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CABINET

SUGAR

Memorandum by the Minister of Agriculture, Fisheries and Food

THE WORLD PRICE

1. Since I circulated my memorandum C(74) 117 the world market price of sugar has again moved sharply upwards. By Friday the spot price was £480 per ton and the December futures price no less than £570. The immediate reasons for this are said to be renewed buying by the United States refiners and strong rumours that Russia has now entered the market for substantial quantities. The prospect of the Community's import subsidy is also affecting sentiment. With the United States, Russia and the European Economic Community (EEC) likely to be bidding against each other for the limited quantities of sugar available between now and the beginning of the Southern Hemisphere season in the second half of 1975, some traders believe the price could go to £600 or £700.

EFFECT ON SUPPLIES

2. The higher the world price goes, the smaller the chance of our getting any significant quantities of sugar from the West Indies in the first half of 1975. United States refiners are prepared to pay the world price; and Jamaica, Trinidad and Barbados are anxious to establish themselves as substantial suppliers of the United States market against the possibility of renewed United States import quotas at some time in the future. If the spot price went to £600 and the futures price for a year ahead to, say, £400, the West Indies would be able to ensure at once an average return of £500 for two seasons - equivalent to seven years' sales at the present Commonwealth Sugar Agreement price of £140. Thus the Caribbean suppliers will be under a strong temptation to reject or defer even a generous long-term deal under Protocol 22 or to sign it and fail to deliver; and other developing Commonwealth countries might follow their example, at any rate in part.

3. As my colleagues will realise from my earlier paper, there is no simple way out of this problem through a deal with Australia. They have relatively little sugar available in the crucial first half of 1975 and their growers will also want a higher price now in any long-term deal.
CONCLUSIONS

4. I think there are four conclusions to be drawn from this:

i. We must do all we can to enable our port refiners to buy world market sugar and to get Community subsidy on it when it is imported from next February. This means persuading the British Sugar Corporation to sell them sugar from the 1975 crop; lending the refiners money to fund the purchase of world market sugar; and insuring them against the risks they run in buying forward, which are too great for the companies themselves to take. I am exploring the financial aspects urgently with the Paymaster General.

ii. We must get the Protocol 22 arrangements for a long-term agreement with the developing Commonwealth settled as soon as possible, and at a realistic price level - which will now almost certainly have to exceed £140.

iii. We must still hold the Community to its promise to subsidise the import of the whole deficit in supplies. For the Community as a whole this could be upwards of a million tons, requiring a total subsidy possibly in excess of £300 million if the price were to be subsidised down to threshold price levels. In such circumstances it would probably become necessary to accept a far higher price for British consumers than at present, given the prospect of the world price for cane raws (as opposed to beet) still soaring. Meanwhile the Community needs to decide quickly on arrangements to succeed those for the first 200,000 tons, or it will run the risk of finding available supplies cornered by others, or the price and subsidy cost at deterrent levels.

iv. Finally, we have to recognise that with a total import requirement of over two million tons during the next 12 months we are in a very vulnerable position. The only absolutely certain way of maximising supplies and refinery throughout would be for the Government itself to buy at once as much cane sugar as can be obtained on the world market. I do not recommend this course. The cost of obtaining, say, 600,000 tons - if this could be found - would be anywhere from £300 million to £400 million. Our chances of getting EEC subsidy on its importation would be greatly reduced if it were to become known, as it would, that we were the purchasers. And although I suspect consumers would pay the price, if it were averaged over the whole supply, I do not think that the advantages of a less restricted supply of sugar justify deliberately incurring a balance of payments cost of this magnitude. But if we do not do this - and perhaps even if we did - I must warn that there is risk of an acute shortage in the spring and summer, with all that this entails.

Ministry of Agriculture, Fisheries and Food
4 November 1974

CONFIDENTIAL
1. I would like to inform my colleagues about the situation which has arisen in Scotland as a result of recent discussions about teachers' pay and of the action which, subject to further consultation with the Secretary of State for Education and Science, I would propose to take.

2. In May of this year the Government recognised that the pay of nurses and teachers had fallen behind and decided to appoint independent Committees to review the pay of members of these professions. A Committee under Lord Halsbury was appointed to deal with the nurses; and on 24 May the Secretary of State for Education and Science and I appointed a Committee under Lord Houghton "to examine the pay structure and levels of remuneration of non-university teachers in Great Britain". We said in a public statement appointing the Committee that "The recommendations of the review body will be referred to the appropriate negotiating machinery in England, Wales and Scotland which will be free to decide to backdate any resulting increases in pay to the date of this announcement".

3. The appointment of the Houghton Committee was generally welcomed and it looked for some time as if the teaching profession would be content to await its recommendations - even although in Scotland there was a good deal of disruption in some schools as a result of unilateral decisions by the main teachers' organisation to encourage a "work-to-rule" in favour of reduced class sizes and other improved conditions.

4. Just before the Election the Teachers' Side of the Scottish Teachers Salaries Committee made a claim for an interim payment of 10 per cent pending the outcome of the Houghton Report. This led to a series of complicated negotiations, the result of which, after Ministerial discussion, was that the claim was turned down by the Management Side. I am represented on the Management Side and this decision was made only as a result of my seeing personally the other members (local authority representatives) most of whom were firmly convinced that an interim payment should be made immediately. I was however able to suggest to the Management Side (after having consulted the Secretaries of State for Scotland...
Education and Science and for Employment) that they might indicate their willingness to make an interim payment immediately on receipt of the Houghton Report. This was conveyed by them to the teachers but it was not acceptable. The outcome was a one-day strike of most teachers on 31 October, and we now have threats of three-day strikes in selected areas for an indefinite period.

5. We are therefore faced at present in Scotland with a very unhappy situation in the schools. In addition to official three-day strikes in certain areas, there have been, and will continue to be, outbursts of strike action by various unofficial action groups. This is obviously disturbing to children's education and many parents are naturally concerned and confused about what is happening.

6. The Management Side in turning down the claim preserved the confidentiality of Management Side discussions; but it seems to be widely assumed in Scotland that the Secretary of State was responsible for rejecting the claim for an immediate increase. I think our position is readily defensible provided the Houghton Committee does in fact report fairly soon and we are able to arrange for an interim payment very quickly thereafter. Ideally this would best be done on the same kind of basis as the interim payment which was made to nurses on the day after publication of the Halsbury Report.

7. I therefore propose in consultation with the Secretary of State for Education and Science to see whether it will be possible to make arrangements for the payment in December of an interim award which will not cut across the recommendations of the Houghton Report.

W R

Scottish Office

5 November 1974
5 November, 1974

CABINET

BILL TO AMEND THE TRADE UNION AND LABOUR RELATIONS ACT 1974

Memorandum by the Secretary of State for Employment

1. My colleagues on the Committee on Economic Policy have discussed at length the provision in this Bill which repeals the section of the Trade Union and Labour Relations Act 1974 dealing with rights of appeal for individuals unreasonably expelled or excluded from trade unions in a closed shop situation and which substitutes a more satisfactory provision for appeal to a special tribunal. The Trades Union Congress (TUC) have always been opposed to any statutory provision in this matter, and it was in order to allow more time for discussion with them that we dropped the relevant provision from the Trade Union and Labour Relations Act.

2. During the passage of the Act I made it clear in the House of Commons that we believed some action was necessary, whether by means of a provision in the Employment Protection Bill or through action by the TUC itself.

3. Accordingly, when we began to prepare proposals for the Employment Protection Bill, I wrote to the TUC making it clear that while the Government were resolved to repeal the unsatisfactory provisions in the 1974 Act, they believed that something must be put in its place. I then offered the TUC two alternatives - either a statutory appeals procedure, or the establishment of appeals machinery on a voluntary basis, under TUC auspices without any statutory provision. I append extracts from my letter to the TUC posing these two alternatives and setting out the kind of voluntary machinery we had in mind if the TUC were prepared to adopt that course.

4. In my discussions with the TUC up to now, they have continued to criticise strongly our proposals for a statutory appeals procedure but have not come forward with proposals for voluntary machinery of their own. However, at a meeting which I had with members of the TUC Finance and General Purposes Committee on 4 November, the TUC representatives faced with a proposal for a statutory provision which met the main criticisms they had so far made, finally declared their willingness to make a firm recommendation to the General Council to adopt voluntary appeals
machinery on the lines proposed in my letter (the relevant extract of which appears in the Annex). They are confident that the General Council would accept and act on their recommendation. I hope to have, before my colleagues discuss this, a letter from the TUC setting this out.

5. During the debates on the Trade Union and Labour Relations Act, I often suggested that if the unions could make effective provision themselves, this would be a satisfactory substitute for a statutory procedure which did not command their support and which might therefore contain the seeds of great difficulties and possible confrontations in the future.

6. Provided we can be sure that the TUC will in fact take prompt action to establish their own machinery on the lines set out in my letter, I believe we should drop the provision for a statutory procedure which now appears in the Bill.

7. My proposal is that on the basis of the offer by the TUC, we should confine the Bill to a straight repeal of the relevant provision of the 1974 Act. We should tell the TUC that we should need a firm decision by the General Council by the end of this month and an assurance that they would establish voluntary machinery without delay. We should make it clear to the TUC and in Parliament that if voluntary action by the TUC does not materialise, we must reserve the right to introduce a legislative provision.

8. I invite my colleagues to agree to this course, which would allow us to proceed with the introduction of the Bill without loss of time.

M F

Department of Employment

5 November 1974
ANNEX

EXTRACTS FROM LETTER AND ENCLOSURE OF 15 OCTOBER 1974 FROM SECRETARY OF STATE FOR EMPLOYMENT TO MR LEN MURRAY

(i) Letter

"Safeguards for union members

I accept of course that Section 5 of the Act as drafted is completely defective and its use by disgruntled union members might cause problems. On the other hand, I have already made clear in Parliament my view that there is a need to provide some alternative safeguard against arbitrary exclusion or expulsion from union membership, whether by statutory or voluntary means. I therefore see very great difficulty in repealing Section 5 in the short Bill without putting something concrete in its place.

There seem to me to be two possibilities. The first, which I would much prefer, is to delete Section 5 and to replace it with a new provision on the lines recommended by the Donovan Commission and proposed by the Government when the Trade Union and Labour Relations Bill was being drafted. The second is voluntary action by the TUC which would include the setting up of a new body to which aggrieved individuals could appeal if dissatisfied with the results of their internal union procedures. This would present greater difficulties from my point of view but I am sure the Government would be very ready to consider it if the TUC expressed a strong preference for it. The two alternatives are set out more fully in the attached note, on which I would welcome the General Council's views."

(ii) Enclosure

(See Over)
An alternative to a statutory provision would be a voluntary move by the TUC itself. The nature of this would be for the TUC to consider, but possible steps might be:-

(i) The TUC could up-date and reaffirm their 1969 guidance to affiliated unions;

(ii) the TUC could undertake to follow up with unions to encourage conformity with TUC standards;

(iii) the TUC could arrange for a small conciliation committee to which individuals aggrieved by expulsion or exclusion in a closed shop situation could apply if they were still dissatisfied after going through all internal union procedures;

(iv) this committee could make recommendations for settlements which affiliated unions would undertake to accept. Alternatively, the committee could have no powers but would discuss the case with the union and the individual concerned and would use its best endeavours to bring about an agreed settlement;

(v) the conciliation committee might be headed by an independent person eg from the CAS panel of arbitrators."
CABINET

CONCORDE

Note by the Lord Chancellor

Following the discussion in Cabinet in July (CC(74) 26th Conclusions, Minute 2) and the subsequent meeting between the Prime Minister and the President of France on 19 July, the Ministerial Committee on the Concorde Project has discussed the texts of the draft Notes for exchange with the French Government, designed to formalise the understanding which was reached between the Prime Minister and the President. These texts have now been agreed by the Committee, and the Prime Minister has agreed that they should be transmitted to the French Government. I enclose copies of the texts for the information of my Cabinet colleagues.

E J

Lord Chancellor's Office

6 November 1974
EXCHANGE OF NOTES

between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the French Republic regarding the continuation of the Concorde aircraft programme.

Her Majesty's Ambassador at Paris to the Minister of Foreign Affairs of the French Republic.

British Embassy
Paris
1974

Your Excellency,

I have the honour to refer to the Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the French Republic regarding the Development and Production of a Civil Supersonic Transport Aircraft signed at London on 29 November 1962 (hereinafter referred to as "the 1962 Agreement"), and to the discussions concerning the Concorde aircraft programme held in Paris on 19 July 1974 between Her Majesty's Prime Minister and First Lord of the Treasury and the President of the French Republic. In accordance with the understandings reached during these discussions the Government of the United Kingdom propose an Agreement with the Government of the French Republic in the following terms:
1 On the basis of equal responsibility for the project and of equal sharing of work and of the expenditure incurred by them, the two Governments shall continue to support the development programme already agreed between them for the Concorde aircraft known as the entry into service version.

2 On the basis of equal responsibility for the project and of equal sharing of work, of the expenditure incurred by them and of the proceeds of sales, the two Governments shall continue to support the production of the sixteen Concorde aircraft whose production has already been agreed between them.

3 Neither Government is obliged by the 1962 Agreement to give any support for the development or production of Concorde aircraft beyond that described in paragraphs 1 and 2 above. However, if in the opinion of either Government, new and unforeseen circumstances have arisen which justify a development or production programme beyond that described in paragraphs 1 and 2 above, representatives of the two Governments shall meet at a mutually convenient time to discuss the matter.

4 Either Government may give the other three months' written notice of termination of this Agreement and of termination of the 1962 Agreement on the occurrence of any one of the following conditions:

(a) if it becomes clear that the total cost to the two Governments of completing as from 19 July 1974 that part of the development programme described in paragraph 1 above which is to be undertaken by the manufacturers will, when calculated on the basis of January 1974 economic conditions, exceed 245 million units of account where one
unit of account is equivalent to £1 and to 11.50 French francs. For the purpose of the calculation described in this paragraph no account shall be taken of any cost incurred by the two Governments in consequence of a decision by them to authorise the refurbishing for sale to a known customer of either or both of the first two production standard aircraft.

(b) If it becomes clear that the gross costs to either Government of completing as from 19 July its share of the manufacture of sixteen Concorde aircraft and ninety Olympus 593 engines will when calculated on the basis of January 1974 economic conditions exceed, in the case of the Government of the United Kingdom £125 million or in the case of the Government of the French Republic \( \frac{\text{L}}{\text{F}} \); or

(c) if it becomes clear that circumstances, to be determined from time to time by the two Governments acting jointly, have arisen which make it impracticable for Concorde to operate particular commercial services.

5 Three months after the receipt of the notice given in accordance with paragraph 4 above, this Agreement and the 1962 Agreement shall terminate on the following terms, unless these are varied by agreement between the two Governments:

(a) neither Government shall be required to pay any compensation to the other in respect of the termination of the project; 

(b) ..
SECRET

(b) the obligation in this Agreement and in the 1962 Agreement regarding the equal sharing of the proceeds of sales shall continue to subsist;

(c) the obligation in this Agreement and in the 1962 Agreement regarding the equal sharing of expenditure incurred by the two Governments shall continue to subsist only in regard to expenditure incurred before termination of the Agreements.

(d) The obligations in any agreement between the two Governments regarding ownership of physical or intellectual property acquired or produced under the 1962 Agreement shall continue to subsist; and

(e) the two Governments shall consult in regard to the use or disposal of physical or intellectual property acquired or produced under the 1962 Agreement or under this Agreement.

If the above proposals are acceptable to the Government of the French Republic, I have the honour to suggest that the present Note and your Excellency's reply in that sense shall constitute an Agreement between the two Governments which shall enter into force on the date of your reply.

I avail myself of this opportunity to renew to Your Excellency the assurance of my highest consideration.

EDWARD TOMKINS
EXCHANGE OF NOTES
between the Government of the United Kingdom of Great
Britain and Northern Ireland and the Government of the
French Republic regarding the continuation of the Concorde
aircraft programme.

Her Majesty's Ambassador at Paris to the Minister of
Foreign Affairs of the French Republic

British Embassy
Paris
1974

Your Excellency,
I have the honour to refer to paragraph 4(c) of my Note
of today's date regarding the continuation of the Concorde
aircraft programme and to state that the following represents
the understanding of the Government of the United Kingdom in
respect of the circumstances which will make it impracticable for
Concorde aircraft to operate certain commercial services:

1 either Government may give notice of termination
under paragraph 4(c) of my Note of today's date
if it becomes impracticable for Concorde aircraft to
operate commercial services:

(a) between London and Kennedy Airport, New York; or
(b) between Paris and Kennedy Airport,
     New York; or
(c) between London and Sydney and between London
    and Tokyo

SECRET
It will be impracticable for Concorde aircraft to operate such a commercial service if:

1. the authorities in the United States, Australia or Japan (as the case may be) which are empowered to take the ultimate decisions regarding such matters:
   a. refuse outright to permit Concorde to operate that service; or
   b. grant permission in respect of that service subject to compliance with such conditions whether economic or operational as to render it impracticable to provide it on a reasonable basis; or
   c. have not come to a final decision in regard to the operation of that service by 31 March 1976 or

2. the authorities in any country from which overflying rights must be obtained to make such a commercial service practicable:
   a. refuse outright to grant the necessary overflying rights; or
   b. grant overflying rights subject to compliance with such conditions whether economic or operational as to render it impracticable.
impracticable to provide that commercial service on a reasonable basis; or

have not come to a final decision in regard to the grant of overflying rights by 31 March 1976.

(3) If the above equally represents the understanding of the Government of the French Republic, I have the honour to suggest that the present Note and Your Excellency's reply in that sense shall constitute the determination referred to in paragraph 4(c) of my Note of today's date.

I avail myself of this opportunity to renew to your Excellency the assurance of my highest consideration.

EDWARD TOMKINS
I circulate for the information of my colleagues a copy of the Consultative Document on the Review of the Price Code in the form in which it has been sent for printing.

S W

Department of Prices and Consumer Protection

7 November 1974
Review of The Price Code

A Consultative Document

Presented to Parliament by the
by Command of Her Majesty
November 1974

LONDON
HER MAJESTY'S STATIONERY OFFICE
Cmd.

SECRET
CONTENTS

PART I: General

PART II: Amendments to the Code

Section I: Commentary on Amendments
Section II: Draft of a revised Price Code
Appendices: 1 The Investment Relief Scheme
            2 Notification and Information Orders
1 The Secretary of State for Prices and Consumer Protection announced on 11 July 1974 that a major review of the Price Code, established under the Counter-Inflation Act 1973, was to be begun immediately. This followed two broad measures introduced by the Government soon after taking office - the initiation of consultations on proposals to strengthen the existing Price Code and the introduction of a new Prices Bill.

2 The measures to strengthen the Price Code which, after consultations, came into effect early in May, included the following:

a) The frequency with which manufacturers and those in service industries could make price increases was limited in principle to not more than once in each three months, although the need for exceptions was recognised;

b) The permissible gross percentage margins of non-food distributors, other than smaller traders, were reduced by 10% with effect from 6 May. On 1 April the Price Commission had, under powers conferred upon them by the previous administration, introduced similar reductions for food distributors.

c) The repricing on shop shelves of goods bought frequently by the housewife was restricted.

3 The Prices Act, which received the Royal Assent on 9 July, provided powers to pay food subsidies and to fix prices for food and for certain other necessities. Under these powers subsidies have been introduced or increased on milk, butter, bread, cheese, household flour and tea, and maximum prices and, where appropriate, margins are being prescribed.
A voluntary agreement was also concluded with the retail trades and food manufacturers following the 10% reduction in gross margins, under which they agreed to sell a list of basic foods and other essential items at favourable prices. The Prices Act also provided power to abolish the Pay Board, and this was done on 26 July under the Counter-Inflation (Abolition of Pay Board) Order 1974 (SI 1974 No 1218); with the removal thereby of the statutory control on wages what had hitherto been known as the "Price and Pay Code" became the "Price Code".

