Cyprus

THE FOREIGN AND COMMONWEALTH SECRETARY said that Mr George Vassiliou had been elected President of Cyprus in the second round of elections on 21 February. Mr Vassiliou was a millionaire who had the electoral backing of the Communist Party of Cyprus. It did not appear that he would exert early pressure on the United Kingdom concerning the Sovereign Base Areas on the island. Mr Vassiliou was committed to seek renewal of diplomatic efforts for progress on the Cyprus problem. In the context of the improved atmosphere between the Governments of Turkey and Greece, it would be interesting to observe what happened. But the underlying problems were complex and it was hard to be optimistic.

The Cabinet -

Took note.

COMMUNITY  
AFFAIRS  
---  
Foreign  
Affairs  
Council  
22 February

THE FOREIGN AND COMMONWEALTH SECRETARY said that the Foreign Affairs Council had been able to dispose quickly of the agenda before it on 22 February. The French Foreign Minister, Monsieur Raimond, had made no serious attempt to sustain the line by Monsieur Chirac at the European Council on the eight non-arable agricultural stabilisers. The Presidency was therefore able to conclude that the European Council agreement had been confirmed in its entirety. The Foreign and Commonwealth Secretary had taken the opportunity formally to associate the United Kingdom with the Dutch and Italian statements that the European Council Declaration on agricultural trade should not be interpreted in a protectionist way. The Declaration had been satisfactorily de-linked from the agricultural guideline in the final overall text of the European Council conclusions.

Budget  
Council  
23 February

THE CHANCELLOR OF THE EXCHEQUER said that at its meeting on 23 February the Budget Council had been able, without great difficulty, to reach agreement in principle on a draft budget for 1988 on a basis reflecting the conclusions of the European Council, subject to a waiting reserve by Italy. There had however been protracted discussion of the Presidency's proposal for an intergovernmental agreement to provide the additional revenue necessary pending ratification of the new Own Resources Decision. The Italian delegation had disputed the interpretation given by the Commission to the conclusions of the Brussels European Council on the question of the financing of the United Kingdom's abatement. They had argued that this should be brought to account against the new fourth own resource rather than within the Value Added Tax (VAT) ceiling. Further discussion would be necessary to resolve this issue.

European  
Court of  
Justice  
Ruling  
23 February

THE CHANCELLOR OF THE EXCHEQUER said that the ruling on 23 February by the European Court of Justice that by exempting from VAT certain goods supplied with medical care in the United Kingdom was in breach of its obligations, had attracted a number of ill-informed press reports. The ruling was addressed to the scope of an exemption from the Sixth VAT Directive adopted in 1977. Because the goods had previously been an exempt rather than zero-rated, part of the effect of VAT imposition would be offset by deduction of VAT on inputs which would now be allowed. It had been made clear by the Economic Secretary to the Treasury, in reply to a Private Notice Question from Mr Spearling MP, that this decision had no bearing on the infraction proceedings taken by the Commission against the United Kingdom in respect of certain of its

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zero rates, much less the Commission's more general proposals on tax approximation. The ruling on the infraction proceedings was not expected for several months. The preliminary opinion of the Advocate General suggested that United Kingdom pleas would be accepted in some but not all respects. It would be necessary in due course to give further thought to how the United Kingdom should implement the Court's final ruling.

The Cabinet -

Took note.

5. THE SECRETARY OF STATE FOR NORTHERN IRELAND said that he had visited Dublin on the previous day. The visit had gone well. His meeting of 30 minutes with the Prime Minister of the Irish Republic, Mr Charles Haughey, had been friendly. Mr Haughey had asked about political developments in Northern Ireland and had not raised the matters which recently had caused difficulty between the British and Irish Governments.

He had shown Mr Haughey evidence of the scale of smuggling across the border between Northern Ireland and the Irish Republic, which deprived the Irish exchequer of considerable revenue. Mr Haughey had appeared to be impressed by this evidence, which should give him a further reason for pursuing co-operation on security either side of the border.

