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CAB 128/84

cc (86) 6th Conclusions - 13/2/1986.

cc (86) 28th Conclusions - 17/7/1986.

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cc (86) 41st Conclusions - 11/12/1986.

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MOST CONFIDENTIAL RECORD

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MOST CONFIDENTIAL RECORD
TO
CC(86) 6th Conclusions

Thursday 13 February 1986

ECONOMIC
STRATEGY

The Cabinet considered a memorandum by the Chancellor of the Exchequer (C(86) 5) on Economic Strategy.

THE CHANCELLOR OF THE EXCHEQUER said that the sharp fall in the price of oil had radically changed the budgetary prospect he now faced. Lower oil prices would mean lower inflation in most parts of the world, faster growth and more demand for manufactured goods. The British economy would share in these benefits, but at the same time Government revenue would fall substantially. Overall lower oil prices could be said to be good for the economy but bad for the Budget. With the exception of the continuing problem of very high unemployment, the recent performance of the British economy had generally been good; and 3½ per cent growth achieved the previous year in the Gross Domestic Product (GDP) had been in line with previous forecasts, and although inflation had been a little higher than forecast, exports had risen strongly and the current account surplus had been larger than expected. The outlook for 1986 was for 3 per cent growth in GDP; if achieved, this would be the fifth successive year of growth averaging 3 per cent. Inflation was expected to be down to 4 per cent by the fourth quarter of 1986, the strong rise in exports was likely to continue, and there would again be a substantial current account surplus. Business investment was continuing to increase, and the company sector was making healthy profits. Manufacturing productivity was continuing to increase rather faster than in most other industrial countries, but the faster growth of earnings and unit labour costs remained a most serious problem. The fiscal prospect for 1986 was inevitably clouded by the uncertainty about oil prices; if the 40 per cent reduction below the previous autumn's levels were to be maintained, the Government's oil revenue would be reduced by about £5 billion. The buoyancy of the rest of the economy meant that non-oil revenues would continue on a satisfactory trend, partially offsetting the losses on oil account. It was remarkable that it should be possible, despite the loss of oil revenue, to avoid any increase in taxes; but there was no escaping the conclusion that the scope for tax reductions had been deferred. The British economy remained exposed to substantial risks; oil prices could fall further, and market pressures might cause adverse movements in the exchange rate and in interest rates. The Organisation of Petroleum Exporting Countries were seeking to put maximum pressure on the British Government by holding their next meeting exactly at the time of the Budget. Privatisation receipts in 1986-87 were now put at £4¾ billion, over £2 billion higher than the previous year's estimate; given that such receipts effectively financed rather than reduced Government demands on the rest of the economy, some would argue that the underlying Public Sector Borrowing Requirement (PSBR), on the basis of the 1985 projection in the Medium Term Financial Strategy (MTFS), should be regarded as more than £12 billion, rather than £7½ billion. The position in the financial markets had been held

by the prompt 1 per cent increase in interest rates that January, followed by determined resistance to any further upward movements, and with any strain taken on the exchange rate. The markets appeared now to have suspended judgment until the Budget. His judgment was that, particularly in view of the additional privatisation receipts as well as this substantial downside risk, it would be prudent to aim at a PSBR a little below the previous year's MTFS figure of £7½ billion if the confidence of the markets was to be retained. In all the circumstances the fact that it was possible to contemplate a Budget without an increase in taxes was impressive evidence of the strength of the economy; great concern had been expressed about the impact on the economy of the coming rundown in oil production over a long period, but in value terms half of the impact of that had already been felt. This could reduce substantially any remaining problems of adjustment.