4 In launching the fundamental review of the Price Code, the Secretary of State for Prices and Consumer Protection said:

"The review will be directed, first, to possible changes in the Code which would encourage the industrial efficiency and productive investment on which our future employment and wealth as a nation depend, and, secondly, to difficulties or anomalies which experience has identified in particular industries or sectors of the economy."

The Secretary of State added that for the present no consultative document was being issued but views were invited from the Confederation of British Industry, the Trades Union Congress, the Retail Consortium and other representative bodies, as well as from the Price Commission, nationalised industries, and consumer organisations. It was made clear that any firm, trade union or representative organisation was most welcome to offer views, and steps were taken to see that this invitation was widely known. A great many representative organisations and individual firms have offered the Government views and suggestions.

5 The Government have considered the action which should be taken both in the Budget and on the Price Code in the light of the latest economic assessment. That part of the Government's proposals which relates to the Price Code is in this document. The more important changes are discussed generally in the following paragraphs, while Part II provides a commentary on all the proposed amendments and a revised text of the Code as it would appear under the proposals.
The Government believe that it is desirable that the new Price Code should enter into effect as soon as possible. The intervention of the General Election has unavoidably meant that the operation of the new Code will be later than envisaged in the original programme. They intend, therefore, that the consultations required by Section 2 of the Counter Inflation Act 1973 should be conducted as quickly as is practicable; and following consideration of views or further views expressed by representative organisations, individual firms or trade unions, they will make the new Code Order, and the necessary associated Orders, as early in December as possible. The new Price Code can come into force shortly after the Order is made but, in accordance with Section 2 of the Counter-Inflation Act 1973, it requires the approval of both Houses of Parliament.

Many organisations and firms in industry, trade and commerce have urged that the price control should be abandoned following the abolition of the Pay Board and the Pay Code: and that the erosion of profit margins that has occurred as a result of the operation of the Code up to the present time, and which would continue with greater severity in prospective economic conditions, poses serious threats both to employment and to the level of investment. As an alternative to the complete removal of price control, organisations and firms have proposed that the detailed cost control should be abandoned and reliance placed only upon the control of profit margins. In launching the review, the Secretary of State made it plain that it was the Government's intention that the Price Commission and the Price Code should continue to provide an effective control over unjustifiable price increases and to require price reductions wherever possible. In the consultations that have taken place since then, the Secretary of State has reiterated this view and emphasized that an effective price and profit control is an essential support to the Social Contract. At the same time the Government recognise that greater efficiency in the use of resources, higher exports and job opportunities all depend on industry's capacity and
willingness to invest and innovate and in the competitive vigour with which it responds to market opportunities. The Price Code must be adapted to meet these requirements.

Investment Relief

8 A principal change proposed in the Code is therefore to provide a new relief from the full effect of the cost and profit control available to firms which undertake investment in certain selected forms. Companies will be entitled to recover 17% of firmly budgeted capital expenditure on investment for the home market provided that this investment is for plant and machinery or industrial buildings. The relief will apply to all firms in manufacturing, services and distribution but not to nationalised industries (where investment programmes are in any case subject to Government review).

9 It is clearly essential that relief given for investment should be followed by investment. The Code will therefore require that any firm which has fallen below its programme must hold back to the necessary extent on other price increases allowed under the Code; and for the larger firms the Price Commission will be provided with information to check the progress of investment against each company's programme so that the relief will be fully accountable.

10 The existing powers of the Price Commission under paragraph 70 of the Code to permit, on a selective basis, further easements of the price control where this is necessary to encourage or ensure investment, are being maintained.

The Productivity Deduction

11 The Government consider that the productivity deduction must remain in operation. In 1973 it was set at 50%, when productivity was generally increasing fast. But these conditions no longer exist, particularly while we adjust our production and consumption to higher costs of energy and other materials. Moreover, now that increases in labour costs, rather than increases in the cost of materials, will form a larger
element in total costs, the practical effect of the productivity deduction is becoming much more severe. A fixed percentage productivity deduction on the basis of unit costs therefore has a larger proportionate effect on most firms' profits than was the case last year.

12. The Government consider that the productivity deduction should be both lower and more selective than at present. They therefore propose that it should be reduced to a maximum of 35% which would apply only to the most capital-intensive products and processes. The standard rate would be 20% and, as in the present Code, this would be tapered down to a figure of less than 10% for the most labour-intensive products and processes. These changes will apply to labour cost increases first incurred on or after 1 November 1974.

13. The Government would be prepared to consider an alternative approach if this proved acceptable to both sides of industry which would have the same average effect but which would be composed of a lower and a higher rate of productivity deduction. The rates would depend upon the size of increases in unit labour costs; for example, the rate of deduction could be expressed as the average of a lower productivity deduction on increases in unit labour costs up to a certain percentage and a higher productivity deduction on all unit labour cost increases above that percentage.

Distribution

14. As noted in paragraph 8, it is proposed that the investment relief should extend to distributors on the same terms as for manufacturing and service industries in the form of an addition to gross and net margins. In many cases distributors are operating below the safeguard level set last May by the Government at 75% of net profit margin reference levels. In such cases the Government propose to allow distributors to widen their gross margins to the extent necessary to achieve the 75% level of net profit, where market conditions allow. At present they cannot do this if this would cause them to exceed 100% of gross margin; the Government propose to allow gross margins in such circumstances to be increased to a strictly limited degree, up to 105%.

Safeguards

16. The Government consider that the current safeguard for manufacturing and service enterprises against erosion of profits in paragraph 34 of the Code should be amended to deal with erosion of profit on product ranges or individual products rather than on the net profit margin of the enterprise as a whole. Moreover, it will not be necessary for a firm to demonstrate, before it can invoke the safeguard, that the erosion of profit has been caused solely by the operation of the Code. In other
words, the safeguard will apply whatever the cause of the erosion. These changes will make the safeguards much easier to work and much more readily available than if companies had to demonstrate, as under the present enterprise-based paragraph 34, that reductions in margins on particular products or ranges had caused a 10% erosion in the net profit margins of the enterprise as a whole. It is therefore proposed that the degree of erosion at which the new safeguard will operate to override the allowable and total cost constraints of the Code should be not one-tenth but one third, related to the net profit margin on the product at 30 April 1973. For those firms which suffered considerable profit erosion during the previous Government's wage and price standstill and thus had unrepresentative net profit margins at 30 April 1973, the alternative base date or 30 September 1972 will be available in certain prescribed circumstances. It is further proposed that

i) as a minimum product prices should be allowed to be raised to cover cost plus a 2% profit margin;

ii) the minimum return below which an enterprise as a whole is not constrained by the rules of the Code should be raised from 8% on net assets to 10% (paragraph 68 of the Code);

iii) the equivalent low profit safeguard as a percentage of turnover should be raised from 1 1/2% to 2% (paragraph 69).

Nationalised Industry Prices

17 In order to make a significant contribution to the reduction of the price level, the prices of the nationalised industries have for a number of years been restrained more severely than those of private sector industries. The present Code provides that nationalised industries in deficit - and they are the majority - should be permitted at the most such price increases as are necessary to contain their deficit to the level of that in their 1972, or 1972/3, accounting year; and the general safeguard provisions in the Code designed to limit reductions in profit margins, to give relief for low profits and to encourage investment do not protect any of the industries. However, given
the importance of their prices to the consumer, the industries have not in practice been able to make even such increases as were open to them under the Code and, as a result, they have made increasingly substantial deficits which the Government have financed through subsidies.

18 In restraining prices in this way, and in financing the growing deficits which have resulted, successive governments have recognised that, taken together, the charges for services provided by nationalised industries are a significant part of household expenditure. However, the consequences of deficit financing become less acceptable the longer it continues. The Government see, therefore, a need for giving scope for higher price increases by nationalised industries in those cases where such increases would not be inconsistent with the needs of counter inflation policy. Without increased flexibility of this kind there would be little chance of making any progress towards the Government's objective of returning as many of the industries as possible to a position in which their deficits, and the accompanying public expenditure on subsidies, are eliminated, and in which they are making a trading surplus as a contribution to their investment programmes, thereby reducing their borrowing requirements. The removal of subsidies on fuel would also contribute in the longer term to economy in the use of energy.

19 Accordingly, the Government propose that, under the new Price Code, there should be provision for the nationalised industries to make price increases sufficient for them to earn a modest surplus in 1975/76, defined either as 2% on their turnover or 10% return on net assets (at the option of the particular industry). In certain important respects the position of nationalised industries is not comparable to that of the private sector. For example, in many cases, they cannot increase prices as frequently as the private sector. The provisions in the Code for nationalised industries, therefore, have certain features which would not be appropriate to the private sector and the Government propose to retain their power to cut back prices justified under the strict criteria of the Code.
to the levels which would be permitted by the allowable costs formula alone. In these circumstances the role of the Price Commission will be to calculate both the minimum price increase justified under the Code, ie allowable costs, and the maximum which would be required if a surplus were to be made. In deciding what price increase should be made it will be necessary for Ministers to strike a balance between restoration of the industries to profitability and the need to keep down the rate of increase in prices to the consumer.

Other proposals

The main features of the allowable cost and profit margin rules will remain unchanged. Amendments have been made to provide for changed circumstances since the Code was last revised, to correct anomalies and to clarify the existing rules where necessary. The more important changes are:

1) a new reserve power for use by the Secretary of State in exceptional circumstances, enabling appropriate action to be taken in the case of any product where a severe shortage of supply is threatened (paragraph 71A of the draft Code).

ii) minor additions to the list of allowable costs (paragraph 28) - the additions to the list will apply to cost increases incurred on or after 1 November 1974;

iii) provision for the speedier recovery of retrospective and anticipated cost increases (paragraphs 22 and 46);

iv) minor easements in the application of the 3-month rule (paragraph 26B);

v) a tightening up of the application of the Code to mixed enterprises (paragraph 17);

vi) a revised safeguard provision relating to the application of the productivity deduction to variation-of-price clauses in contracts (paragraph 52).
vii) exemption from the Code for certain specific categories of the self-employed (paragraphs 6(xiv) and (xv) and 103);

viii) clarification of how depreciation and capital should be calculated for the purpose of the Code (paragraphs 28 and 68).

21 A considerable number of changes will also be made to the associated Notification and Information Orders which enable the Price Commission to examine proposed price increases and to monitor the observance of the Code. The major change which is proposed is that Category III firms, which are at present obliged to keep records of their price increases and profit margins, are to be required to identify themselves to the Price Commission. The Commission proposed this in its quarterly report for the period March-31 May 1974, in order to enable its regional staff to monitor more comprehensively the observance of the Code by these firms, especially those which are of considerable importance in their own sectors of industry and commerce. This and the other main changes in these Orders are briefly described at Appendix 2, together with a proposed amendment to the Counter Inflation (Modification of Civil Aviation Act 1971) Order.

22 As stated in paragraph 6, the Government desire to bring the Price Code into operation as early in December as is practicable and it is hoped that views and representations can be communicated to them by 27 November 1974.
AMENDMENTS TO THE PRICE CODE

This part of the Consultative Document is prepared in a form intended to assist the statutory consultations on amendments to the Price Code which the Government are required to undertake by Section 2 of the Counter-Inflation Act 1973.

Section I is a commentary on proposed amendments to the Code; Section II is a complete draft of the Price Code revised so as to include the amendments in heavy type. The paragraph numbers of the existing Code have been retained, and additional paragraphs have been included in heavy type as eg paragraph 3A. The existing Code is contained in the Counter-Inflation (Price and Pay Code) (No 2) Order 1973 - SI 1973 No 1785 - as amended by SI (1974) Nos 661, 785 and 1218. In the revised Code these amending Orders will be consolidated.

SECTION I - COMMENTARY ON AMENDMENTS

Paragraph 3(ii); The objective of encouraging investment is specifically included in the general principles of the Code, in order to emphasise the intention behind the Government’s proposal to introduce an automatic investment relief.

Paragraph 6(viii); The exemption for Government contracts for warlike stores and services is extended to all contracts which are covered by, and subject to the controls provided in, the profit formula arrangements agreed in 1968 between Government and industry in relation to the pricing of non-competitive contracts. The effect will be to exclude from control contracts for non-warlike stores for the Ministry of Defence and certain equipment for the Property Services Agency and the Department of Health and Social Security.

Paragraph 6(ix); A drafting amendment.

Paragraph 6(xiv); Payments from the National Health Service for agency activities carried out by chemists, opticians and medical appliance contractors are to be excluded from control. Their remuneration is already effectively controlled by the Government. The application of the control to the other
commercial activities of chemists, opticians and medical appliance contractors will remain unchanged. The reference to the exclusion from control of charges to the NHS by doctors and dentists has been transferred from paragraph 103 of the present Code.

**Paragraph 6(xy):** Payments by the Post Office to sub postmasters are to be excluded from control for the same reason, that remuneration is effectively under public control.

**Paragraph 7:** Sugar is deleted from the illustrative list of semi-processed foodstuffs subject to control, because raw beet sugar is exempted from control under the amendment to paragraph 8.

**Paragraph 8:** Raw beet sugar for further refining was exempt from pre-notification earlier this year and is now exempted from the Code controls.

**Paragraph 9:** The amendment makes it clear that distributors' margins on the sale of liquid milk are not controlled under the Code, because they are effectively controlled under the powers to regulate milk prices.

**Paragraph 10:** The base levels for the price of milk for the manufacture of butter and skim milk powder are more precisely defined, and the premia used in the calculation of the prices of milk for the manufacture of other products are to be increased by half of the difference between the present cash premia and the premia which would have been produced by maintaining the premia in the same percentage terms as applied in the year ending 30 April 1973. This will allow the Milk Marketing Boards more flexibility to deal with market distortions.

**Paragraph 11:** The amendments are consequential on the changes to other parts of the Code.
Paragraph 17: Enterprises which carry out more than one activity, i.e. manufacturing, service and distribution, will be required to treat each activity of their business separately for Code purposes, unless separate accounts satisfying paragraph 14 of the Code cannot be made available for each of them. This is to ensure that, wherever possible, the activities of mixed enterprises are subject to the Code rules most appropriate to them; difficulties have arisen in the past where it has been necessary, for example, to control the minority manufacturing activities of a distribution enterprise on the basis of gross percentage margins.

Paragraph 18: The amendment is intended to make clear that it is the percentage, not the cash, increase in total costs which may not be exceeded by the percentage increase in price. No change in practice is involved.

Paragraph 19A: Food subsidy payments under the Prices Act are to be treated by enterprises who receive them as part of their return from the market. This reflects the fact that food subsidy payments are made to reduce or avoid price increases under the Code which would otherwise be recovered from the market. The new provision applies only to enterprises which actually receive subsidy payments and not to enterprises which sell subsidised foods at subsequent stages of distribution.

Paragraph 20: The method of calculation of price reductions is specified as being the mirror-image of the calculation of permitted price increases - this is in line with the Price Commission's current practice.

Paragraph 22: The major change to the retrospective recovery rules is that the period of recoupment is shortened from 12 months to a minimum of 6 months. This takes account of the increased inflationary pressures since the present Code was introduced and of the effect of the 3-month rule in putting greater
emphasis on retrospective recoupment. The drafting of the rules has also been changed to make clear that cost increases incurred before the date of the previous price increase may be taken into account if they have not already been fully recovered in prices.

Paragraph 26B: The three month rule is amended in three ways; firstly, the exemptions which are at present based on the proportion of 'raw' materials (together with fuel and power) in total costs are in future to be based on the proportion represented by all materials, fuel and power; secondly, the requirement that a product cannot be increased in price within 3 months of a price increase on a related product is not to be retained; and thirdly enterprises are permitted to take 13 weeks rather than 3 months if that fits in better with their accounting periods. The 3-month rule will not apply to price increases under the investment relief provision in paragraph 69A.

Paragraph 27: A technical transitional provision.

Paragraph 28: Several minor additions are made to the list of allowable costs. They take account of representations received from industries which because of the nature of their business have a higher than average share of non-allowable costs. They also remove the element of discrimination against smaller firms which resulted from disallowing certain bought-in services which may be provided by directly-employed labour or equipment in larger firms. In addition, editorial contributions are to be included in the category of fully allowable costs. The additions to the list of allowable costs will apply to cost increases first incurred on or after 1 November 1974. The Government propose to amend the definition of allowable depreciation to specify more precisely the basis on which depreciation is to be calculated for the purposes of the Code. The amendment makes it clear that an historic cost
basis should be used, but account may be taken of revaluation of assets which took
place in accounts for financial years ending on or before 30 September 1972.
In this context it is not the Government's current intention to allow re-
valuation within the life of the counter-inflation programme to enable
prices to be increased. The amplifications of "generally accepted accounting
principles" under this paragraph applies also to paragraphs 53 (definition of
net profit margin) and 68 (definition of capital).

Paragraph 32: The effect of the proposals set out in paragraphs 11-12 of
Part I on different types of products or product ranges is illustrated in
the table below (rates rounded to the nearest whole number):

<table>
<thead>
<tr>
<th>Labour costs as share</th>
<th>Productivity Deduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>of total costs</td>
<td></td>
</tr>
<tr>
<td>5%</td>
<td>35%</td>
</tr>
<tr>
<td>10%</td>
<td>50%</td>
</tr>
<tr>
<td>15 - 39%</td>
<td>20%</td>
</tr>
<tr>
<td>40%</td>
<td>18%</td>
</tr>
<tr>
<td>50%</td>
<td>14%</td>
</tr>
<tr>
<td>60%</td>
<td>12%</td>
</tr>
<tr>
<td>70%</td>
<td>10%</td>
</tr>
<tr>
<td>80%</td>
<td>9%</td>
</tr>
</tbody>
</table>

Paragraph 33: Deficiency payments to pension funds are to be included
in the category of fully allowable labour costs not subject to the productivity
deduction.

Paragraph 34: The new safeguard against low profit and profit erosion on
a product basis replaces paragraphs 34 and 56 of the present Code. The main
differences are:

(a) The safeguard will apply to a range of products or services (or individual
products or services where an enterprise has normally treated its products individually for the purpose of calculating its permitted price increases) rather than to the enterprise as a whole.

(b) A firm will be able, for each product or range of products, to increase its prices to the extent necessary, either to cover costs with an additional \( \frac{2}{3} \) profit margin or to achieve a profit margin of \( \frac{A}{2} \) of the margin on 30 April 1973 (or of the margin on 30 September 1972 if between those two dates the profit margin fell by \( \frac{25}{4} \) or more).

(c) It will no longer be necessary to demonstrate that the erosion of profit has been caused solely by the operation of the Code.

(d) The allowable costs provisions (paragraph 28 of the Code), the productivity deduction (paragraph 32) and the total cost constraint (paragraph 18) will all be overridden by the operation of the safeguard. However, once it has been invoked, the safeguard will be assumed to have absorbed all the available allowable cost increases for the product or service concerned. Only any element for the new investment relief (paragraph 69A) will be regarded as additional to a permitted price increase under the safeguard provision. As under the present Code, the new safeguard may not be invoked by an enterprise which is exceeding, or is likely to exceed, its profit margin reference level.

(e) The base date for the profit-erosion safeguard is to be a single date, rather than a representative period, although the level of output for the calculation of the profit margin at that date should be based on a representative period as provided in paragraphs 24 and 25 of the Code.