He had also held a meeting with the Irish Foreign Minister, Mr Brian Lenihan, and participated in a full meeting of the Anglo-Irish Intergovernmental Conference. A wide range of issues had been discussed. One of these had been the case of a private soldier in the British army who had returned to duty after serving a period in prison following conviction for murder in Northern Ireland; it was surprising that the news of his release from prison should have broken at that time, more than a year after it had taken place. The two sides had agreed that there should be a further meeting of the Intergovernmental Conference shortly, with a full agenda. He had made clear to Mr Lenihan that cross-border co-operation on security must be included. That was in line with clear public statements by Mr Haughey that such co-operation would continue. When this subject was discussed in the Intergovernmental Conference, the Chief Constable of the Royal Ulster Constabulary and his Irish equivalent were present. Moreover, in private discussion Mr Lenihan had raised no difficulty about the continuation of this arrangement. It was therefore surprising that the Irish Foreign Minister had reacted negatively to his public statement that the two Chief Constables would participate in the forthcoming meeting.

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After the meeting of the Intergovernmental Conference, he and Mr Lenihan had walked across St Stephen's Green in the centre of Dublin, as a means of showing that their relationship remained good. This walk had featured in news programmes on British television the same evening.

In discussion, it was agreed that the public line for the Government on the question of the participation of the two Chief Constables in the forthcoming meeting of the Intergovernmental Conference should be prepared with care. It should include the point that the two Chief Constables always attended when cross-border co-operation on security was discussed; and the point that the meeting of the Intergovernmental Conference on 24 February had gone well.

The Cabinet -

Took note.

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ELECTRICITY  
PRIVATISATION

6. The Cabinet had before them a minute from the Secretary of State for Energy to the Prime Minister of 23 February and a minute from the Secretary of State for Scotland to the Prime Minister of 24 February.

THE SECRETARY OF STATE FOR ENERGY said that on 22 February the Ministerial Steering Committee on Economic Strategy, Sub-Committee on Economic Affairs (E(A)), had endorsed his proposals for the privatisation of the electricity supply industry in England and Wales. If the Cabinet agreed, he planned to make an announcement to Parliament and publish a White Paper that afternoon. Under his proposals, the 12 distribution Area Boards would be privatised as independent companies. The national grid would be transferred from the Central Electricity Generating Board (CEGB) to a company jointly owned by the 12 distribution companies. The generating assets of the CEGB would be divided, to promote competition: 70 per cent of its capacity, including all the nuclear assets, would be transferred to an identifiable successor to the CEGB, which would take on the responsibility for the nuclear power programme. The remaining 30 per cent of capacity, all fossil-fuelled, would be transferred to a new generating company. The statutory obligation to supply would be transferred from the CEGB to the distribution companies. The national grid would be available to all generators as a common carrier and would act as a collective purchaser for the distribution companies. The result of these arrangements would be that over time a greater diversity in generation would be established. There would be a tough regulatory regime covering the monopoly activities of the distribution companies, and an attractive package of performance standards and new rights for customers.

These proposals were supported by all 12 Area Board Chairmen and in the main by the Electricity Council. The management of the CEGB were disappointed, but it would not have been politically acceptable to have privatised the CEGB as a monopoly, as they had wished. His announcement would be controversial, particularly with the unions, but he would be able to say that he had consulted all interested parties in the industry extensively. Obtaining the support of the industry's employees would be most important; he planned to have an attractive package for them covering such matters as share incentives and preservation of pension rights.

THE SECRETARY OF STATE FOR SCOTLAND said that on 22 February E(A) had also endorsed his proposals for the privatisation of the electricity supply industry in Scotland. If the Cabinet agreed, he planned to make an announcement to Parliament and publish a White Paper on 1 March. The Scottish electricity industry was different from that in England and Wales in two crucial respects: nuclear power provided a high proportion of its generating capacity, up to 80 per cent for a time after the completion of the Torness power station, and the two Scottish Boards were vertically integrated with responsibilities for both generation and transmission. He shared the Secretary of State for Energy's desire to increase competition in the industry; and he believed that this would be best achieved in Scotland by privatising two vertically integrated electricity companies. The existing Scottish nuclear assets would be transferred to a company jointly owned by the two new companies, so that

it would be viable to float the southern company which would otherwise have been disproportionately dependent on nuclear power. Both the existing Scottish Boards supported this holding company arrangement. He expected widespread support for his proposals on structure in Scotland, with the exception of the management of the South of Scotland Electricity Board who had favoured a single monopoly company.