In discussion, the following main points were made -

a. Great importance was attached to the problem of continuing high unemployment. Any available resources should be devoted to measures to counter unemployment. There would be great advantage if the number unemployed could be reduced below 3 million, and at least unemployment should not go above its present level. The fact that the expansion of the Community Programme and the two-year Youth Training Scheme announced in the 1985 Budget were only now coming into effect gave some grounds for optimism, and should be recalled in the presentation of the Budget. One approach would be to look to a further expansion of the Community Programme, together with some kind of extension of Enterprise Allowances; but it was arguable that it would be better to devote available resources to the creation of new capital assets rather than to 'making work'. The difficulty was that experience showed that it would cost a very great deal of money to have any substantial impact on unemployment; the view of the House of Commons Employment Committee that the main problem of unemployment could be overcome at an annual cost of about £3½ billion reflected that Committee's failure to realise that the people employed under the arrangements they recommended would in many cases displace existing employees.

b. Much concern was expressed about trends in earnings and in unit labour costs. Despite the correct advice offered year after year by the Government and by the Confederation of British Industry private sector employers persistently refused, when they were making reasonable profits, to hold out against demands for inflationary wage increases. This produced a situation in which competitiveness could only be maintained by progressive depreciation of sterling, which in turn created market pressure for interest rates higher than they would otherwise need to be. High interest rates were a major source of difficulty both for small businesses and for the increasing number of people buying their houses on mortgages.

d. The problem of incentives, and the unemployment trap, remained serious; although specific initiatives could help to reduce the

numbers of people on the register, and to make the labour market work better, the underlying difficulty that many people could expect practically the same household income out of work as in work remained a serious obstacle to progress in reducing unemployment. The removal of the wage-stop, although helpful from the standpoint of reducing the extent of family poverty, had made the problem of incentives worse. So far as the Budget was concerned, it was arguable that reductions in income tax rates, which would improve incentives throughout the economy and strengthen political support for public expenditure restraint, would be preferable to real increases in tax thresholds as a means of using any available 'fiscal adjustment'.

d. It was doubtful whether it would be prudent to seek to create room for direct tax reductions by real increases in indirect taxes, as had been done in 1979. There could be a case for some real increase in the duty on road fuel, which would counter-balance the impact on pump prices of the fall in world oil prices; but the overall prospect for inflation relied on reductions in oil product prices to counter-balance the impact on the general price level of the reduction in the value in sterling.

e. Although the overall net effect of lower oil prices on the British economy could be presented as positive, this country would benefit relatively very much less than Japan and Germany which could look forward to zero inflation or even a fall in price levels, substantial increases in real incomes, and some reduction in unemployment. It would become harder for the Government to maintain the line that high unemployment was an international problem about which they, like other national Governments, could do little.

f. Some commentators expected the British economy to do much worse than the Chancellor of the Exchequer had suggested; fears had been expressed of a current account deficit, a much higher PSBR, and an increase in inflation of $1\frac{1}{2}$ per cent. The prospect shown by the Chancellor of the Exchequer was much more reassuring, but most of the risks were on the downside.

g. The future stability and growth of the economy depended on the maintenance of confidence that the Government could win the next General Election. If the overall effect of lower oil prices on the economy were broadly neutral - in terms of prospects for inflation and output - would it be possible to make the previously intended fiscal adjustment despite the deterioration in oil revenue? Additional expenditure on housing, construction and the urban programme could prove effective in recovering political support as well as in reducing the numbers unemployed. There was very heavy pressure for additional public expenditure in all these areas, as well as in education.

h. Relatively modest increases in public expenditure could in some circumstances prove the key to much larger increases in

private sector expenditure, with beneficial effects on employment. Possible examples were Urban Development Grant, improvement grants for private sector housing, and improvements to the transport infrastructure. Undue rigour in classifying some of these activities to the public sector should be avoided.

i. Great skill would be needed if an essentially stand-still Budget were to be presented in an attractive way. Efforts would need to be made to find attractive low-cost 'sweeteners' which would attract public support. One possible example might be a concession on gifts to charities.