(f) In order to give the Price Commission adequate time to examine initial applications for the use of this safeguard, any pre-notifying
firm wishing to apply the new provision for the first time will be
required to give 56 rather than 28 days' notice to the Commission.

Paragraph 44A: The charging of a common price, calculated as a weighted
average of individual permitted price increases, is to be allowed for enter­
prises which are parties to common price agreements upheld by the Restrictive
Practices Court. This will enable the common price agreement for cement to be
maintained, in the light of the Court's decision in January this year reaffirming
its sanction of this agreement. Individual companies will not, however, be
permitted to exceed their profit margin reference levels, and all the firms
concerned will be subject to the pre-notification requirement.

The averaging of individual
permitted price increases will not include any price increase in respect of
investment relief (paragraph 57A), as the relief does not relate to particular
products, e.g. those within a common price agreement.

Paragraph 46: The period over which anticipation of known cost increases
may be spread is reduced from a minimum of 6 months to a minimum of 3 months,
and the period over which the new price must be quoted without further increase
is similarly reduced.

Paragraph 47: In line with the change proposed to the 3-month rule (paragraph
26B) to remove the distinction between 'raw' materials and other materials,
the facility to anticipate estimated cost increases is extended from raw
materials to any materials which fluctuate frequently and unpredictably in
price.

Paragraph 49: A drafting change is proposed in order to make clear how the
productivity deduction operates in variation-of-price clauses.

Paragraph 50: A drafting amendment.

Paragraph 52: The present safeguard which applies to contracts has proved
difficult to operate primarily because it requires that the application of the
productivity deduction to a particular contract would cause an enterprise as a whole to fall below 90\% of its base profit margin. A new form of safeguard is therefore proposed which still relates to the profit margin of the enterprise as a whole but which exempts variation-of-price clauses from the productivity deduction whenever this profit margin falls below \( \frac{2}{3} \) of the reference level.

**Paragraph 56:** This paragraph has been absorbed into the revised paragraph 34.

**Paragraph 59:** The sentence referring to reference levels under previous Codes is now redundant and has been deleted; this amendment also applies to paragraph 79.

**Paragraph 65:** Amendments are made to remove potential conflict between this paragraph and paragraph 57, which provides that the reference period ends no later than 30 April 1973.

**Paragraph 66A:** The new provision makes it clear that, as in the case of reconstruction or amalgamation of enterprises, acquisitions and disposals made by companies which do not amount to reconstruction or amalgamation of enterprises should be taken into account in calculating profit margin reference levels and current profit margins; no money borrowed or interest paid in connection with an acquisition should be included in the calculation.

**Paragraph 66B:** This removes an anomaly in the present Code, whereby the acquisition of a new company after 29 April 1973 appears to prevent any sub-division of the acquiring company for profit control purposes under paragraph 60 of the Code. The incentive to turn round loss-making companies is increased by providing that the losses of a company acquired after 29 April 1973 no longer have to be taken into the profit margin reference level calculation but may be replaced for the purposes of the calculation by the minimum return available under paragraphs 68 or 69 of the Code.

**Paragraph 67:** Consequential on the new paragraphs 66A and 66B.
SECRET

Paragraph 68: Bearing in mind the increased rate of inflation since the figure of 8% was fixed as the minimum return on capital under the Code, but taking account also of the substantial changes proposed for other provisions of the Code (particularly the product-based safeguard in paragraph 34) which should reduce the need for enterprises to have recourse to this safeguard, the Government propose to raise the minimum return on capital from 8% to 10%. The definition of capital is amended as indicated in the commentary on paragraph 28.

Paragraph 69: Corresponding to the amendment to paragraph 68, the Government propose to raise the minimum return on turnover, which may be substituted for the minimum return on capital at the option of the enterprise, from 1½% to 2½%.

Paragraph 69A: A separate note on the details of the proposed investment relief scheme is at Appendix 1.

Paragraph 70: Beneficiaries of investment relief under paragraph 69A are not debarred from applying to the Commission for further relief under paragraph 70 in special cases which satisfy the criteria in this paragraph, but the Commission will be obliged to have regard to the amount of relief obtainable under paragraph 69A.

Paragraph 71A: A new power is proposed for the Secretary of State for Prices and Consumer Protection to certify in relation to any product that, where a severe shortage of supply or serious threat of such shortage exists and threatens to cause significant damage to the interests of industry or consumers, price increases may take place up to a specified level irrespective of the allowable cost rules of the Code. The certificate may also provide for the profit margin control to be overridden if necessary.

Paragraph 74: Distribution enterprises which had completed less than a quarter's trading by 30 April 1973 but which can produce separate accounts for a 12-month period ending not later than 31 March 1974 are to be brought within the control on gross percentage margins. Distributors who are at present subject to control on the basis of a single quarter's figures up to 30 April 1973 will thus be able to establish gross margins on the basis of a year's results.

Paragraph 74E: The distributors' safeguard is amended to allow gross margins to rise above 10½% — though not above 10½% — of the margin specified in
paragraph 74(i), to allow net profit margins to reach 75% of net reference levels.

Paragraph 78: This amendment is consequential on the changes made to the safeguards for manufacturers and service enterprises. Any unit of a distribution enterprise which is treated separately under paragraphs 14 and 17 of the Code for gross margin control purposes will be permitted, in addition to covering its costs, to obtain a return of 2% on turnover, provided that the net profit margin reference level of the enterprise is not likely to be exceeded.

Paragraph 79: See paragraph 59.

Paragraph 83: The effect of the changes is to replace the deficit containment provisions which apply to the nationalised industries with provisions broadly similar to the low-profit safeguards applying to the private sector, after allowing for the different way in which the nationalised industries are financed. They continue to be subject to the Ministerial powers of intervention in paragraph 85.

Paragraph 83A: This is a purely technical addition.

Paragraph 84 and 84A: The provision on multi-part tariffs has been clarified and takes account of fuel adjustment clause price increases.

Paragraph 85: The amendments here are consequential changes following revisions to paragraph 83, but include provisions for a price increase justified in one year to be continued in later years.

Paragraph 86A: These provisions have been made necessary by the reconstruction of the finances of British Rail following the passage of the Railways Act 1974.

Paragraph 89: Local authority trading services are to remain subject to price control, but local authorities are to be given flexibility to nationalise their charges to take account of the local government re-organisation which took effect in England and Wales.
on 1 April 1974. Charges for parking on-street and in local authority car parks, with the exception of the short-stay charges (less than 4 hours) which most affect regular shoppers in off-street car parks, are to be freed from price control in order to assist authorities in dealing with traffic management problems. Local authorities are no longer to be subject to profit margin control, which cannot be effectively applied to the relatively few unsubsidised trading services.

Paragraph 90: In the light of re-organisation of the water industry in England and Wales as a result of the Water Act 1973, the new regional water authorities and statutory water undertakers are to be subject to the overriding rule of compliance with their statutory obligations, which may include directions given by Ministers under the Water Act 1973. The role of the Price Commission will be to monitor that charges for water, sewerage and other water services do not exceed the level which is required to comply with those obligations. Similar rules will apply to metered water charges in Scotland. Other charges for water services in Scotland and Northern Ireland are not subject to control as they are financed out of local or national taxation. Moves towards the restructuring of charges are to be permitted within the overall limits imposed by the Code.

Paragraph 91: Drafting amendments.
Paragraph 95A: Tax variation clauses in equipment leasing agreements provide for variations of rental upwards or downwards in response to tax changes, as such changes can affect very substantially the balance of the agreements. These clauses are now to be allowed to operate when corporation tax is increased, provided that the return to the lessor on his capital expenditure becomes no greater than it would have been if the rate of tax had remained the same.

Paragraph 99: Consequential on the addition of paragraph 86A.
Paragraph 103: The control has applied in an anomalous manner to small tradesmen, such as window-cleaners and jobbing gardeners, and others whose total revenue is mostly used for the living expenses of themselves and their families.
In effect their level of increase in remuneration has been set by the percentage increase in their business expenses, which being relatively small can vary by large percentages and for some considerable periods may not vary at all. The Government therefore propose to exempt from the Code self-employed persons whose business expenses do not exceed 10% of their profit or gains. The reference to the remuneration of doctors and dentists has been transferred to paragraph 6(xiv).
1. The Code has a dual function. First, the Price Commission are required to exercise their powers so as to ensure that it is implemented. Secondly, all those concerned with the determination of prices and charges should have regard to it.

2. The Code is therefore addressed both to the Commission and to all those concerned with price and charge determination.

General Principles

3. The general principles relating to prices are:
   (i) to limit the extent to which prices may be increased on account of increased costs, and to secure reductions as a result of reduced costs;
   (ii) to reinforce the control of prices by a control on profit margins while safeguarding and encouraging investment;
   (iii) to reinforce the effects of competition, and to secure its full benefits in the general level of prices.

Field of Application

4. With the exceptions specified in paragraphs 5 to 11 below, the prices of goods and services supplied to the United Kingdom home market are within the scope of the control.

5. The prices of goods and services exported (whether directly or through an agent or merchant) are not controlled.

6. The following are not controlled:
   (i) prices paid on first sale into the United Kingdom of imported goods and services;
(ii) prices of goods and services where the application of the control would be inconsistent with an international agreement or arrangement. For this purpose, an international agreement or arrangement is one between states or organisations of states, not between firms;

(iii) prices at sales by auction, where such sales are a normal practice in the particular trade;

(iv) prices of goods at the point of sale on a commodity market in the United Kingdom such as the London Metal Exchange or prices directly determined by reference to such markets;

(v) prices of second-hand goods (other than second-hand road vehicles sold by distributors);

(vi) charges for the carriage of goods or passengers on international journeys; charges for air navigation, landing and related services and ship, passenger and goods dues provided that they relate wholly or mainly to such traffic; charges for international mail, Giro, remittance and telecommunication services;

(vii) prices of ethical medicines supplied to the United Kingdom market to the extent that regulation of their prices is within the scope of any agreement relating to those prices made between the Secretary of State for Social Services and representatives of manufacturers of those medicines; but only so long as such an agreement is in force;

(viii) prices in Government contracts for warlike and other stores and services which are within the agreement between Her Majesty's Government and industry governing the pricing of, and control of profit from, non-competitive contracts. These prices will be subject to the controls provided in that agreement;

(ix) insurance premiums, which are subject to restriction by the Secretary of State for Trade;

(x) taxi fares, where subject to control by the Home Secretary or the Secretary of State for Scotland;

(xi) charges payable to returning officers in connection with Parliamentary elections, determined under the Representation of the People Act 1949;

(xii) prices determined by a statutory body which, as a result of an order made under section 8 of the Counter-Inflation Act 1973, is required to apply the Code to the determination of those prices;

(xiii) subscriptions and certain prices charged by non-profit-making organisations as in paragraphs 107 to 109;

(xiv) charges for services to the National Health Service by doctors, dispensing pharmacists, dispensing and ophthalmic opticians and medical appliance contractors;

(xv) charges for services to the Post Office by sub-postmasters.

Application to food, farming and forestry products

7. The prices of manufactured food and drink, like those of manufactured products generally, are within the scope of the control as are those of semi-processed foodstuffs such as butter, cheese and quick-frozen vegetables.

8. The prices paid to United Kingdom producers or producers' organisations or to overseas suppliers for fresh foods and similar products, which are subject to fluctuations on world and United Kingdom markets because of seasonal factors or changes in the relationship between supply and demand, are not controlled. This applies in particular to meat, including bacon and poultry, fish, eggs, fruit and vegetables. However enterprises which resell these products, whether home-produced or imported, at any subsequent stage will be subject to control.

(iii) The price for the sale of raw beet sugar for further refining is not controlled.
9. The retail price of milk for liquid consumption and the margins of milk distributors will continue to be subject to the existing controls by the Minister of Agriculture, Fisheries and Food and the Secretary of State for Scotland. So long as these controls apply, the price of milk for liquid consumption and distributors' margins on milk for liquid consumption will not be subject to the Code.

10. The prices for milk for manufacture of products for sale in the United Kingdom will, however, be subject to the following requirements. Except where a Milk Marketing Board incurs additional allowable cost increases in marketing milk:

(i) the price for the sale of milk for the manufacture of butter and skimmed milk powder may not be increased above the level prevailing at 30 April 1973 (adjusted as necessary to reflect later changes in the intervention prices); and

(ii) the price for the sale of milk for the manufacture of other products may not be increased above the sum of the maximum price permissible under sub-paragraph (i) above and half the sum of:

(a) the average premium received by the Board in respect of the product concerned in the year ending 30 April 1973 over the price of milk; and

(b) an amount found by applying to the maximum price permissible under subparagraph (i) above the percentage which the average premium referred to in (a) above bears to the price of milk;

being, in either case the price of the milk for the manufacture of butter and skimmed milk powder in the year ending 30 April 1973.

11. What is said in paragraph 8 in relation to prices paid for fresh foods applies also to prices of other primary products of animal or vegetable origin which are subject to similar fluctuations.

Charges

12. References in the Code to prices include references to charges, unless there is explicit provision to the contrary.

Goods and services

13. References in the Code to goods or products include references to services, unless there is explicit provision to the contrary.

Definition of Enterprise

14. With the exceptions described in paragraph 15, for the purposes of the Code an enterprise means either an enterprise as a whole or a separate constituent company or sub-division provided that in the latter case separate accounts for such sub-divisions:

(i) are or can be made available for all relevant periods;

(ii) are not materially distorted by transactions conducted otherwise than on arm's length terms;

(iii) would, if combined with one another and with the accounts of all other activities or transactions of the enterprise, produce results consistent with those shown by the accounts of the enterprise taken as a whole.
15. The definition in paragraph 14 does not apply where the unit for net profit margin control, as defined in paragraphs 60 and 61, is the relevant one. Accordingly, the definition in paragraph 14 does not apply in paragraphs 57 to 69, or in paragraphs 20, 44A, 70, 71A, 76 and 79; or in other paragraphs which refer to these.

16. A reference to an enterprise includes a reference to a co-operative, a partnership or to an individual carrying on a business.

Mixed enterprises

17. Where the activities of an enterprise are not confined to manufacturing, distribution, or the provision of services, but include more than one of these, each of these activities must be treated separately for the purposes of allowable cost increases and prices percentage margin unless separate accounts satisfying paragraph 14 cannot be made available for each of them. Where these activities are not treated separately, the main activity of the enterprise will determine whether the provisions of the Code relating to manufacturing, distribution or services apply.

Costs and Prices

18. Prices which are within the control may not be increased unless there is an increase in total costs per unit of output. No price may be increased by a greater percentage than the percentage increase in total costs per unit of output.

19. Where there is an increase in total costs per unit, only those increases defined in the Code as “allowable cost increases” may be taken into account in arriving at the permitted price increase, and they will be subject to a productivity deduction where appropriate.

19A. An enterprise which receives a subsidy on any food under section 1 of the Prices Act 1974 must treat the subsidy as part of the price it receives for that food or for any product in which that food is an ingredient.

Price reductions

20. Prices should be reduced whenever possible. Where there is a net reduction in allowable costs per unit of output, prices should be reduced by an amount equal to any percentage reduction in allowable costs calculated in a similar manner to that prescribed for calculation of permitted price increases under paragraph 23. Reductions are however not required to exceed the percentage fall in total costs per unit of output. In addition prices should be reduced as required in paragraphs 59 and 79 where, in the case of a distributor, its gross percentage margin, and in the case of any enterprise, its profit margin reference level is exceeded, or is likely to be exceeded.

Base date

21. The starting point for the calculation of permitted price increases is the level of costs per unit of output at 30 April 1973. In calculating permitted price increases, cost increases first incurred after 30 April 1973 may be taken into account, to the extent that they have not already been reflected in prices. Where the price of a particular product or of a range of related products has not been increased since 30 September 1972, that date may, at the option of the enterprise, be substituted for 30 April 1973 in paragraphs 23 and 28 below. However, except as in paragraph 22, the permitted price increase may not include any element of retrospective recovery of costs incurred before the date on which the price increase takes effect.
A permitted price increase may include recovery in such terms of cost increases first incurred between 30 April 1973 and the date of the permitted price increase, provided that:

(i) the amount included for such costs is such as to recover the costs over a period of not less than 6 months beginning with the date of implementation of the permitted price increase;
(ii) the costs were allowable cost increases under the provisions of the Code in force at the time they were incurred; and
(iii) in the calculation of any subsequent price increase under the Code, the "selling price" referred to in paragraph 23(iii) should exclude any element which represents a recovery of costs under this paragraph.

The permitted price increase may take full account of cost increases which have not been fully recovered before the date of the price increase.

Calculation of Permitted Price Increase

23. The maximum permitted price increase should be arrived at as follows:

(i) calculate the change in total costs per unit and allowable cost increases per unit (as reduced by the productivity deduction) between the base date and the date of the price increase; cost increases which have already been reflected in prices should be excluded;
(ii) express allowable cost increases per unit as a percentage of total costs per unit at the base date;
(iii) apply the resulting percentage to the selling price at the base date in order to establish the new permitted price level.

In (i), (ii) and (iii) above, "base date" means 30 April 1973, or at the option of the enterprise, the date of any subsequent price increase.

24. The calculation of the level of costs per unit referred to in paragraph 23(i) should be based on the levels of pay and other costs ruling at the base date and on the level of output over the most recent representative period completed by that date (eg the previous quarter) for which adequate records are available. Similarly the calculation of costs per unit at the date of the price increase may take account, in accordance with the normal practice of the enterprise, of increases in raw material prices and other allowable cost increases up to the date of the price increase and should reflect the output level achieved in the most recent representative period (eg the quarter preceding the date of the price increase).

25. The levels of unit costs calculated in this way will not necessarily be the same as the average figures recorded for the whole of the period chosen, eg if pay or other costs changed during the period. If output in the period was materially affected by abnormal factors such as holidays, an appropriate adjustment should be made. If this is impossible, the previous normal operating period should be chosen with appropriate adjustments to allow for changes in the level of pay or other costs.
26. Where price increases are being made not on a single product but on a range of related products (under paragraphs 42 or 43) the procedure in paragraphs 23 to 25 still applies. But in this case the group of related products should be considered as a single product; the costs per unit can be expressed either as costs per unit of volume of output or if a volume measure is impracticable as costs per £ of sales value. Where the calculated permitted percentage price increase is not applied uniformly to the whole range of products, the weighted average percentage price increase made on the selling prices of the products within the group may not exceed this percentage.

26A (i) Where after 25 March 1974 an indirect tax has been increased in addition not exceeding the cash amount of the increase borne by the vendor may be made to the prices permitted by other provisions of the Code for goods bearing the increased tax. Where an indirect tax is reduced the reduction must be fully reflected in prices.

(ii) This paragraph applies also to the effects of changes in the coverage of indirect taxes.

(iii) In calculating maximum permitted price increases after 25 March 1974, the figures for total costs per unit and the selling price at the base date must exclude any additions or reductions under this paragraph.

(iv) VAT is not regarded as part of the price for calculating prices and price increases for manufacturing and service enterprises, and this paragraph does not affect the treatment of VAT for this purpose.

Frequency of price increases

26B. A price to which the provisions on allowable cost increases apply may not be increased within 3 months, or at the option of the enterprise, within 13 weeks of its last increase, unless:—

(i) the price increase permitted by the Code is at least 10 per cent; or

(ii) the costs of materials, fuel and power in the product account for at least 75 per cent of total costs at the time of the price increase; or

(iii) the price increase permitted by the Code is at least 5 per cent and the costs of materials, fuel and power account for at least 50 per cent of total costs at the time of the price increase; or

(iv) the price increase is permitted under paragraph 34 (profit margin safeguard), the second sentence of paragraph 55 (special offers), paragraph 68 or 69 (low profit) or paragraphs 59A, 70 or 71 (investment) apply.