In discussion the following main points were made -

a. Giving the generating companies the freedom to import coal could have a substantial impact on the continued viability of British Coal. If British deep-mined pits had to be closed because their markets were supplied with cheaper imported opencast coal, then our longer term security of supply could be jeopardised. In a free market situation, British Coal might threaten that, unless the terms of supply was satisfactory to them, they would withdraw supplies altogether. On the other hand, the capacity of British ports to handle imported coal in the next few years would be limited, and domestic coal enjoyed a substantial competitive advantage over imports in transport costs in inland power stations. The generating companies would know they could not obtain all their supplies at current marginal prices on the world market: the market was too small and volatile. It would be in their commercial interest to enter into long term contracts with British Coal, and the presence of the international market would provide valuable competitive pressures on the costs of British Coal. Placing restrictions on the freedom of negotiation between British Coal and the generators would be likely only to lead to further indefinite subsidies from taxpayers to British Coal. In presenting this aspect of the announcement, it would be important to emphasise that generators would be likely to seek the bulk of their coal supplies from British Coal for security of supply reasons, rather than that they would now have the opportunity to import substantial volumes of coal from abroad.

b. There was likely to be vigorous opposition both in Parliament and from the electricity unions to the Government's proposals. In particular, the leader of the power engineers, Mr John Lyons, was highly respected and would be advising the Alliance. The reorganisation of the industry would be complex and controversial and it would not be possible to complete privatisation of the industry during the present Parliament: this could affect the price. On the other hand, it would not be acceptable to the Government's supporters to privatise the industry as a monopoly supplier and so reorganisation was inevitable. There had been union opposition to all previous major privatisations. This had never prevented the employees concerned from recognising the benefits of privatisation.

c. It could be argued that there would be greater competition between the generating companies if the CEGB's existing nuclear power stations were divided between the two new companies. But this would be likely to result in a delay in permission being

granted for construction of the three nuclear stations after Sizewell B. Only if responsibility for the nuclear programme was vested in an identifiable successor to the CEGB could there be confidence that the nuclear programme would be carried forward in accordance with Government policy.

d. There would be difficulties for further companies in establishing themselves in the generating market. Such companies would have to finance the entire current cost of capital in any new power station investment, whereas the two companies being created out of the CEGB would have large portfolios of existing capital assets at historic cost and more limited capital financing requirements. On the other hand, this was a problem which often faced new companies wishing to enter an established market. In the case of electricity it was not impossible that new entrants could compete successfully, for instance with a new coastal power station burning imported coal.

e. The proposal to impose a requirement on the northern Scottish company to charge uniform tariffs, ran contrary to the philosophy being applied in the rest of this privatisation exercise. On the other hand, a principal consideration in establishing the North of Scotland Hydro-Electric Board had been to equalise tariffs so that the remoter areas were not unduly penalised by the costs of transmission. Abolishing it would cause major difficulties.

THE PRIME MINISTER, summing up the discussion, said that the Cabinet had considered carefully the issues which had been raised and endorsed the proposals before them on electricity privatisation in England and Wales, and in Scotland. The Secretary of State for Energy should finalise his statement to Parliament for that afternoon, taking account of suggestions made in the discussion, and proceed with the publication of a White Paper later that day as he had proposed. The Secretary of State for Scotland should consult further with the Chancellor of the Exchequer and the Secretary of State for Energy on the issue of uniform tariffs in northern Scotland. Subject to this point, he too should proceed with his statement to Parliament and the publication of a White Paper on 1 March, as planned.

The Cabinet -

Took note, with approval, of the Prime Minister's summing up of the discussion and invited the Secretary of State for Energy and the Secretary of State for Scotland to proceed accordingly.

Cabinet Office

25 February 1988