THE PRIME MINISTER, summing up the discussion, said that the Cabinet fully endorsed the maintenance of the sound and prudent policies pursued by the Chancellor of the Exchequer. They considered it a major achievement that he should be able to avoid any net increase in taxation in his forthcoming Budget, and endorsed his intention to aim at a PSBR a little below the previously projected £7½ billion for 1986-87. They recognised the difficulties the Government would face in holding public expenditure within the planning totals set out in the recent White Paper, particularly in the light of difficulties with local authorities, and agreed that it would be particularly important to look for possibilities of increasing freedom of manoeuvre by making savings in existing programmes. Insofar as the Chancellor of the Exchequer had any room for manoeuvre in his Budget, they considered that this should be devoted to measures which offered the prospect of some reduction in unemployment at very modest budgetary cost. They agreed that possible minor concessions should be sought which would make the Budget attractive and interesting, but without having any major effect on the underlying arithmetic. Similarly consideration should be given to modest public expenditure proposals where these could be shown to be the key to much larger expenditure by the private sector. The overall fiscal stance should be a cautious one, as recommended by the Chancellor of the Exchequer; it would always be possible to relax that stance later if circumstances permitted, while a Budget incorporating unjustified concessions could do damage which would be very hard to reverse. Meanwhile greater efforts should be made to secure wider understanding of the need to reduce the rate of increase in unit labour costs, which remained a major obstacle to the achievement of lower interest rates and lower unemployment.

The Cabinet -

1. Took note, with approval, of the Prime Minister's summing up of their discussion.
2. Invited the Chancellor of the Exchequer to take account of their discussion in preparing his forthcoming Budget.

Cabinet Office

14 February 1986

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MOST CONFIDENTIAL RECORD
TO

CC(86) 28th Conclusions

Thursday 17 July 1986

IMMIGRATION
CONTROLS AT
LONDON
AIRPORT

THE HOME SECRETARY said that, as he had previously warned colleagues, the pressures on the immigration services at London Airport had become very great. He was considering whether to introduce a visa requirement for nationals of five Commonwealth countries, including Nigeria and Ghana, but had decided after consultation with the Foreign and Commonwealth Secretary to postpone further consideration of such a step until after the forthcoming meeting of seven Commonwealth Prime Ministers. The problem was, however, especially acute in relation to Nigeria. The arrival of unusually large numbers of people from Nigeria, many of them on extra unscheduled flights, had produced a further sharp increase on the strains faced by the immigration services at London Airport. The facilities were over-crowded; conditions of squalor now obtained. The staff were understandably dissatisfied. It appeared that the main reason for the sudden influx of Nigerians was rumours in Nigeria of an impending increase in air fares to the United Kingdom. He believed that, if Nigeria could not be persuaded to halt the extra flights to the United Kingdom, he would have as a matter of urgency to introduce visas for Nigerians wishing to visit this country. The reasons, relating to the over-strain of the immigration services, would be convincing; a decision on visas should thus be seen by the public as unrelated to the problems of South Africa. He would consult the Foreign and Commonwealth Secretary, the Secretary of State for Trade and Industry and other Ministers closely interested about the question of a visa regime for Nigeria.

In discussion, the view was expressed that the difficulties for the immigration services at London Airport should take priority over other considerations in this matter. At the same time, it was noted that the introduction of a visa regime for Nigeria would cost £7 million net per annum and that there would be significant initial costs as well. The public reaction in this country to the introduction of visas for Nigerians would probably be positive.

The Cabinet -

1. Invited the Home Secretary, in consultation with the Foreign and Commonwealth Secretary and other interested Ministers, to consider further as a matter of urgency the question of introducing visas for Nigerians.
2. Noted that it might in any case be necessary during the Recess to introduce visas for visitors from Nigeria and four other Commonwealth countries.

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MOST CONFIDENTIAL RECORD
TO
CC(86) 28th Conclusions

TURKS AND
CAICOS
ISLANDS

Previous
Reference:
CC(85) 11.2

THE FOREIGN AND COMMONWEALTH SECRETARY said that, following an inquiry by Mr L J Blom-Cooper QC into allegations of corruption in the administration of the Turks and Caicos Islands, it would shortly be necessary to take action to secure the removal from office of the Prime Minister and two other Ministers in that administration. The Cabinet would recall that the previous Prime Minister was serving a five year prison sentence in Florida for drug trafficking offences. Following the removal of the Prime Minister, the Governor would govern the Colony, on the basis of the advice of an advisory council. A statement would be made in due course; until then the matter should remain strictly confidential.