26C. In applying paragraph 26B price increases under paragraph 26A attributable solely to increases in indirect taxes should be disregarded.
Allowable Cost increases

28. Subject to the following paragraphs, a cost increase may be regarded as an allowable cost increase for the purpose of paragraph 19 if:

(i) it was first incurred after 30 April 1973; and

(ii) it was incurred for one of the following:

(a) labour;
(b) materials, components, consumable stores and supplies, fuel and power;
(c) rent of premises, rates, payment for licences over or in respect of land;
(d) interest charges, as defined in paragraph 31, and depreciation, calculated in accordance with generally accepted accounting principles consistently applied by the enterprise concerned, but based on the historic cost of the assets except that when, in annual accounts for a year ended on or before 30 September 1972, the enterprise has revalued an asset the value may be based on the value of the asset shown in those accounts;
(e) certain bought-in services, not of a capital nature, that is: transport, hire of equipment, insurance, storage, postage, maintenance, telephone and engineering services, research and development, security services, computer services, editorial contributions;
(f) commission processing and other sub-contracted operations on materials or components incorporated into the product;
(g) fees for professional services, payments by the Post Office to sub-postmasters;
(h) royalties; and

(iii) it has not already been reflected in prices.

This paragraph does not apply to cost increases if they were first incurred on the following before 1 November:

- payment for licences over and in respect of land;
- bought-in research and development, computer services, security services, editorial contributions; and items referred to in sub-paragraphs (c) and (h).

Interest charges

31. Increases in interest charges payable by an enterprise are allowable cost increases, unless the charges or the increases in them:

(i) represent a distribution of profits rather than a true interest charge; or

(ii) where they arise on loans between related undertakings, relate to loans which are not strictly required for the business or represent interest in excess of that which would be charged in a transaction at arm's length; or

(iii) represent interest which would properly be regarded as capital expenditure in the period in which it is incurred.
Productivity Deduction

32(0) In order to ensure that the benefits of increased productivity are passed on to the consumer, a deduction should be made from allowable cost increases. Enterprises are required to absorb 20% of allowable cost increases arising from increases in labour costs (excluding the labour costs listed in paragraph 33) except that:

(a) where the share of labour costs in total costs exceeds 35% enterprises are required to absorb an amount equal to the percentage of total costs which would apply if labour costs represented 35% of total costs;

(b) where the share of labour costs in total costs is less than 15% enterprises are required to absorb an amount equal to the percentage of total costs which would apply if labour costs represented 15% of total costs;

(ii) The rate of productivity deduction shall in no case exceed 35%.

(iii) Where, however, the increase in labour costs was first incurred before 1 November 1974, this paragraph shall have effect with the substitution of 50% for 20% in subparagraph (i) and for 35% in subparagraph (ii).
33. The deduction for productivity under paragraph 32 need not be applied to increases in or arising from:

(i) employers' national insurance contributions;

(ii) training costs;

(iii) the cost of improvements in respect of progress towards the achievement of the requirements of the Equal Pay Act 1970;

(iv) the cost of improvements to meet the purposes of section 8 of the Terms and Conditions of Employment Act 1958, the Road Haulage Wages Act 1938, and similar legislation, and the Fair Wages Resolution of 1946;

(v) new or improved benefits under occupational pension or death benefit schemes which are tax approved, or under comparable schemes not requiring tax approval, any deficiency payments to such schemes, and any reimbursement of a corresponding increase in employee contributions. However where a change in a pension scheme has the effect of increasing the pay, net of any pension contribution, of a substantial proportion of the group of employees covered by the scheme, that increase shall be subject to the productivity deduction unless:

(a) a revaluation of the scheme, made in accordance with generally accepted principles for such revaluations, has shown a surplus in respect of those receiving the increase, the value of which equals or exceeds the increase; or

(b) there has been a corresponding reduction in benefits to those receiving the increase; or

(c) the change had been proposed before 6 November 1972;

(vi) new or improved benefits under schemes which:

(a) provide payments to employees who leave an employer's service or are redeployed to a job with lower earnings because of redundancy in the circumstances described in (a) and (b) of section 1(2) of the Redundancy Payments Act 1965, and

(b) require a minimum of at least 52 weeks continuous service as a condition of such payments.

Benefits which become payable after six months of incapacity are similarly not subject to the productivity deduction.
Safeguard against low profits or erosion of profit margins on products
(excluding any increase under paragraph 69A)

Section 24

(i) Where the price of a product does not afford a margin over total costs per unit of output calculated under (ii) and (iii) below, an enterprise may increase the price of the product concerned to the extent required to give such a margin, but any increase under this paragraph shall be limited so far as is necessary to ensure that the reference level is not exceeded. Furthermore, once an increase has been made under this paragraph no further increase shall at any time be made in respect of cost increases incurred before this increase was made under any provision of the Code.

(ii) The margin referred to in (i) above is, at the option of the enterprise -

(a) 2 per cent; or

(b) two-thirds of the margin at 30 April 1973, or at 30 September 1972 where the margin has declined by one quarter or more between 30 September 1972 and 30 April 1973.

(iii) For the purpose of this paragraph the calculation of total costs per unit of output should be based on the levels of pay and other costs at the relevant dates and the level of output over the most recent representative period completed by these dates.

(iv) This paragraph has effect in relation to a range of products within the meaning of paragraph 26 as it has effect in relation to a single product, and a product shall not be treated as a single product for the purposes of this paragraph if it has normally been treated as one of a range of related products for the calculation of permitted price increases since 30 April 1973.
25. Allocation of costs to particular controlled goods or services for the calculation of allowable cost increases or increases in total costs may be necessary where an enterprise:

(i) sells in both home and overseas markets; or
(ii) makes sales at home, some of which are within and some outside the scope of the control; or
(iii) makes sales of different products or groups of products which are within the control, and has to divide costs between them for the purposes of the Code.

Where such an enterprise:

(a) has made allocations which represent a fair division of costs in its circumstances, over part or all of the field; and

(b) has done so on a consistent basis,

it should continue to use this basis for all calculations relevant to the Code. In other cases enterprises may make such allocations by dividing costs in proportion to the value of sales in each area, or on any other basis which represents good accounting practice, provided that it adheres to the chosen basis for all calculations relevant to the Code.

Stocks

26. In calculating the cost of current production or sales, enterprises may need to include an element for stocks of raw materials, of components or of finished goods, used for production or sales. When making such calculations in order to arrive at costs per unit of output and at any allowable cost increases, enterprises should adhere to the practice they have followed consistently for the treatment of such costs for pricing purposes.

Transfer prices

27. Where the Commission are satisfied that prices, either of purchases or of sales, which an enterprise proposes to regard as a basis for the calculation of allowable cost increases or of net profit margins, differ from what they would be if the goods or services had been transferred on an arm's length basis, they may substitute modified cost increases or profit margins which in their judgement fairly reflect what would be appropriate on that basis.

Costs of sectors including small enterprises

28. Where the Commission are satisfied that:

(i) significant reductions or increases in allowable costs have occurred or are about to occur in a sector of industry or commerce which includes a considerable number of small enterprises, especially those providing services; and

(ii) the information available to them indicates that these changes in costs are likely to be of broadly the same order for a substantial number of such enterprises, in respect either of some or all of the goods or services which they supply,

the Commission, after consulting any body or persons which they regard as representative of enterprises affected and after taking into account information supplied by them, may calculate average allowable cost increases or reductions for the relevant goods or services. In the case of cost increases, these increases should then be taken as the allowable cost increases for the relevant goods or services; in the case of cost reductions, the Commission may specify reductions under paragraph 20 in the prices of the relevant goods or services which should then be made by all the enterprises concerned.

29. In calculating average allowable cost changes under paragraph 28 the Commission will take account of:

(i) all relevant information available to them on cost changes for the goods or services concerned, including information supplied by any trade association or other body which they consider is representative of the enterprises concerned; and

(ii) any other relevant provisions of the Code.
40. The Commission will publish information about any average allowable cost changes which they have determined under paragraphs 38 and 39 together with an indication of any price changes which they regard as justified or required under the Code on the basis of those average allowable cost changes.

41. Where the allowable cost changes of a particular enterprise differ from those published by the Commission under paragraph 40, that enterprise may apply the normal provisions of the Code relating to allowable cost increases or price reductions. It will be the responsibility of the enterprise to satisfy the Commission if required that this was justified.

Product Costs and Allowable Cost Increases

Single product enterprises

42. Where an enterprise makes a single product or a single range of products the calculations required by the Code may be carried out by reference to the costs and prices of that enterprise as a whole.

Multi-product enterprises: related products

43. This paragraph applies to enterprises making a variety of products. Where:

(i) allowable cost increases arise on one or more of a range of related products; and

(ii) a price increase in respect of them is permissible under the Code, the enterprise need not relate the price increase for individual products within the range closely to the cost increase for each product, provided

(a) it has been established practice to treat the range of products in this way; and

(b) the average increase in price, weighted by the value of sales in a recent period, will not exceed the sum of what the Code would permit on the products affected by the cost increases.

44. In cases not covered by paragraphs 42 and 43 the calculations required by the Code should be made by reference to individual products.

Common Pricing Agreements upheld by the Restrictive Practices Court

44A. (i) Where a number of enterprises are parties in a common pricing agreement which has been declared by the Restrictive Practices Court to be not contrary to the public interest, they may increase prices for products to which the agreement applies by the average (weighted by value of sales in a recent representative period) of the increases otherwise permitted by the Code (except paragraph 69A) to each enterprise which is party to the agreement notwithstanding that, in the case of any enterprise, the increase exceeds its permitted price increase. Cost increases reflected in price increases implemented under this paragraph may not be taken into account in calculating any subsequent price increases under any provision of the Code.

(ii) The weighted average increase permitted under sub-paragraph (i) should not be applied where the profit margin reference level of any of the enterprises concerned is exceeded or, in the light of interim accounts or other evidence, is likely to be exceeded.

(iii) Nothing in this paragraph shall prohibit any enterprise which is party to the agreement from implementing an increased price under paragraph 69A.
Anticipation of cost increases

45. Prices may not be increased in anticipation of cost increases, except as described in paragraphs 46 to 48. However:—

(i) an enterprise may determine and announce a price increase consistent with the Code which takes account of future allowable cost increases which are already known as to both date and amount, provided that the price increase is not implemented before the allowable cost increases are incurred; and

(ii) an enterprise required to pre-notify an intended price increase to the Commission may seek the agreement of the Commission to a price increase consistent with the Code which takes account of such known future cost increases, subject to the same proviso as in (i).

46. Where:—

(i) a future allowable cost increase is already known, as to both date and amount; and

(ii) it is proposed to quote a price for supply on demand which will not be increased for at least 3 months from the date on which it takes effect,
an enterprise may average the future allowable cost increase over the period of not less than 3 months for which it quotes the price in arriving at a price increase for that period, provided that:—

(a) the total amount raised will not be increased by the averaging; and

(b) the averaging is in accordance with a well-established practice in the trade concerned.

47. Paragraph 46(i) may be read as applying to an estimated future cost increase if:—

(i) it relates to a material which fluctuates frequently and unpredictably in price; and

(ii) the use of estimates of such cost increases is a well-established practice of the trade; and

(iii) in framing the estimates the enterprise adheres to the methods it has consistently used for the treatment of such costs for pricing purposes.

48. This paragraph applies to tenders to the extent that they are at fixed prices. In framing such tenders, those concerned should have regard to the Code, but where tenders are the custom of the trade

(i) competitive tenders may provide for estimated future cost increases,

(ii) non-competitive tenders may provide for estimated future cost increases if the contract is to run for at least six months from the date on which work is to begin.
Escalation and variation of price clauses

49. Price increases made under an escalation or variation of price clause may reflect cost increases for items listed in paragraph 23(ii), to the extent that this is permitted under the contract, and the productivity deduction specified in paragraph 32 is applied to any labour cost increase incurred. But if the application of the productivity deduction causes or increases a loss on a particular contract, taken as a whole, the terms of the escalation or variation of price clauses may be applied to the extent necessary to avoid the loss, or the increase in it. In addition to new contracts, this paragraph applies to existing contracts and to increases in prices under those contracts, to the extent that they relate to cost increases after 5 November 1972.

49A. Price increases under an escalation or variation of price clause should be taken into account in applying paragraph 26B only if they are notifiable to the Commission under an order under section 5 of the Counter-Inflation Act 1973.

Prime cost and cost reimbursement contracts

50. Where a claim for payment by a contractor under any form of prime cost or cost reimbursement arrangement includes an element for increased labour cost levels since the start of the contract or since 6 November 1972, whichever is the later, the productivity deduction specified in paragraph 32 must be applied. But if the application of the productivity deduction causes or increases a loss on a particular contract, taken as a whole, the terms of the contract may be applied to the extent necessary to avoid the loss, or the increase in it. This paragraph applies to new and existing contracts.

51. Paragraph 50 does not apply where the terms of a prime cost or cost reimbursement arrangement ensure that the benefit of economies in the use of labour pass directly to the client. For non-competitive contracts of this type placed after 1 November 1973 the contractor may not quote a rate of fee which is higher than that which he has charged since 30 April 1973 for the same service or a similar one.

52. There, in the case of a contract to which paragraph 49 applies, the net profit margin (excluding the amount of any increase in the reference level permitted under paragraph 59) of the unit for profit margin control as defined in paragraphs 50 and 51 is more than one-third below the reference level, the productivity deduction need not be applied for so long as the net profit margin remains below this figure.

Discounts and rebates

53. The withdrawal or reduction of a discount or rebate, including a discount or rebate to a particular customer, is equivalent for the purposes of the Code to an increase in the price. This does not apply, however, to a discount or rebate directly related to the promotion of one or more products or services for a limited period or in a limited area.

Quantity or quality change and new products

54. A change in the quantity or quality of goods is equivalent for the purposes of the Code to a change in the price. Quality change in goods or services, quantity change in sales units, or artificial creation of new products should not be used as a means of avoiding the requirements of the Code. Where the Commission form the opinion that this has been done, they may seek price reductions, or disallow or reduce price increases.

55. However, where a new product is marketed on an experimental and restricted basis for a period of not more than twelve months, the price charged by the manufacturer need not be treated for the purposes of the Code as establishing a price for the product.
Prices and Profit Margins

57. Prices should be determined so as to secure that net profit margins, as defined in paragraph 58, do not exceed the average level of the best two of the last five years of account of the unit to which net profit margin control applies ending not later than 30 April 1973 (the “reference level”).

58. “Net profit margin” means the margin of net profit expressed as a percentage of sales or turnover. “Net profit” means the net profit, determined in accordance with generally accepted accounting principles consistently applied by the enterprise concerned, which arises from trading operations within the control after taking into account all expenses of conducting and financing them, including depreciation and interest as defined in paragraphs 28 and 31, but before deducting corporation tax or income tax.

Action where profit margin is likely to be exceeded

59. Where:
   (i) the reference level has been exceeded; or
   (ii) in the light of interim accounts or other evidence, is likely to be exceeded,
abatements in allowable cost increases or price reductions should be made; provided that in either case account has been taken of seasonal and other distorting factors. The abatements or reductions should be sufficient to eliminate the actual or expected excess over the reference level as soon as reasonably possible, and to offset any excess which has already arisen in a period subsequent to 30 April 1973.

Unit for profit margins

60. In calculating the net profit margin under paragraph 57, the unit for profit margin control shall be either:
   (i) the enterprise as a whole; or
   (ii) an activity treated separately under paragraph 17; or
   (iii) a unit of an enterprise, being a separate constituent company or subdivision, provided that the Commission are satisfied that:
      (a) the unit constituted, before 30 April 1973, and still constitutes, a separate unit immediately below the level of the main Board of the enterprise as a whole for management, operational and accounting purposes. In applying the test in this sub-paragraph the Commission may disregard an intermediate non-trading company; and
      (b) the accounts of all such units, if combined with one another, can be reconciled with those of the enterprise as a whole, and are not materially distorted by transactions conducted otherwise than on arm’s length terms.
The same unit should then be adhered to for all the purposes of the Code to which the net profit margin is relevant.

61. For the purpose of paragraph 60, where the enterprise is a company, “the enterprise as a whole” means the company or (where the company is a member of a group) all the companies in the group, but includes only members of the group carrying on business in the United Kingdom, and in this paragraph:
   (i) “company” includes any body corporate; and
   (ii) “group” means the person (including a company) having control of a company together with all companies directly or indirectly controlled by him.

Allocation of profits to controlled prices

62. Allocation of profits between prices within the control and those which are not may be necessary for the calculation of net profit margins. The requirements of paragraph 35 apply to such allocations of profits as they do to allocations of costs.
Profit margins and indirect taxes

63. In making comparisons between net profit margins as a percentage of sales and the reference level, due account must be taken of the effect on margins of changes in indirect tax on goods and services sold, so that the comparison is not materially distorted. The comparison with earlier years should be made on a basis which excludes purchase tax from sales in the period up to the end of March 1973 and excludes VAT from 1 April 1973 onwards. Where customs and excise duties have been included in the sales figures, these duties should be included throughout, adjusted as necessary to take account of the partial replacement of excise duties by VAT and of other changes in those duties. Where indirect taxes have been increased after 25 March 1974, a deduction should be made from the value of sales corresponding to the cash value of the extra tax borne by the goods sold; conversely, where indirect taxes have been reduced after 25 March 1974, a corresponding addition should be made to the value of sales.

64. Where an enterprise does not already have accounts showing separately the purchase tax element in the turnover of previous years, or which permit the precise calculation of the amount of excise duty abatement from records of duty paid, such elements should be estimated on the basis of the best available information. Where total purchase tax can be ascertained from purchase invoices this total can be deducted from tax inclusive sales. Where such purchase invoices are not available, the purchase tax element may be estimated by applying to the value of purchases of goods charged to different rates of purchase tax appropriate factors derived from those rates.

Modified base period for profit margin calculation

65. Where an enterprise has traded for less than five complete years of account up to 30 April 1973, or has traded at a loss in one or more of those years, the reference level for paragraph 57 may be calculated as follows:

(i) if there have been four years of trading up to 31 October 1973, the average of the best two; if three or two years, the best year;

(ii) if there have been less than two years of trading up to 31 October 1973, the limitation on profit margins will not apply;

(iii) any year in which an enterprise made a loss may be treated as equivalent to a year of no trading and sub-paragraphs (i) and (ii) may be applied accordingly.

66. For a new enterprise formed from a reconstruction or amalgamation of existing enterprises the reference level will be calculated as defined in paragraph 57 by using the aggregate net trading profits of the constituent enterprises expressed as a percentage of their aggregate sales. The same principles may be applied to an amalgamation of partnerships.
66A. Where the membership of a group of companies changes by the acquisition of a new member company or the disposal of an existing member company, then, in calculating net profit margins and reference levels in relation to the group and its members after the acquisition or disposal, the sales and profits of the member acquired (before and after the acquisition) shall be included and the sales and profits of the member disposed of (before and after the disposal) shall be excluded, and no account shall be taken in the case of an acquisition of money borrowed or interest paid in connection with the acquisition.

66B. (i) Where the membership of a group of companies changes by the acquisition of a new member company after 29 April 1973—

(a) the words "constituted, before 30 April 1973, and still" in paragraph 60(iii) will not apply in relation to the new member company; and

(b) the new member company may be integrated into a unit for profit margin control which has been or could have been established under paragraph 60(i), (ii) or (iii), so long as the conditions of paragraph 60(ii) or (iii) continue to be met where applicable.

(ii) If the new member company is integrated into such a unit—

(a) the reference level of the unit will be calculated for the purposes of paragraph 57 by using the aggregate net trading profits of the new member and the remainder of the unit expressed as a percentage of their aggregate sales; and

(b) if paragraph 68 or 69 was applicable to the new member company before the integration, the new member company's contribution to the unit's reference level may be calculated as if paragraph 68 or 69 still applied.

(iii) In calculating the net profit margin or the reference level of the new member company or of such a unit, no account shall be taken of money borrowed or interest paid in connection with the acquisition of the new member company.

(iv) This paragraph will not apply unless—

(a) the acquisition of the new member company is the result of a transaction at arm's length; and

(b) the new member company existed outside the group before the transaction.
67. Where the Commission are satisfied that the reference level of an enterprise, calculated as in paragraphs 57-61 requires modification, for example because of

(i) a substantial reconstruction of the enterprise during the base period; or

(ii) a substantial change in the character of the business; or

(iii) a substantial change in the ratio between the value of net fixed assets (other than land and buildings) and the value of sales, arising from investment which has enabled the enterprise either

(a) to undertake an earlier stage of production of goods or services; or

(b) to achieve substantial savings in labour costs per unit of output,

ey may permit some departure from that reference level. In deciding whether, and to what extent, to permit such a departure the Commission should have regard, as appropriate, to the principles referred to in paragraph 66 and, for example, to the profit history of the main parts of the business which now make up the enterprise; the profits of any substantial parts of the business acquired or added to the enterprise during the base period, excluding any such parts which have been disposed of or discontinued; the change in the relative importance of different elements of the business; the extent of the change in the ratio between the value of net fixed assets and sales referred to in sub-paragraph (iii).

68. Where the Commission are satisfied that the net profit margin calculated as described in paragraphs 57-61, 66, 68 or 69 represents a return on capital of less than 10 per cent, the restrictions on price increases and on gross percentage and net profit margins shall not be applied so as to restrict the return below 10 per cent. In such cases the net profit margin which would be needed to produce a return of 10 per cent on capital may be treated as the reference level. Where in the earlier of the two best years referred to in paragraph 57 the net profit margin represented a return on capital of less than 10 per cent, a figure equivalent to a 10 per cent rate of return may be used for that year in calculating the reference level. "Capital" means the net assets employed excluding any part of them which is represented by borrowings the interest on which is deducted in arriving at net profit as defined in paragraph 58. The value of the assets concerned shall be determined in accordance with generally accepted accounting principles consistently applied by the enterprise but should be based on the historic costs of the assets except that where in annual accounts for a year ended on or before 30 September 1972 the enterprise has revalued an asset the value may be based on the value of the asset shown in those accounts.

69. At the option of the enterprise paragraph 68 may be read as referring to a net profit margin of 2 per cent on turnover rather than a 10 per cent return on capital.
Belief for Investment

69A (i) Enterprises may increase net profit margin reference levels, the levels of gross percentage margins and prices, by reference to their estimated capital expenditure on investment in the United Kingdom, in accordance with the provisions of this paragraph.

In this paragraph and in paragraph 69B—

"expenditure on investment" means the estimated capital expenditure (revised from time to time as circumstances may require) approved in the case of a company by the board of directors, in the relief year on new or secondhand plant and machinery (except road vehicles) and on the construction of industrial buildings less the disposal value of any such assets disposed of in the relief year, provided that expenditure relating to products of which the price is not controlled shall be left out of account and that, where the estimated expenditure cannot be appropriated to each activity within the meaning of paragraph 17 or between controlled and uncontrolled products, it shall be apportioned in proportion to the turnovers of all the activities concerned in the year of account ended not more than 12 months before the beginning of the relief year;

"the relief year" means a period of 12 months chosen by the enterprise—

(a) in the case—

(i) of a manufacturer or provider of services required to give notice to the Commission of an increased price or charge pursuant to an order under section 5 of the Counter-Inflation Act 1973; and

(ii) of a distributor required to furnish periodical returns to the Commission pursuant to an order under section 15 of that Act;

beginning not earlier than 56 days after the enterprise concerned has informed the Commission that it intends to apply this paragraph; and

(b) in the case of any other enterprise, beginning not earlier than the date on which this Code comes into force;

"relevant expenditure" means an amount (revised from time to time to take account of revision of expenditure on investment) being 17 1/2% of the expenditure on investment.
"turnover", in relation to the relief year, means the turnover which may reasonably be expected to be achieved in the relief year, revised from time to time as circumstances may require.

(ii) The permitted increases in net profit margin reference levels, the levels of gross percentage margins and prices shall be calculated in accordance with the following provisions of this paragraph. An enterprise

(a) may, for the relief year, treat the net profit margin reference level as increased by the addition of a figure found by expressing the relevant expenditure as a percentage of turnover;

(b) in respect of its distribution activities, may, for the relief year, treat the level of the gross percentage margin ascertained under paragraph 74 as increased by the addition of a figure found by expressing the relevant expenditure as a percentage of turnover; and

(c) in respect of its manufacturing and service activities, may increase any price within control for a period of 12 months beginning in the relief year by an amount the additional yield from which, taken with the additional yield from all other such increases, will not exceed the relevant expenditure, and the total increase under this head in the price for any individual product shall not exceed a percentage equal to three times the increase in the net profit margin reference level under this subparagraph.

(iii) If the application of subparagraph (ii) has not caused the relevant expenditure to be recovered in sales, an enterprise for so long as may be necessary -

(a) may, in respect of its manufacturing and service activities, treat the reference level as increased by an amount sufficient to permit a price calculated under paragraph (ii)(c) to remain in force until the relevant expenditure has been recovered;

(b) may, in respect of its distribution activities, treat the reference level and the level of the gross percentage margin ascertained under paragraph 74 as increased by an amount sufficient to permit the recovery of any part of the relevant expenditure which has not been recovered.

(iv) Investment expenditure in respect of which the enterprise has benefited under paragraph 70 or any provision which it replaces may not be included in the calculation of relevant expenditure for the purposes of this paragraph.
(v) Increases in prices under this paragraph must be disregarded in determining increases in any price under any other provision of this Code.

69B. (i) If relief under paragraph 69A is likely to exceed the relevant expenditure relief under paragraph 69A shall cease or shall be reduced to the extent necessary to ensure that no more than the relevant expenditure is recovered by its operation.

(ii) If relief under paragraph 69A has exceeded the relevant expenditure then, notwithstanding any other provisions of the Code, net profit margin reference levels, the levels of gross percentage margins and prices shall each be reduced by an amount necessary to ensure that no more than the amount of the relevant expenditure is recovered.
70. Where the Commission are satisfied that in a particular case it is necessary in order to encourage or ensure investment to modify the application of the provisions relating to allowable cost increases or to increases in total costs or in profit margins, they may permit some modification of any of these provisions.

In deciding whether, and to what extent, to permit such a departure the Commission should have regard to the following criteria:

(i) whether there is satisfactory evidence that if this is done expenditure on the investment will begin within 12 months of the date of the price being increased or the profit margin limit being modified; and

(ii) whether

(a) the application of the limits would deprive the enterprise of funds essential for investment which it could not reasonably be expected, or would not be able, to raise in some other way, or would reduce the prospective rate of return on the investment to a level which would deter the enterprise from undertaking it; or

(b) there is satisfactory evidence that the enterprise had absorbed cost increases to an exceptional degree as a result of voluntary price restraint and in consequence had significantly reduced profit margins in the 12 months ending 30 September 1972; and

(iii) the extent to which prices, gross percentage margins and net profit margin reference levels are modified by the application of paragraph 69A.

71. Where the Commission are satisfied that:

(i) an enterprise as defined in paragraphs (50 and 61 has net tangible fixed assets, excluding land and buildings, per employee which exceed £2,000 per head; and

(ii) has a plant or group of plants and facilities, employed in the manufacture of a group of related products, which had a fixed asset value at original cost of at least £10m; and

(iii) that the capacity of this plant or group of plants was seriously under-used over the most recent representative period before 30 September 1972 or before the base date, as defined in paragraphs 21 and 23; and

(iv) that the rate of utilisation has since risen by 12½ percentage points;

the Commission may, on application from the enterprise, modify the calculation of allowable and total costs per unit at the base date by substituting the figures for unit costs that, in the Commission's view, would have applied at that time if the plant had been operating at the average rate of capacity use which applied over the most recent representative period before the date of the application. Where, however, an enterprise has already received approval under this paragraph for a price increase after 1 November 1973, the date of that price increase shall be substituted for 30 September 1972 or the base date in sub-paragraph (iii).

Shortage of Supplies

71A. Where, having regard to the need to alleviate the shortage or threatened shortage referred to below, the Secretary of State has certified in relation to any product or commodity that:

(i) there is a severe shortage of supplies in the domestic market or serious threat of such shortage; and

(ii) significant damage is being thereby caused or threatened to the interests of particular industries or of consumers in the United Kingdom;

then, for so long as the certificate remains in force, such departures from the provisions of the Code relating to allowable cost increases, increases in total costs and net profit margins shall be permitted by the Commission as the Secretary of State may specify in the certificate.
Particular Sectors

72. The paragraphs which follow deal with the application of this Part of the Code to certain important sectors. Unless there is express provision to the contrary in those paragraphs, however, paragraphs 3 to 71 must be taken as applying to all enterprises.

Manufacturing and Mining

73. Paragraphs 3 to 71 above apply in their entirety.

Distribution

74. (i) In the determination of prices for sales within the United Kingdom, wholesalers, retailers and other enterprises engaged in distribution should ensure that their gross percentage margins do not exceed the proportion specified in sub-paragraph (ii) of the level of the gross percentage margin in either

(a) the last complete account year of the enterprise ending on or before 30 April 1973; or

(b) a 12-month period ending between 30 October 1972 and 30 April 1973 for which separate accounts are or can be made available

less in either case an appropriate reduction for the abolition of SET. Where an enterprise has not traded long enough to establish a gross percentage margin under (a) or (b), there shall be substituted the margin for a 12-month period ending not later than 31 March 1974 for which separate accounts are or can be made available.

(ii) The proportion of the gross percentage margin referred to in sub-paragraph (i) will be

(a) 100 per cent for any period before 6 May 1974;

(b) 90 per cent for any period on or after 6 May 1974.

(iii) A figure of 100 per cent and not 90 per cent will however apply from 6 May 1974 to

(a) distributors engaged mainly in retailing with total annual sales of less than £250,000;

(b) other distributors with total annual sales of less than £500,000;

(c) all sales of goods exempted from restrictions on resale price maintenance by an order under section 5 of the Resale Prices Act 1964.

74A. Where indirect taxes have been increased after 25 March 1974, in addition not exceeding the cash amount of the increase may be made to prices charged by distributors. Where indirect taxes are reduced, the reduction must be fully reflected in prices. The cash amount of the increase or reduction need not however be applied precisely to the goods bearing the indirect taxes.

Safeguard for net profit margins

74B. Where the application of the figure of 90 per cent in paragraph 74 (ii) (b) would reduce the net profit margin of the enterprise as defined in paragraphs 60 and 61 to a level more than one-quarter below the reference level, the figure may be increased (though not above 105 per cent) to the extent necessary to limit that reduction to one-quarter.

To increase under paragraph 69A shall be taken into account in applying this paragraph.

75. For all the purposes of the Code "gross percentage margin" means the aggregate difference between the cost to the distributor of all the goods he sells in the home market in a period and the value of his sales of those goods in that period, expressed as a percentage of the sales value. The difference should be calculated according to the normal accounting practice consistently applied by the enterprise in arriving at sales and costs of sales, indirect taxes should be treated on the same basis as for calculating net profit margins in paragraph 63. In particular the cash value of increases in indirect taxes after 25 March 1974 should be deducted from both sales and costs of sales in arriving at current gross percentage margins. Similarly the cash equivalent of any tax reductions should be added to costs and sales.

76. The provisions of the Code relating to all increases do not apply to distribution.
77. In most cases prices determined by distributive enterprises will have to take account of the cost of goods used from stock for sale. Such enterprises should adhere to the practice they have followed consistently for pricing purposes in arriving at such costs and at the relevant gross percentage margins.

Repricing

77A. (i) Retailers should not increase the prices of goods that are or have been displayed for sale by reference to increases in replacement costs, even if such price increases would otherwise be permitted by the Code.

(ii) This paragraph does not apply:
(a) to goods on which the average rate of annual stockturn is less than 10; or
(b) to price increases directly resulting from the withdrawal of special offers; or
(c) to goods exempted from restrictions on resale price maintenance by an order under section 5 of the Resale Prices Act 1954; or
(d) where the Commission are satisfied, after consulting representative bodies, that the effect on prices of applying the paragraph would be contrary to consumers' interests.

78. An enterprise engaged in distribution may increase prices to cover its total costs plus a margin (excluding any increase under paragraph 69A) of 2 percent, notwithstanding the limitation on gross percentage margins. Price increases may not be made under this paragraph if they cause the profit margin reference level referred to in paragraphs 57 to 69 to be exceeded.

Action where gross or net percentage margins are likely to be exceeded

79. Where:
(i) a distributor's net profit margin or gross percentage margin has exceeded the level allowed under this Code; or
(ii) where in the light of interim accounts or other evidence, that level is likely to be exceeded,
price reductions should be made, provided that in either case account has been taken of seasonal and other distorting factors. The reduction should be sufficient to eliminate the actual or expected excess over the permitted level as soon as reasonably possible, and to offset any excess which has already arisen in a period subsequent to 30 April 1973.

Variation of gross percentage margins

80. (i) Where in the judgment of the Commission the conditions in sub-paragraph (iii) are met, they shall:
(a) consult any body or person whom they regard as representative of enterprises affected and take into account all relevant information supplied by them;
(b) consider whether the proportion of the gross percentage margin specified in paragraph 74 (ii) (b) should be varied accordingly whether by way of reduction or increase;
(c) after consultation with the bodies or persons referred to in sub-paragraph (a) inform them of any variation in gross percentage margins which they consider appropriate in the light of the conditions in sub-paragraph (iii) and notify this to any enterprise.

(ii) Where a variation in gross percentage margins is notified under this paragraph, paragraph 74 (ii) (b) shall be varied accordingly in its application to that enterprise.

(iii) The conditions referred to in sub-paragraph (i) are that as a result of changes in value of turnover or operating costs for any enterprise or group of enterprises, the gross percentage margin control in paragraph 74 affects net profit margins in a way that is substantially different from the general position in distribution, or which leads to widespread application of the safeguard in paragraph 74.

Agriculture

81. Part I of the Code does not apply to agricultural enterprises engaged in the production and sale of unprocessed agricultural produce. Where such enterprises are engaged in manufacturing or preserving, however, their prices are controlled by reference to allowable cost increases and net profit margins. Where they are engaged in distribution, their prices are controlled by reference to gross percentage margins and net profit margins.
2. Paragraphs 83 to 86 apply to the following nationalised industries:

- National Coal Board
- Electricity Council
- Area Electricity Boards
- Central Electricity Generating Board
- North of Scotland Hydro-Electric Board
- South of Scotland Electricity Board
- Northern Ireland Electricity Service
- British Gas Corporation
- British Steel Corporation
- Post Office
- British Airways Board
- British Airports Authority
- British Railways Board
- British Transport Docks Board
- British Waterways Board

The provisions of the Code, except paragraphs 34 and 68 to 71, apply to the controlled activities of the nationalised industries listed in paragraph 82, according to the nature of the business of the industry as they apply to private sector undertakings. This paragraph and paragraphs 83A to 87 apply in addition.

(a) In particular, a nationalised industry which is not in deficit on controlled activities may increase prices in accordance with those provisions of the Code.

(b) However, a nationalised industry which is in deficit on controlled activities may increase prices in accordance with those provisions, calculated without any deduction under paragraph 32.

(c) A nationalised industry, whether or not it is in deficit on controlled activities, may, in addition to any increase under sub-paragraph (a) or (b) above and paragraph 84A below, increase prices on controlled activities by any further amount necessary to ensure that sufficient revenue is received within the period from the date on which the increased price takes effect to the end of the accounting year in question to provide on controlled activities over the whole of that year a surplus of 2 per cent, calculated on turnover on those activities in that year, or, at the option of the industry concerned, a return of 10 per cent on net assets employed in controlled activities, allowance being made in either case for any change in the volume of sales which may reasonably be expected to result from increased prices and for any estimated cost increases during the remainder of that year. In the case of any conflict between the provisions of this sub-paragraph and those of paragraphs 57 to 59, this sub-paragraph shall prevail.

A nationalised industry may apply sub-paragraphs (a) to (c) separately to a separate activity as defined in paragraph 17 or to a separate unit as defined in paragraph 60 (iii) whether or not the industry is in deficit.
For the purpose of this paragraph:

(a) Subject to the provisions of paragraph 86A:

(i) a nationalised industry is in deficit if it incurs a deficit on revenue account in the previous accounting year after providing for interest and depreciation;

(ii) in calculating a surplus all trading costs, and provision for interest and depreciation shall be deducted from revenue;

(iii) depreciation for the purposes of (i) and (ii) above includes provision for the writing off of displaced plant and deferred charges, and shall be calculated in accordance with accounting principles consistently applied by the industry concerned (including the supplementary provision for depreciation at replacement cost made by the Post Office and British Transport Docks Board).

(b) return on net assets shall be calculated by expressing net revenue as a percentage of assets, where:

(i) "net revenue" means revenue in the accounting year in which the price increase takes effect less trading costs and after providing for depreciation (excluding supplementary provision for depreciation at replacement cost) but before taking account of interest and taxation; and

(ii) "net assets" means the net book value of total assets less current liabilities at the end of the industry's accounting year preceding the accounting year in question.

(c) no account shall be taken of Government compensation or grants taken directly to revenue account.
83A. In determining sales value for the purpose of paragraph 26, no account shall, in the case of a nationalised industry, be taken of Government compensation or grants taken directly to revenue account.

84. The calculation of permitted tariff increases in the gas and electricity supply industries should be made having regard to the likely demand and consumption in the light of their statutory obligation to meet that demand.

84A. (1) If the operation of a system of multi-part tariffs in the gas and electricity supply industries reduces the average revenue per unit, the following additional provisions apply. In this paragraph, "revenue" means average revenue per unit and "costs" means average costs per unit.

(a) revenue has fallen more than costs, prices may be increased by an amount sufficient to restore the average cash margin per unit at the base date;

(b) revenue has fallen and costs have risen, prices may be increased to the extent needed to restore revenue to the level at the base date and also by allowable cost increases; and

(c) prices have been increased and revenue has risen by less than costs have risen, prices may be increased to the extent needed to produce revenue which is equivalent to the revenue at the base date plus allowable cost increases incurred since the base date (including any cost increases already reflected in prices but excluding those which are to be reflected in future price increases to be made under any formula which allows for increases in the industry's prices on account of variation in costs).
85. Where the responsible Minister notifies the Commission that a price increase resulting from the application of paragraph 83 would have an unacceptable effect on the general level of prices, the Commission will limit the permitted price increase to the amount specified as acceptable by the Minister, but not so as to reduce the increase below what is permitted by paragraph 83(i)(a) or (i)(b) as appropriate or paragraphs 82 and 84A. Furthermore, any increase permitted under paragraph 83(i)(c) (restricted if that be the case, under this paragraph) may be charged after the end of the accounting year in which it is first charged, but the responsible Minister—

(i) may, from time to time, direct that the increase shall after the end of that accounting year be reduced by such amount or amounts as he shall specify; and

(ii) may direct that the increase shall be extinguished on such a date after the end of that accounting year as he shall specify.