The Foreign and Commonwealth Secretary added that he had embarked upon a study of how best to secure and train the right people for discharging the duties of Colonial Governors, now that there was no Colonial Service.

The Cabinet -

Took note.

Cabinet Office

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MOST CONFIDENTIAL RECORD
TO
CC(86) 41st Conclusions

LOCAL
GOVERNMENT
FINANCE
LEGISLATION

THE LORD PRESIDENT OF THE COUNCIL said that urgent legislation was required to rectify a flaw in the interpretation of local authorities' total expenditure under the Local Government, Planning and Land Act, 1980. Total expenditure formed the basis for the distribution of block grant to local authorities, and played a key role in the rate and precept limitation process, and all these mechanisms were at a standstill until the matter was resolved. Although the Government's interpretation of total expenditure had been adopted at the request of the local authority associations in 1980, the Attorney General had now advised that it was wrong in law. Operating on a strict interpretation of the statutory language was not a realistic option. There was, therefore, no alternative but to validate the Government's existing interpretation, both retrospectively and prospectively, by a Bill that would need to be enacted as quickly as possible. The preparation of this measure had proved to be more complex than had been expected and it was now clear that, if it did no more than validate the point at issue, the sequence of Orders and consultative periods on rate and precept limitation would extend through May, and even to June. He had therefore agreed with the Secretary of State for the Environment and other Ministers most closely concerned, including the Lord Privy Seal and the Chief Whip, that there was no realistic alternative but to enact rate limitation and precept limitation on the face of the Bill, by reference to classes of authorities, in order to avoid problems of hybridity. The Bill would need to be introduced in the following week, and taken to Royal Assent by Easter. Its Parliamentary passage could be difficult, and the Government would doubtless be accused of muddle. But there was no alternative.

THE SECRETARY OF STATE FOR THE ENVIRONMENT agreed with the Lord President's statement of the problem. The interpretation of total expenditure that the Government had adopted was, in fact, less effective as a matter of financial discipline than would be a strict interpretation of the 1980 Act, but he agreed there was no alternative but to validate the interpretation that had been used in practice. The legislation would have to be introduced urgently, not only to secure Royal Assent in time to bear on the next financial year, but because the point at issue would be exposed in a case brought against his Department by Greenwich Council, which was being heard the following Wednesday. The essential point to stress throughout the presentation of this legislation would be that it did no more than validate the law as it had generally been supposed to be, and did not in any way represent a substantive new policy initiative.

THE PRIME MINISTER, summing up a short discussion, said that the need for the legislation described by the Lord President of the Council was manifest, and that it was essential that it should not itself contain any flaws. The Secretary of State for the Environment might wish to

arrange for it to be seen in draft by leading Counsel. The necessity of the Bill, in order to validate the law as hitherto understood, should be emphasised at all stages of its Parliamentary passage. The Cabinet noted that the Secretary of State for the Environment did not intend to make a Statement about the Rate Support Grant (RSG) settlement for England for 1987-88 until January, after a reasonable consultation period on his latest proposals, though the Secretary of State for Wales had not put proposals out to consultation and was therefore under some pressure to make a Statement soon. The Secretary of State for Wales should consult the Lord Privy Seal and the Chief Whip about the timing and handling of a Statement on the RSG settlement for Wales: it was unlikely that this could be finalised until the Secretary of State for the Environment had made his Statement on the need for validating legislation, and the Parliamentary response to that had been assessed.

The Cabinet -

1. Took note, with approval, of the Prime Minister's summing up of the discussion.
2. Invited the Secretary of State for the Environment to make a Statement in the following week about the need for legislation to validate the existing practice on the existing practice on the interpretation of local authorities' total expenditure, and to bring forward a Bill as described by the Lord President of the Council for introduction as soon as possible.
3. Invited the Secretary of State for Wales to discuss with the Lord Privy Seal and the Chief Whip the timing of a Statement on the Rate Support Grant settlement for Wales for 1987-88.

Cabinet Office

12 December 1986