86A. Where the finances of a nationalised industry are, as a result of any statute, reconstructed in or after 1974, the following provisions apply:

(i) where the base date for the purpose of calculating the allowable cost increases of the industry precedes the reconstruction and the date of implementation of the increased price follows the reconstruction, it shall be assumed for the purposes of the calculation that the reconstruction had taken effect; and

(ii) any changes arising from the reconstruction in the accounting practices of the industry or in the value of its assets and liabilities shall be taken into account in calculations under this Code.

Coal and steel

87. Prices charged by producers for coal, coal-based solid fuels, and most iron and steel products are outside the scope of the control by virtue of paragraph 6(ii). They are subject to international obligations through United Kingdom membership of the European Coal and Steel Community. Prices of non-ECSC iron and steel products are controlled like those of other manufactured products. Enterprises which produce both ECSC and non-ECSC iron and steel products will be subject to price control on the latter only. Prices of coal merchants and iron and steel merchants in the United Kingdom will be subject to the control on gross percentage margins and net profit margins applied to wholesaling and retailing enterprises.

Other public sector trading enterprises

88. The Commission will apply to proposals for price increases which are referred to them by Government Departments engaged in substantial trading operations the same principles as to proposals by the nationalised industries.

89. The Code applies to the prices of the following enterprises, according to the nature of the business of the undertaking, as it applies to the prices of private sector enterprises:
(a) trading services, (but not including on-street parking, or off-street parking where the charges are for periods of 4 hours or more) of local authorities, local authority joint boards, public utility undertakings and other similar public sector undertakings (not being a nationalised industry listed in paragraph 82 or an undertaking to which paragraph relates); and

(b) companies registered under the Companies Act which are wholly or partly owned by Her Majesty's Government or by a nationalised industry;

except that the net profit margin control does not apply to the trading services of local authorities.

(i) The charges for local authority trading services shall be calculated with regard to the established accounting practices of the enterprise concerned and to changes in those practices resulting from reorganisation. Local authorities may adjust their charges taken as a whole within the overall levels permitted by the Code to take account of the steps which they may take towards the restructuring of charges within their areas.

Water Undertakings

92(i) Water authorities and water undertakers in England and Wales must comply with their obligations under statute (including, in the case of a company, any agreement between a water authority and the company under section 12 of the Water Act 1973) but shall have regard to the principles of the Code and shall not make charges which, taken as a whole, are likely to result in a higher revenue in any accounting year than is required to comply with these obligations.

(ii) Subparagraph (i) applies to regional water boards or to water authorities in Scotland as it applies to water authorities in England and Wales, but in relation only to water supplied by meter.

(iii) The principles set out in paragraph 92(ii) above apply also to the enterprises covered by this paragraph.

Services

91. In general, paragraphs 3 to 70 of the Code apply to the prices of service enterprises as they apply to those of manufacturers, so that the system of allowable cost increases and the limitation on net profit margins as a percentage of sales or turnover apply to them. There will be an offset to allowable cost increases as a result of the abolition of Selective Employment Tax for service enterprises where this was paid without refund. Paragraphs 33 to 40 permit the Commission to calculate average allowable cost changes for certain small service enterprises where the circumstances are appropriate. Paragraph 89 would permit service enterprises with low profits to calculate their reference levels for the limit on net profit margins by reference either to turnover or capital employed. Paragraphs 92 to 106 deal with the application of the Code to some particular service sectors, and explain any modifications of the general principles which apply to them.
Banks, finance houses and similar enterprises

92. Most banks, finance houses and similar financial enterprises are engaged partly in business for which the charge is a rate of interest and partly in business for which the charge is of a different nature. Interest charges are not within the control. The other charges of these enterprises are subject to control. It will therefore be necessary to allocate costs and profits between the two classes of business for the purpose of the control on non-interest charges. Paragraph 35 applies.

93. For the purposes of the Code the enterprises described in paragraph 92 may treat as goods and services exported:
   (i) transactions in sterling with any person or body corporate resident outside the United Kingdom; and
   (ii) dealings in foreign currencies.

94. The provisions of the Code relating to allowable cost increases and to the limitation on net profit margins, defined in the case of these enterprises as in paragraphs 96 and 97, apply to their non-interest charges. These include commissions, fees and all similar charges. Where ad valorem rates are charged and these rates are charged generally, they must be treated as maxima. Enterprises will, however, be free to adjust their rates to match the credit status of a client provided such adjustments are in accordance with normal practice in such cases. In calculating charges these enterprises should take fully into account all factors including customers' balances which enter the costing of the class of transaction for which the charge is made. They should treat changes in these factors as the basis for increases or reductions in the charges in accordance with the Code.

95. The provisions of the Code will apply in full to charges in hire purchase, conditional sale and plant and machinery leasing agreements. Changes in the monthly Finance Houses Base Rate may be taken as the measure of increases or reductions in interest costs for the calculation of allowable cost increases, provided that rate is used consistently for all the purposes of the Code.

95A. In the case of an agreement for the leasing of any equipment on which the lessor's capital expenditure is more than £5,000, increases in rentals may be made under a formula, specified in the agreement, providing for variation of rentals on account of changes in the rate of corporation tax to the extent that the rate of return to the lessor on his capital expenditure net of corporation tax is not greater than it would have been if the rate of corporation tax had remained at that in force at the date of the agreement or, if the formula specifies another date for that purpose, at that date.

96. For the purposes of paragraph 57 "net profit margin" means:
   (i) in the case of enterprises undertaking hire purchase, conditional sale or plant and machinery leasing contracts, where either the greater part of the business of the enterprise consists of such contracts, or separate accounts can be produced for such contracts, net income from charges for this business less associated costs, including overheads, expressed as a proportion of average resources employed;
   (ii) in the case of all other enterprises of the kind described in paragraph 92 net income from charges (that is, gross income less costs, including associated overheads) expressed as a percentage of gross income (that is, total income from the transactions concerned).

97. In comparing net profit margins, as defined in paragraph 96, with the reference level, account should be taken of the total profitability of the non-interest business of the enterprise concerned in determining the permitted level of charges.
Construction

98. In determining prices for construction contracts enterprises should have regard to the Code as it applies to manufacturing enterprises. Of particular relevance to construction are paragraph 48, which applies to tenders for construction work to the extent that they are at fixed prices, and paragraphs 49 to 52, which apply to variation of price clauses, prime cost and cost reimbursement arrangements.

Transport

99. The Code applies to transport undertakings as it does to other service enterprises. Charges for international freight and passenger traffic are outside the control under paragraph 6(vi). Charges of nationalised transport undertakings, passenger transport authorities, local authority transport undertakings and transport companies owned by nationalised industries and their subsidiaries are governed by paragraphs 82 to 89.

100. Charges of private road haulage undertakings are subject to the provisions relating to allowable cost increases and to the limitations on net profit margins.

Vehicle sales and services

101. Charges for repair, maintenance and servicing of vehicles are subject to the provisions relating to allowable cost increases and to the limitation on net profit margins. The prices of vehicles sold by distributors, whether new or second-hand, are subject to the limitations on gross percentage margins and on net profit margins. Paragraph 17 applies to enterprises which both sell and maintain vehicles.

Hotels and catering enterprises

102. What is said in paragraph 91 applies to these enterprises also, in respect both of charges for food and drink and for accommodation.

Professional or other services

103. Fees and charges for professional or other services by firms or by individuals who are self-employed are governed as prices by the Code, except where the disbursements or expenses wholly and exclusively laid out or expended for the purposes of the enterprise concerned do not exceed 10 per cent of the profits or gains of that enterprise.

104. Where scales or rates of charges of general application, whether calculated per item, at an hourly rate or ad valorem, are in use in a profession under instructions or advice issued by a professional organisation, those scales or rates must be treated as maxima and may not be increased without the agreement of the Commission. Where rates above scale have normally been agreed and have become normal charges, such rates need not be reduced but the margin by which such rates exceed the scale may not be increased. The Commission will apply the provisions relating to allowable cost increases to increases in scales or rates. Those provisions will also apply to increases in fees or charges calculated on a time basis, except that the productivity deduction in paragraph 32 need not be applied where the fee or charge reflects only the labour cost of any employee's time.

105. Where there are no scales or rates of general application, the rates or scales charged for a professional service may not be increased except to reflect increases in allowable costs. Increases in labour costs under paragraph 28(d)(i)(a) may not include any element in respect of proprietors' or partners', as distinct from employees', time.
105. The limitation on net profit margins will apply to profits of firms or individuals providing professional or other services irrespective of the method by which fees are determined. Where the number of partners in a professional practice has changed as a result of the substitution of a partner for an employee, or of an employee for a partner, the reference level may be recalculated by reference to the changed number of partners. Paragraph 66 applies to amalgamations of partnerships. In applying the provisions relating to allowable cost increases to scales or rates of charges, the Commission will have regard to profit margins in the profession generally and will apply paragraphs 34, 59 and 68-69 as necessary.

Non-profit-making organisations

107. Subscriptions charged by organisations which:
   (i) exist for religious, charitable, educational, representational or recreational purposes; and
   (ii) are non-profit-making; and
   (iii) do not carry on a trade or business as their main activity, will not be controlled.

108. The Code will not apply to prices charged by an organisation satisfying the tests in paragraph 107, or by any properly authorised person acting on behalf of that organisation, if they are charged in order to raise funds for the purposes of the organisation, and involve no substantial or continuing competition with trading enterprises.

109. Except where they are outside the control under paragraph 108, prices charged in any trading activity carried on by an organisation which meets the requirements of paragraph 107 are governed by the Code, unless the customers of the trading activity are confined to members of the organisation.

General

110. Where the particular provisions of the Code cannot be directly applied to particular cases or sectors without modification, the Commission will, in exercising their functions, apply those provisions with such adaptations or modifications as appear to them to be necessary to give effect to the principles and objectives of the Code.
THE INVESTMENT RELIEF SCHEME

Manufacturing and Service Sectors

Qualifying Expenditure

1 The scheme permits enterprises in these sectors to reflect in their profit margins and prices a proportion of their estimated capital expenditure in a forward period of 12 months on new and secondhand plant and machinery (excluding vehicles) and on the construction of industrial buildings, but excluding expenditure on the acquisition of existing companies. To qualify, expenditure must relate to activities within the control; but where this cannot be precisely established, apportionment of total investment in plant, machinery and industrial buildings will be based upon the proportion of total turnover in the last completed year of account that was within the control.

2 The cash amount of the relief will be 17\% of the qualifying expenditure approved by the Board of the enterprise to be spent over a period of 12 months from a date following the introduction of the scheme. Any amounts expected to be received from the disposal of plant, machinery and industrial buildings during the same period will be deducted from qualifying expenditure under the scheme; but amounts relating to the sale, as a going concern, of parts of the enterprise to another enterprise need not be deducted.

Price Increases

3 Prices may be increased to the extent necessary to increase profits by the amount of the relief. Price increases will not
be restricted to products which are the direct subject of the qualifying investment. However, to avoid excessive price increases on any one product:—

a The price of any individual product, whether or not it forms part of a range of related products, may not be increased under the investment relief provisions by more than three times the average increase (which is represented by the permitted increase in the net profit margin reference level).

b Any investment relief price increase will be calculated on the assumption that it will apply for a period of 12 months from the date of implementation. The total amount of the relief should not, in consequence, be recouped in less than 12 months.

These price increases will not be taken into account in deciding whether the provisions of the Code on safeguards against low profit or erosion of profit may be invoked.

Increases in Net Profit Margin Reference Levels

4 Net profit margin reference levels may be increased to accommodate additional profit equivalent to the cash amount of the relief, calculated as a percentage of the estimated turnover of the enterprise in the forward-period of 12 months (beginning at any date after the revised Code takes effect) referred to in paragraph 1 above.

Example:

Enterprise with estimated turnover of £120m and forecast qualifying investment of £10m.

Cash amount of relief at 17½% of qualifying expenditure ……………………………………… £1.75m

Addition to reference level $\frac{1.75}{120} \times 100 \approx 1.45\%$

Thus a reference level of 8% will rise to ... 9.45%
Implementation: Category I and II Enterprises

5 Before benefiting from this relief – ie before reference levels may be increased, or prices may be increased, or both – manufacturing and service enterprises in these Categories will be required to give the Price Commission 56 days notice of the total cash amount of relief claimed, supported by evidence of Board approval of the planned qualifying investment; and of the manner in which it is proposed to apply this either in adjusting reference levels or in making the first price increases under the scheme, or both. Subsequent price increases under the scheme will be subject, for enterprises in these Categories, to 28 days prenotification. The information required is set out in more detail in Section C below.

Implementation: Other Categories

6 Enterprises below Category II are not required to prenotify or report increases in reference levels or price increases under this scheme; and such increases may be implemented as soon as the scheme comes into effect. Category III enterprises availing themselves of the relief will however be required to keep appropriate records which officials of the Price Commission will have power to inspect.

Implementation: General

7 Price increases under the scheme will not be subject to the "three month rule" in paragraph 26B of the Code.

8 The scheme only permits the cash amount of the relief to be recovered. Price increases permitted under the
scheme are therefore to be regarded as separate such charges which cannot attract further profit margins if prices are increased subsequently under other provisions of the Code.

B Distribution Enterprises

9 The provisions set out above and relating to net profit margins apply equally to distribution enterprises. Such enterprises may also make an addition to their permitted gross percentage margins, calculated as in the following example:

Example:

Enterprise with estimated turnover of £20 million and forecast qualifying investment of £2 million
Cash amount of relief at 17 1/2% of qualifying expenditure

Addition to gross percentage margin as ascertained under paragraph 74 of the Code

\[
\frac{\£350,000}{\£20.0m} \times 100 = 1.75\%
\]

Thus, a permitted gross percentage margin of 20% may rise to 21.75%.

10 Category II distributors will be required to submit a claim for relief to the Price Commission 56 days before putting their revised net and/or gross profit margins into effect. Category III distributors availing themselves of the relief will be required to keep appropriate records which the officials of the Price Commission will have power to inspect.

C Monitoring Procedures for all Enterprises

11 Initially, all Category I and II enterprises as defined for net profit margin purposes wishing to participate in the scheme will be required to furnish the following information to the Price Commission:
SECRET

a Name and address of unit for profit margin control

b Statements of:
   i expenditure on plant, machinery (excluding vehicles) and the construction of industrial buildings and the method of allocation between controlled and uncontrolled activities;
   ii sales within the control;

in each of the three previous years of account.

c Estimates of qualifying expenditure and the period of 12 months to which it relates, divided between the first and second periods of 6 months and supported by evidence of Board approval. Estimates of the receipts from disposals of such assets during the same period will also be required.

d Cash amount of the relief claimed, based on 17 1/2% of qualifying expenditure net of proceeds of disposals.

e Estimated sales within the control during the period of 12 months used in calculating the investment relief.

f Claimed addition to net profit margin reference level and, for distributors, claimed addition to gross percentage margin.

12 In addition to the above, manufacturers and service enterprises prenotifying price increases based on investment relief (see also paragraph 5 above) should provide the following information:-
a description of product or range of products
b Date and amount of proposed price increase
c Forecast yield from the price increase over 12 months from implementation.

13 At regular intervals in the course of the relief year, Category I and II enterprises benefitting from the investment relief will be required to re-affirm to the Price Commission their intention to carry out their submitted programme of investment in the relief year. Six months after the date on which a Category I or II enterprise first benefits from the relief, the enterprise for profit margin purposes will be required to submit a report to the Commission containing the following information:

   a Actual qualifying expenditure (and disposals) in the first 6 months.
   b Actual sales within the control during the first 6 months.
   c Amounts recouped from price increases under the scheme in the first 6 months.
   d Estimated qualifying expenditure (revised as necessary) in the second 6 months.
   e Estimated sales within the control (revised as necessary) during the second 6 months.
   f Estimated future recoupment from the price increases already made, assuming that they remain in operation for the full 12 months from the date of implementation.
   g A calculation of the shortfall or excess in the amount of relief taken, together with proposals for correcting any excess, eg by price reductions or by foregoing price increases that would otherwise be permissible.
Items (c) and (f) above do not apply to distributors.

14 At the end of the relief year, the procedure for the 6-monthly report described in paragraph 13 above will need to be repeated.
These Orders impose obligations on companies to prenotify price increases, make regular reports to the Price Commission or to keep specified records, according to the size and activity of the company concerned. The Price Commission thereby able to obtain the information necessary to examine proposed price increases and to monitor the observance of the Code.

The Government do not propose to make any major change to the structure of notification, reporting and record keeping which has been built up over the life of price controls. However, a considerable number of amendments to the Orders will be required in consequence of the proposed changes to the Code. In addition, five significant changes are to be made to the Orders which do not flow directly from the proposed amendments to the Code. They are as follows:

(a) Identification of Category III firms

Category III firms are defined in the Information Order (SI 1973/1787) as:

- a manufacturers with sales in the last year of account of £1m-£5m
- b distributors with sales of £250,000-£1m
- c providers of services with sales of £250,000-£5m
- d providers of construction services with sales of £1m-£5m
- e providers of professional services with sales of £100,000-£500,000
- f banks, finance houses and similar enterprises with outstanding balances of more than £10m but with gross sterling deposits of £200m or less.

They are at present required to keep records including the information specified in Part I of the Schedule to the Information Order. The Government intend to require that before 1 February 1975, all Category III firms should send to the Price Commission a return giving particulars of their name and address, the name and address of any subsidiary and the sales in the latest complete year of account for each activity, including those of any subsidiaries. The information required will be the minimum necessary to enable the regional staff of the Price Commission to direct their monitoring activities more towards the key areas in this very important section of industry.

(b) Exemption of minor activities from pre-notification

Article 6 of the Notification Order (SI 1973/1786) provides for the exemption from pre-notification of the minor and separate activities of pre-notifying firms. At present the maximum value for each exempted activity is set at £5m for Category I firms (manufacturers with annual sales of over £30m and service enterprises with annual sales of over £20m) but at only £500,000 for Category II firms (manufacturers with sales of £5m-£50m and service enterprises with sales of £5-£20m). Thus there is a very pronounced difference in the position under this Article between, for example, manufacturers with sales of £50m and £100m. The Government intend to even out this disparity by allowing the exemption for minor activities of Category II companies, under the conditions currently specified in the Notification Order, provided that the value of each activity does not exceed 10% of the total sales of the enterprise.

(c) Exemptions for sales within a group of companies

Under Article 9 of the Notification Order sales within a group of companies are at present exempt from the obligation to pre-notify price increases. The Government intend to reduce the scope of this exemption to...
prevent a manufacturer from escaping from the requirement to pre-notify price increases by means of setting up a distribution company within the group. The exemption is therefore to be limited to sales within a group where both buyer and seller are manufacturers or providers of services.

(d) Reclassification of scrap processors and small bakehouses

In response to representations from the trade associations concerned, the Government propose to change the classification, for price control purposes, of scrap processors and of bakers manufacturing in small bakehouses attached to retail establishments. Both categories will be transferred from the distribution to the manufacturing sector, and the Code rules for manufacturers will apply.

(e) Local authorities

Whilst the Code applies generally to the "trading services" of local authorities, it has proved difficult to define more precisely the services for which local authorities should be obliged to pre-notify price increases and make regular reports to the Price Commission. Different authorities may provide different ranges of services and may have different views of the degree to which these services should be operated on commercial lines. Taking account of the need to avoid imposing unnecessary administrative burdens on local authorities, the Government therefore propose that the obligations of local authorities under the Notification and Information Orders should be confined to the keeping of the appropriate records, by authorities down by district council level, for any service covered by the Orders which is provided by the authority concerned. The Price Commission will be free to undertake inspections of these records and to investigate complaints about charges for any of these services which it considers to be operated as trading services by the local authority concerned.

COUNTER-INFLATION (MODIFICATION OF CIVIL AVIATION ACT 1971) ORDER

An Order was made on 26 April 1973 which modified the Civil Aviation Act 1971 in such a way as to require the Civil Aviation Authority to have regard to the Price Code in determining charges for carriage by air within the United Kingdom. The Authority prescribes a common tariff for all airlines operating services on a route. Some routes are served both by British Airways and by other airlines, and a potential problem lay in the fact that British Airways, as a nationalised industry, was not required to observe the same provisions in the Price Code as were private sector airlines. To avoid this anomaly the Order is to be amended: the Authority will in future have regard to the provisions of the Code but subject to the criteria set out in Policy Guidance Cmd 4899.
THE SIMONSTOWN AGREEMENTS

Memorandum by the Secretary of State for Defence

1. The Foreign and Commonwealth Secretary in his memorandum C(74) 119 proposed that I should give my views on the military consequences of closing Simonstown and the alternative facilities that would be required. In the light of the Cabinet's discussion on Thursday, 31 October (CC(74) 42nd Conclusions), I am circulating this note for the information of my Cabinet colleagues and as background to our further deliberations.

THE AGREEMENTS

2. The Simonstown Agreements provide for:
   
   a. The continued use by the Royal Navy in peace and war of the Naval Base at Simonstown. The facilities include berthing, maintenance, docking, fuel and access to naval communications. The facilities could be used in a war not involving South Africa only by mutual agreement.

   b. Co-operation in the defence of sea routes around Southern Africa. Commander-in-Chief Fleet is responsible for joint maritime war planning and for the organisation and conduct of combined training in peacetime. In war he is responsible for the conduct of maritime operations and has operational command of all forces assigned to the area by Britain and South Africa.

CURRENT USE BY ROYAL NAVY

3. In peacetime the Agreements enable us - at no cost to ourselves - to deploy ships or groups of ships in the South Atlantic and Eastwards of the Cape with a minimum of afloat support.

4. They provide us with our only docking and maintenance facilities between Gibraltar and Singapore - a distance of 10,400 nautical miles via the Cape - and with one of the very few ports around the world where nuclear-powered submarines are received.
5. South African ports also provide rest and recreation facilities for the crews of our ships - especially those engaged on the Beira patrol by means of which we fulfil our United Nations responsibility in relation to Rhodesia - of a kind which are not available elsewhere in the area.

6. Diego Garcia is not a substitute for Simonstown, nor are Black African ports, such as Mombasa, even if we could rely upon their use indefinitely.

7. Since February 1974 at least six Royal Navy ships have used shore facilities at Simonstown for necessary repairs which could not have been done elsewhere in the area.

STRATEGIC FACTORS

8. Unlike Western Europe the Soviet Union has no substantial shipping or vital trading interests to protect in the Indian Ocean.

9. Nevertheless Soviet influence in the area is growing. In 1970 there was an average of only 9 Soviet naval units in the Indian Ocean; their average deployment in 1974 was 30 ships.

10. The Soviet Navy has also established operating facilities at Berbera in Somalia and at Aden. Their ability to increase their forces substantially has also been demonstrated and the reopening of the Suez Canal will add flexibility to their deployments.

11. The possible need for British participation in maritime operations in the focal area of the Cape arises from the need to preserve an evident capability, in the face of the Soviet threat, to assist in safeguarding supplies to this country and to our European allies in tension or war. For example, over 1000 merchant ships on average pass the Cape each month, of which about half are tankers. Of these some 180 and 90 respectively are United Kingdom Flag ships.

12. Even after North Sea oil is being fully exploited, Western Europe will still be dependent for substantial crude supplies coming round the Cape in tankers too large to transit the Suez Canal.

13. Against this background the value of the Simonstown arrangements is two-fold:

a. The guaranteed availability of good base facilities, including a dry dock, greatly facilitates the operation of British and in wartime Allied warhips East of the Cape. They require less elaborate afloat support and there is less likelihood, should some breakdown occur, of embarrassing difficulty in dealing with it.
b. More importantly, they offer the only means by which the West can realistically hope to safeguard shipping routes around Southern Africa. Without them it would not be possible for us to play our part in mounting a credible defence of shipping in the area and this fact would be recognised by friend and foe alike.

14. The Agreements envisage the defence of shipping as comprising: firstly, the provision of communications, command and control, base, bunkering and repair facilities for the Royal Navy (and other Allied maritime forces) operating in the area; secondly, the maintenance of the efficiency of the South African Navy so that it could work effectively with the Royal Navy; and, thirdly, co-operation with Allied and friendly forces.

15. We must expect opposition to termination of the Agreements from the major British shipping interests. The National Union of Seamen in a letter to "The Times" published on 7 November has already expressed concern at the possibility that the Simonstown facilities should be denied to us.

MILITARY CONSEQUENCES OF ABROGATION

16. Termination of the Agreements would relieve the South Africans of their obligation to maintain up to date facilities for our warships at Simonstown. It would also lessen the importance which they attach to the South African Navy and we would expect a diversion of their resources to other military purposes.

17. In consequence the entire arrangements for the defence of Allied shipping on the Cape routes, including our national responsibility for the Naval Control of Merchant Shipping (NCS) in an emergency, could be undermined.

18. These arrangements are a significant feature of NATO's and SACLANT's plans for the defence of shipping outside the existing NATO boundaries. NATO's requirement for an NCS organisation outside the NATO area was established in 1959 and in 1962 Britain was designated the Co-ordinating Nation in the sea areas around the Southern African Continent.

19. Termination would not, however, prevent us from deploying ships into the Indian Ocean; though this would become less convenient and more expensive.

WIDER CONSIDERATIONS

20. The significance of these arrangements in the light of the Defence Review is now to be discussed with our Allies.
21. Although the Agreements bring us political embarrassment in some quarters, they also confer some standing upon us in the eyes of our Allies, especially the Americans who look to us to share some of the burden which they carry in the Indian Ocean; and, I believe, in the eyes of the Shah, who is also concerned at the build-up of Soviet maritime strength in the area and whose Navy makes use of the Simonstown facilities.

22. The value of these Agreements, and our relations with South Africa as a whole, must also be viewed against the background of these wider considerations, and of their possible value in the longer term future.

R M

Ministry of Defence

8 November 1974
CABINET

DEFENCE REVIEW - ECONOMIC AND EMPLOYMENT IMPLICATIONS

Memorandum by the Central Policy Review Staff

1. At their meeting on 31 October (CC(74) 42nd Conclusions) the Cabinet instructed the Central Policy Review Staff, in consultation with the Departments concerned, to prepare studies on the impact on the economy broadly of the resource demands of defence and on the implications of the proposed reductions for the shipbuilding and aerospace industries.

2. Our reports are attached to this note; they have been prepared in consultation with the Treasury, the Departments of Employment and Industry, and the Ministry of Defence.

3. Study of the impact on the economy of defence expenditure leads to the following conclusions:

   a. In the 1950s, following the Korean War, United Kingdom defence expenditure rose rapidly and this expansion adversely affected exports, investment and economic growth.

   b. How much our growth performance during the past 10-15 years has been affected by the level of defence expenditure is much more uncertain; it is arguable that, if industry had been more dynamic, it could have created the productive capacity and skills necessary for faster growth while sustaining a defence burden which was in fact falling; on the other hand, it can be argued that the kind of shifts which would have been required to move towards faster growth were made more difficult by the concentration of skill and effort on defence.

   c. The economic situation requires a major shift of resources into the balance of payments and productive investment over the next five years; redeployment of resources from defence has an important part to play in this process. Moreover, given the fact that defence is a large consumer of skilled manpower, resources released from it could make a particular contribution to meeting the present and prospective shortage.
d. When compared for example with the reduction of defence expenditure between 1964 and 1970, the scale of the rundown should be, in general, manageable.

4. The employment implications of the proposed reductions for the defence industries are as follows:

a. Compared with previous plans, the defence review will make available to the labour market by 1978-79 some 44,000 servicemen and 20,000 United Kingdom based civil servants; by 1978-79 10,000 workers will be released from the defence industries, with a further 35,000 by 1983-84. Thus the total reductions, service and civilian, will be of the order of 74,000 by 1978-79 and a further 35,000 by 1983-84.

b. Decisions on the mix of type 22 frigates and type 42 destroyers are needed before the employment implications can be fully evaluated. A major cut in the frigate programme would threaten the future of Yarrows on Clydeside, where the effects would be felt as early as next year; reduction in the destroyer programme would produce no job losses in Swan Hunter (Tyneside) and Cammell Laird (Merseyside) but these two firms would no longer need, as was previously expected by the Ministry of Defence, to expand their work force in the years ahead for warship building.

c. Reductions in the previously planned defence aircraft programme will produce difficulties for Hawker Siddeley Aviation at Bitteswell (Coventry) and Manchester, for the British Aircraft Corporation (BAC), for Westlands at Yeovil, and for Rolls Royce (71) particularly in the Watford area. The effects, however, will be much less significant than the general decline in the aircraft industry, both military and civil, which was already in prospect before this review began.

d. In the guided weapon and electronics programmes, the loss of Sea Skua would leave BAC(GW) with no development project in prospect; in addition Shorts would lose about 300 jobs in Belfast.

e. Employment in the Royal Ordnance Factories will be affected by the defence review, but potential overseas sales may offset most of the employment implications.
f. Special efforts will therefore need to be made in a few areas, which cannot be precisely identified as yet, if the defence review is not to lead to local unemployment. In general, adequate retraining and resettlement schemes should be sufficient to ensure that the resources released by the defence review are used productively.

Cabinet Office
15 November 1974
Defence and the Economy

In 1973-74 defence expenditure was estimated to account for \( \frac{5}{2} \% \) of total available output (i.e. Gross National Product). This compares with about \( \frac{6}{5} \% \) in 1963-64 and \( \frac{5}{4} \% \) in 1970-71. Unlike many other forms of public expenditure, defence makes significant demands on industrial output. In 1970 (the last year for which figures are available of both the direct and indirect effects of defence procurement) it took \( \frac{4}{9} \% \) of the net output of the aerospace industry, \( \frac{3}{9} \% \) of shipbuilding and marine engineering and \( \frac{6}{10} \% \) of total engineering. Within the latter total defence accounted for \( \frac{17}{10} \% \) of the net output of electronics and telecommunications, \( \frac{7}{10} \% \) of instrument engineering and \( \frac{11}{10} \% \) of other mechanical engineering. By way of contrast other forms of current expenditure by public authorities make much heavier use of the service industries.

2. Defence also makes a call on the balance of payments; allowing for arms exports and the import content of domestically produced equipment, as well as imports of military equipment and the costs of stationing troops abroad, the annual deficit is some £250m.

3. Defence, which is rather more labour-intensive than total final output, is also a user of skilled manpower, much of it directly suitable for industry and currently in short supply. Its direct and indirect labour requirements absorbed about \( \frac{5}{10} \% \) of the total labour force in 1970.

Defence and Economic Growth

4. During the past 25 years:

(a) the share of GNP devoted to defence expenditure in the UK has been higher than that in any other major western industrialised country apart from the United States, and apart from France during the later 1950s and early 1960s. The share, nevertheless, declined progressively between the mid-1950s and the early 1970s:

(b) the UK’s rate of economic growth, as measured by the rate of increase of GDP per person employed, has been slower than that of any other major industrial country apart from the United States. It was, nevertheless, somewhat faster in the 1960s than in the 1950s, and faster than the pre-war trend.

5. This prompts the question: how far is the UK’s slow rate of productivity increase the consequence of a disproportionately high level of defence expenditure? No-one can give an unequivocal answer to this question. The factors explaining differences between rates of productivity growth in different industrialised countries are complex and are not fully understood.
6. It is certainly the case, however, that the very large increase in the UK's defence expenditure which followed the outbreak of the Korean War, when it was increased to 11% of GNP, had very serious consequences. These were mainly caused by the attempt to raise defence expenditure by a large amount in a relatively short period of time. The burden this imposed on the engineering industries:

(a) reduced our capacity to increase productive investment on the scale necessary for faster growth;

(b) diverted to defence resources which might otherwise have been used to increase engineering exports: in consequence, countries with smaller defence burdens — e.g. Germany, Japan and Italy — were able to gain strong competitive advantages in international trade.

7. The effects of a high level of defence expenditure in the period 1950-55 were therefore prejudicial to the investment and export performance which we would have needed if we were to have matched the growth achievements of continental Europe and Japan.

8. It is more difficult to show that in recent years our above average expenditure on defence has been a major cause of our poor economic performance. In part this is because the share of defence expenditure in GNP has been falling, so that some scarce skills and industrial capacity have been released for other purposes. In part it is because over a period of 10 to 15 years one would expect in a dynamic society scarce skills or capacity to be made good by investment and training; our engineering industries could then have expanded productive capacity and productivity more rapidly and have simultaneously been able to meet the claims of defence expenditure and supply export markets and domestic investment demands. If this has not happened one has to look to the general causes of lack of flexibility and dynamism in our economy rather than to a defence expenditure somewhat above average.

9. On the other hand, it is sometimes argued that defence expenditure has positive advantages for economic growth. Defence involves R & D in advanced technology: this provides spin-off for civil technology. While this is true in principle, and may have occurred in some instances in the United States, there is little evidence that the UK has enjoyed any significant advantages from this kind of technological spin-off.

Defence and Inflation

10. In so far as a higher defence burden means a higher tax burden, and the tax burden is a contributory cause of pressure for higher money wages, defence expenditure could be regarded as a contributory cause of cost inflation. But in this respect its effects are not very different from other forms of public expenditure.

The General Implications of the Defence Review

11. It is proposed that defence expenditure as a proportion of GNP be reduced from its 1973-74 level of 5½% to 4½% by 1984. This would involve savings on the 1974 Long-Term Costings of £475m in 1973-79 and £750m in 1983-84, at 1974 prices. Defence expenditure would, as a result, be at about the same level in real terms as it is now and yet the saving of £750m in 1983-84 would correspond to about 1½% of GNP.
12. The general management of the economy over the next 5-10 years requires this kind of restraint on defence expenditure. Over the next 5 years, the most urgent tasks are to get sufficient resources into the current account of the balance of payments to get back into balance by around 1979, and to increase productive investment. The needs of the balance of payments and investment are such that the growth of both public expenditure and private consumption need to be severely restrained. Even if defence expenditure is kept roughly constant in real terms, as the defence review proposes, the rate of increase in other public expenditure programmes and in private consumption will be so slow as to create serious difficulties for the management of incomes and prices and for a lot of public services.

13. Directly or indirectly, defence employs a large amount of skilled engineering labour and productive capacity. Redeployment of labour and investment that would otherwise have gone to defence could make an effective contribution to increasing exports and productive capacity.

14. It remains to be seen how easily a resource shift of the proposed order of magnitude could be made. The proposals in O(74)116 require service strengths to fall by some 44,000 compared with previous plans; this would be achieved by 1978-79, by some cut-back in recruitment, by not extending engagements, by normal wastage and by unavoidable redundancies of up to 12,000. Those leaving the services during this period will be older and more skilled than the average ex-serviceman; their skills may not, however, be those required by industry (aircrew and aircraft maintenance engineers for example) and an effective retraining programme will therefore be needed as well as adequate redundancy terms to ease the transition. There would also be a reduction by 1978-79 of 20,000 UK-based civil servants (10,000 non-industrial and 10,000 industrial); wastage should deal with most of the non-industrial staff but some 6,500 industrial civil servants might be declared redundant and could require retraining before they could be employed elsewhere. Finally, direct employment in the defence industries is likely to fall by some 10,000 by 1978-79 and 45,000 by 1983-84.

15. While some time is needed for the effective redeployment of resources, redeployment on the scale discussed above should not cause overall difficulties. After World War II we carried out an effective redeployment of resources from war production on a much bigger scale than that now at issue; and historically there have been even more massive shifts from one peace-time industry to another. During the period 1964-1970 when the Labour Government were last in office, Service strengths were reduced by 54,000 and civilians employed by MOD were reduced by 30,000. At present there is a severe shortage of some types of skilled engineering manpower which is preventing the general and mechanical engineering industries from exploiting fully the export opportunities open to them; and the latest medium-term industrial assessment foresees a continuation of this situation to at least the end of 1975. The release of skilled manpower from the defence industries could help to alleviate this problem.

16. A shift of the magnitude now envisaged will, however, cause problems of transition for particular groups of employees and for specific firms; the development areas may also require special consideration. But it should be possible to identify these problems in advance and with appropriate planning, both of the implementation of defence cuts and of the re-employment measures, to reduce to a minimum personal hardship and waste of resources. If this is done, a progressive reduction in the proportion of GNP devoted to defence expenditure should result in an efficient switching of resources.
DEFENCE REVIEW - INDUSTRIAL EMPLOYMENT IMPLICATIONS

At this stage of the Defence Review it is possible to identify only the broad implications for industrial employment of the proposed changes in the defence equipment programme. There are two main reasons for the lack of precision:

(a) The pattern of expenditure on equipment cannot be determined in detail until the Ministry of Defence has a decision on the level of resources to be made available; even on the basis set out in G(74)116, more time is required to settle the internal composition of the programme.

(b) At any level of expenditure, a 10 year equipment programme will contain a considerable degree of uncertainty towards the end of the period; the loading on the industry in the 1980s will depend on the outcome of development work in the late 1970s and on changes in the operational requirements of the Services during that time.

The following paragraphs set out the best estimates which can be made, both in total and by specific industry, of the employment implications of the Defence Review.

2. The current level of industrial employment, directly associated with MOD requirements, is estimated at 240,000. On the assumption that productivity in the defense industry improves broadly in accordance with national trends, at about 3% a year, the forecast level of employment in the industry would, on the basis of G(74)116, fall by 10,000 by 1978-79 and 45,000 by 1983-84. Much of this reduction would be likely to be brought about by wastage and retirements. How far it would result in actual redundancies cannot be assessed at this stage - much depends on the general state of the economy and the outlook for particular defence firms in other fields at the time.

3. Alterations to the defence equipment programme will also affect employment in ancillary industries, but the effect cannot be quantified. Thus, the overall decline from the current level of employment on defence equipment of 10,000 jobs by 1978-79 and 45,000 jobs by 1983-84 may be an underestimate. In addition it conceals considerably higher percentage reductions in certain sectors, in some cases in earlier years.

Shipbuilding and repairing

4. The way in which the warship-building firms will be affected by the proposed cuts depends on decisions not yet taken on the mix of type 22 frigate and type 42 destroyer requirements. The worst case from the employment point of view would be a major cut in the type 22 programme, which would threaten the future of Yarrows on Clydeside, which currently employs over 5,000 men, and affect an unknown number of ancillary workers in the area. The company would feel the effects as early as next year. If the axe fell more heavily on the type 42 programme, the effects would be felt by Swan Hunter (Tyneside) and Cammell Laird (Merseyside); there would however be no job losses compared with the present loading, but prospects would be considerably diminished by comparison with MOD's previous...
ten-year forecast. In addition, the decision to carry out more naval ship repair work in the Royal Naval dockyards could mean the loss of about 1,000 jobs, mainly on the Tyne and the Clyde, with some reductions on Merseyside and in Falmouth.

5. UK shipbuilding currently employs some 70,000 and ship repairing 26,000. Decisions on the frigate/destroyer mix could have serious implications for Yarrow but the overall reduction in job opportunities in shipbuilding generally as a result of the defence review should, in itself, prove manageable. The defence implications must however be taken into account in deciding the organisation and objectives for the nationalised shipbuilding and ship repair industry.

Aircraft

6. Before the current defence review began it was estimated that there would be a substantial decline on military aircraft construction as existing projects tail off. Hawker Siddeley Aviation (HSA) will be worst hit. They currently employ nearly 15,000 people on military projects, but this will fall to between 5,500 and 6,500 (depending on how successful exports by the early 1980s and less thereafter; the main rundown would be at their Manchester factories (which are also sensitive to civil aircraft changes). Employment in the British Aircraft Corporation (BAC) on military work, predominately in the Preston area, might have risen from the current level of about 12,000 to about 15,000 (possibly more if exports went well) by the end of 1976, falling to around 11,000 by 1983. (BAC's civil side would fall by the early 1980s from about 12,000 to a negligible number, as the Concorde programme was completed).

7. The defence cuts now proposed will involve the cancellation of the Argosy rear crew trainer conversion, involving the loss of some 500 manufacturing jobs during the next 12 months, which could affect the viability of the HSA factory at Bitteswell, Coventry, (current employment 1,200). Other defence cuts now proposed could bring forward into 1975 the loss of some 4,000 jobs elsewhere in HSA, mainly at Manchester. BAC's work load on military design and production is now likely to rise from about 12,000 to a peak of 14,000 in 1976 falling to around 10,000 by 1983.

8. Westland's viability as a designer of helicopters will be seriously affected by the proposed measures, which include cancellation of the Wessex replacement, reduction in the standard of the Sea King replacement, and cut in requirements for Lynx and Gazelle. Even assuming no improvement in productivity, Westland's workforce on military projects would, it is thought, come down from 6,900 to 4,200 by 1981. The cuts in helicopter requirements will entail a reduction in engine orders on the Rolls Royce Small Engine Division; current employment of 3,200 might be reduced to 2,300 by 1980-81 and this could result in the closure of the Division's factory in the Waff Stall area and the transfer of the rest of the work to other locations. In addition Rolls Royce employment on other military work would probably be cut by about 4,000 from an expected level on military work of some 21,000 in the early 1980s.

9. Apart from the effect on Westland which could lead to difficult redundancy problems in the Yeovil area, the effects of the defence review on the aircraft industry are much less significant than the general rundown of activity which had already been identified, both on the military and civil
sides, before the review began. They will, however, be an additional complication in determining the structure and objectives of the nationalised industry.

Guided weapons and electronics

10. The future loading of the main guided weapons firms (Hawker Siddeley Dynamics and BAC) depends to a large extent on whether orders for service equipment in the next year or two are placed with them or whether they have to be placed with overseas suppliers. The loss of the Sea Skua project will leave BAC(GW) with no development project in prospect. Reductions in orders for Blowpipe, under the defence cuts now proposed, are likely to entail a reduction of one-third of those employed on guided weapons at Shorts in Belfast (potential job losses of 300). In the electronics industry the firms most likely to be affected are not in areas of high unemployment. For example: Marconi Radar Systems, Leicester; Ferranti, Oldham (an intermediate area); Plessey, Ilford, Addlestone, and Cowes; Electric and Musical Industries, Wells; and Marconi Space and Defence Systems, Stanmore, Frimley, and Portsmouth (although the company's factory at Hillend, Edinburgh, may be affected to some extent).

Vehicles and conventional armaments

11. Cuts in vehicle requirements might lead to a reduction in employment at ROF Leeds from 1,600 to 1,100; in isolation, this could affect the factory's viability, but possible large overseas orders could more than offset the cuts resulting from the defence review. Reductions in conventional armaments requirements could mean a cut of 300 in the labour force of the ROFs, the worst affected being Chorley. Both Leeds and Chorley are in intermediate areas. (The employees are mainly industrial civil servants and their numbers are not therefore included in para 2).
C(74) 133

18 November, 1974

CABINET

DEFENCE REVIEW: PARLIAMENTARY STATEMENT

Note by the Secretary of the Cabinet

By direction of the Prime Minister a draft statement on the Defence Review has been prepared by the Secretariat. It is based on the proposals in C(74) 116 and is annexed herewith. It is envisaged that it will be discussed at Cabinet on Monday 25 November; but is circulated as background to the further discussion of the Defence Review which the Cabinet will be having on Wednesday 20 November.

JOHN HUNT

Cabinet Office

18 November 1974
1. On 21 March I announced the start of the most extensive and thorough review of our system of defence ever undertaken by a British Government in peacetime.

2. The proposals which I will now outline are the result of a careful study of all the relevant considerations - defence, political, industrial and financial. They are designed for the circumstances which we must expect over the next ten years. They take account of our economic situation: but they also pay full regard to the threat to our national security, the overriding importance of NATO, the crucial contribution made by the United States, our position as a leading European power and our responsibilities overseas. They will provide for a modern and effective defence structure and will make a significant contribution to establishing our economic health and thus to strengthening the alliance.

3. The Government has decided that it can reduce defence expenditure as a proportion of GNP from its present level of 5½ per cent to 4½ per cent over the next ten years. The long range estimates of defence expenditure as they stood in March 1974 would have amounted to 6 per cent of GNP in 1978-79 and 5½ per cent in 1983-84. By comparison with those plans, our decision will save £475 million a year by 1978-79 and some £750 million a year by 1983-84 - or a total over the whole period up to that date of about £4,300 million. This is fully consistent with our repeated pledges to reduce the cost of defence as a proportion of our national resources.

4. In addition to deciding the general scale of the programme needed to meet our future defence requirements and the level of resources we can devote to defence, the Government has reached provisional conclusions about the force levels involved and the implications for our commitments, for the armed forces and for industry. We are today beginning our consultations with our allies in NATO. These consultations will be thorough and genuine. They are likely to last into the New Year. We have also approached our Commonwealth partners concerned and the other governments in other parts of the world who will or might be affected.
5. First I will describe the general principles that we have followed in conducting the review. NATO is the linchpin of British security and will remain the first charge on the resources available for defence. We therefore propose to concentrate as a first priority upon those areas in which we believe that we can most effectively contribute to the security of the Alliance and of the United Kingdom itself. These consist of our contributions of land and air forces in the Central Region of Europe; of sea and air forces to the Eastern Atlantic and Channel Commands; and in the defence of the United Kingdom and its immediate approaches. We shall also maintain the effectiveness of our Polaris force.

6. We shall, however, be discussing with our NATO allies all aspects of our contribution, including particularly our force declarations to NATO in the Mediterranean and the specialist reinforcement forces that we committed to the Alliance in 1968. In the NATO area we propose to maintain our land and air contribution to the Allied Command Europe Mobile Force, but to reduce our other NATO force declarations to an airportable Brigade Group and a Royal Marine Commando Group, with the necessary accompanying sea and air elements. These latter declarations would be available for the Central Region or the Northern Flank of NATO, with the Commando Group specially trained and equipped for arctic warfare.

7. The priority we are giving to our NATO contribution necessarily requires a contraction in our commitments outside the Alliance. We have reviewed these commitments case by case, bearing particularly in mind the decisions taken by the Labour Government in 1968 about the reduction of the British presence East of Suez. We have concluded that substantial reductions in our forces and defence facilities can be made. But we shall not act precipitately and we shall discuss our proposals in detail with our allies and partners in the Commonwealth and elsewhere before taking final decisions, recognising that the timing and method of the changes we propose may be of particular importance.

8. Subject to these provisos I wish to tell the House what we have in mind. We shall, of course, maintain our obligations towards our remaining dependent territories. We intend to keep our forces in Hong Kong, although we propose to make some reductions in them and to seek from the Hong Kong Government a larger percentage of their cost when the present cost-sharing agreement runs out in 1976. In accordance with the military facilities agreement concluded
in 1972 with the Government of Malta, we shall remain there until 1979. In Cyprus, we propose to make some early reductions, particularly in our air forces stationed there. We propose to withdraw our forces stationed under the Five Power Defence Agreement in South East Asia with the exception of a small group which we shall continue to contribute to the Integrated Air Defence System. The consultative provisions of the Five Power Defence Agreement would however remain in force and it would certainly be our intention to maintain close links with the armed forces and defence authorities of our partners. We would, of course, maintain our membership of CENTO and SEATO but without declaring specific forces to either. We propose to withdraw from Brunei the Gurkha Battalion at present stationed there. We would withdraw our forces from Gan and Mauritius. We do not think it would be right in present circumstances to make any changes in the arrangements we have with the Sultan of Oman. We intend to enter into negotiations with the South African Government with a view to terminating the Simonstown Agreement.

9. Given the effects of these decisions in the Indian Ocean area and the Soviet naval presence there, we have decided to agree to proposals from the United States Government for a relatively modest expansion of the facilities on the island of Diego Garcia which they enjoy, jointly with us, under an existing agreement with Her Majesty's Government. Their use of the facilities other than for routine purposes will however be a matter for joint decision of the two Governments. We and the United States Government have also agreed to pursue consultations with the aim of developing realistic progress towards arms limitation in the Indian Ocean.

10. In working out the implications of these principles in terms of force levels and their effects on the three Services, priority has been given to maintaining as far as possible the level and quality of our front-line forces. We shall equip them in a manner commensurate with their roles and responsibilities, and restructure and reduce the support area to match the new size and shape of the front-line. The effects of our proposals on the forward plans of the three Services as they stood in March 1974 would be broadly as follows.

11. The Royal Navy's planned numbers of frigates, destroyers and mine countermeasures vessels would be reduced by about a seventh; of conventional submarines by a quarter; and of afloat support by a third. Planned new ship
construction would be reduced by about a quarter, including the abandonment of plans to replace our amphibious ships with new purpose-built vessels; and all ship refitting would be concentrated on the Royal Dockyards, all of which will be retained. The nuclear submarine and the cruiser programmes would be maintained. One Royal Marine Commando would be disbanded.

12. The Army’s re-equipment plans would be substantially modified to reduce the growth of their cost. Measures would include the cancellation of the Vixen wheeled reconnaissance vehicle; withdrawal from the collaborative RSRO project for long-range rocket artillery; and reductions in the planned purchases of the Gazelle reconnaissance vehicle. We shall nevertheless ensure that our troops continue to have equipment of the standard needed for their front-line NATO tasks.

13. The Government attaches great importance to the negotiations between NATO and the Warsaw Pact countries on the mutual reduction of forces and armaments in Central Europe. We are committed to seeking an outcome which, while preserving undiminished security for all the countries concerned, would help to create a more stable relationship in the area at a lower level of forces. We hope that the negotiations will be successful in achieving this objective. We do not propose, however, in advance of mutual and balanced force reductions, to reduce the forces which we maintain in Germany in accordance with our Brussels Treaty obligations. In adjusting the size and shape of the Army to meet the framework of priorities I have described and the demands of economy, the Government will aim at a carefully planned restructuring which will take full account of the regimental system and the loyalties and traditions it enshrines. The Brigade of Gurkhas will be retained, primarily for service in Hong Kong. We shall maintain the size and roles of the Territorial and Army Volunteer Reserve.

14. In the case of the Royal Air Force, we intend to preserve, and in some instances improve, the combat air forces committed to NATO on the Continent and in the United Kingdom, and to continue with the MRCA collaborative programme, though we may have to make some reductions in the planned rate of deliveries over the period. However, in accordance with the revised tasks envisaged, the RAF transport force would be progressively reduced by a half and the planned helicopter force by a quarter. Some reduction would also be made in maritime patrol aircraft and in the RAF Regiment; and some twelve RAF Stations in the United Kingdom would be closed.
15. We shall reduce planned expenditure on research and development by some 10 per cent and continue vigorously to support the efforts being made within the Alliance to increase standardisation in equipment and eliminate duplication in research and development.

16. Our proposals would involve reducing the plans as they stood last March by about 40,000 Service men and about 30,000 directly employed civilians, including some 11,000 civilians locally entered abroad. The reductions on present Service strengths may be expected to be rather less. In the interests of efficiency, and equally of the well-being and morale of the forces themselves, the changes we propose will be carefully planned and introduced progressively over the next few years. Reductions will be achieved by normal wastage as far as possible; but some redundancies, both Service and civilian, will be unavoidable if the Services and the headquarters and outstations of the Ministry of Defence are to be adapted to the new range of commitments, and if the balance of ranks and ages necessary for a satisfactory career structure is to be preserved. Those who have to be made redundant will be offered fair terms, and time in which to plan their future employment. We shall be examining ways in which the Government can help with resettlement into civilian life.

17. The reductions in the planned defence programme are likely to reduce employment in the defence industries by only some 10,000 or 4 per cent over the period up to 1978-79 but there will be problems in certain areas and for certain firms. But the changes in our equipment programme will be made as smoothly as possible and with the maximum of notice to enable industry to adjust its plans. I am confident that these problems are manageable; and I am in close touch with my Rt Hon Friends, the Secretary of State for Employment and the Secretary of State for Industry, on these aspects of the review.

18. Early next year, when our consultations have been concluded, I will publish for Parliamentary consideration a White Paper setting out our decisions in detail and saying how they are to be put into effect. But before this we wish not only to consult our allies and partners but to learn the views of Rt Hon and Hon Members upon these matters; and the Government will be ready to arrange through the usual channels for an early debate.
19. Our decisions will save £1.75 million a year by 1978-79 and some £750 million a year by 1983-84. But in conclusion I wish to emphasise one point. No such process of adaptation by the Armed Forces, or any other organisation, to a modified range of commitments and capabilities with a lower level of resources can be made without difficulty. But after we have completed the process of consultations on this thorough and wide-ranging review, and taken our final decisions, I am confident that Britain will continue to play her full part in preserving the strategy and cohesion of the NATO Alliance, and in meeting effectively her remaining commitments outside NATO. The Royal Navy, the Army, and the Royal Air Force will remain highly effective forces, equipped to the highest standards; and the Services and the Ministry of Defence, despite the changes we will be making, will continue to offer a wide range of fine career opportunities in the years ahead.

Cabinet Office
18 November 1974.
CABINET

MINISTERIAL SALARIES

Memorandum by the Prime Minister

1. At our second meeting after the Election (CC(74) 38th Conclusions, Minute 4) the Secretary of State for Prices and Consumer Protection suggested that, in order to strengthen the social contract, consideration should be given to a possible cut in Ministerial salaries, as a way of giving a lead to other recipients of high salaries. It was recognised that such a lead should be aimed primarily at those earning salaries higher than those of Cabinet Ministers, in many cases in private industry with capital and lavish expense accounts behind them, rather than those in the £7,000 to £10,000 range. We did not discuss the context or contexts in which a cut in Ministerial salaries could best be used to give such a lead. At the strategy meeting at Chequers on 17 November the Secretary of State’s proposal was raised again by another colleague.

2. The present levels of Ministerial salaries are those recommended by the Review Body on Top Salaries in their first report (Cmnd. 4836), and came into payment from 1 April 1972. They are:

<table>
<thead>
<tr>
<th>Position</th>
<th>Salary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prime Minister</td>
<td>£20,000</td>
</tr>
<tr>
<td>Cabinet Minister (and Mr. Speaker)</td>
<td>£13,000</td>
</tr>
<tr>
<td>Minister not in the Cabinet (including Minister of State)</td>
<td>£7,500 - £9,500</td>
</tr>
<tr>
<td>Parliamentary Secretary</td>
<td>£5,500</td>
</tr>
<tr>
<td>Lord Chancellor</td>
<td>£20,000</td>
</tr>
<tr>
<td>Attorney General</td>
<td>£14,500</td>
</tr>
<tr>
<td>Solicitor General</td>
<td>£11,000</td>
</tr>
<tr>
<td>Lord Advocate</td>
<td>£11,000</td>
</tr>
<tr>
<td>Solicitor General for Scotland</td>
<td>£7,750</td>
</tr>
<tr>
<td>Chief Whip, House of Commons</td>
<td>£9,500</td>
</tr>
<tr>
<td>Position</td>
<td>Salary (£)</td>
</tr>
<tr>
<td>----------------------------------------------</td>
<td>------------</td>
</tr>
<tr>
<td>Chief Whip, House of Lords</td>
<td>6,500</td>
</tr>
<tr>
<td>Deputy Chief Whip</td>
<td>5,000</td>
</tr>
<tr>
<td>Other Government Whips, House of Commons</td>
<td>4,500</td>
</tr>
<tr>
<td>Other Government Whips, House of Lords</td>
<td>4,000</td>
</tr>
<tr>
<td>Leader of the Opposition, House of Commons</td>
<td>9,500</td>
</tr>
<tr>
<td>Leader of the Opposition, House of Lords</td>
<td>3,500</td>
</tr>
<tr>
<td>Opposition Chief Whips, House of Commons</td>
<td>7,500</td>
</tr>
<tr>
<td>Opposition Chief Whips, House of Lords</td>
<td>2,500</td>
</tr>
</tbody>
</table>

3. Ministers (and other office-holders) in the House of Commons are also entitled to draw a Parliamentary salary of £3,000, in addition to their Ministerial salaries.

4. The same report recommended an increase to £4,500 in the salary of non-ministerial Members of Parliament, which came into effect on 1 January 1972.

5. Since April 1972 the retail price index has risen by 31.6 per cent (to September 1974) and the index of average earnings has risen by 41.3 per cent (to August 1974).

6. The decision to commission the Review Body's first report on the remuneration of Ministers and Members of Parliament was announced on 4 December 1970. The reference to the Review Body was made in May 1971, and the report was published in December 1971. In that report the Review Body said that they considered that there should be a major comprehensive review of these salaries at intervals of four years (i.e. corresponding roughly to once in the lifetime of each Parliament of normal length); that was not intended to preclude the possibility of intermediate adjustments.

7. We are committed to referring the remuneration of Members of Parliament to the Review Body for a further review in January 1975. The normal course would be to ask the Review Body to consider Ministerial salaries at the same time. (It can review Ministerial salaries only if specifically asked by the Government to do so.) We could, if we wished, deliberately refrain from including Ministerial salaries in the reference, though the arguments against doing so, in a period of severe inflation, are self-evident, and we have to bear in mind the position of junior Ministers as well as our own.
8. It would be illogical to cut Ministerial salaries and simultaneously to refer them to the Review Body. If therefore we want to make a gesture of Ministerial salaries in the next few weeks, we have a choice between two courses of action:

i. not to refer Ministerial salaries to the Review Body when we refer remuneration of Members of Parliament;

ii. not only not to refrain from referring Ministerial salaries to the Review Body, but also to announce that Ministers have agreed to forgo a certain proportion of their salaries for a specified period.

9. If we decided not to reduce Ministerial salaries now, and to refer them to the Review Body together with the remuneration of Members of Parliament, another opportunity to consider making a gesture on Ministerial salaries would arise when the Review Body reported and we had to decide what to do about its recommendations: for instance, we might agree not to draw a part or the whole of any increases the Review Body recommended for Cabinet Ministers. In referring Ministerial salaries to the Review Body we could say that we thought it right that the Review Body should look at the whole picture while it was about it, but that we might well think it right when the time came to postpone action on its recommendations in respect of our own (Cabinet Ministers') salaries.

10. As I said when we discussed this in Cabinet, I have tended to regard cuts in Ministerial salaries as gimmicks when they have been suggested in the past, and I have been doubtful whether as gestures they really impress very much those whom they are intended to impress. It may be that in present circumstances such a gesture would have more to commend it, as a sprat to catch a mackerel, in that it would have a bearing on other top salaries in the public sector, and thus indirectly (and in my view more importantly) on top salaries in the private sector, which have a provocative effect when wage claims are put forward. But it is clear that a gesture of this kind cannot be made more than once in the lifetime of a Government, and if it is made is likely to store up future difficulty when the time comes to restore Ministerial salaries to the right level. So, if we are to make any gesture of this kind, we must make sure that we do not waste it, or by using it prematurely deprive ourselves of its benefits when it might in political terms be of greatest advantage to us.

11. We should now clear our minds on this in relation to two forthcoming events:

i. The Lord President will in due course have to announce the reference of Members of Parliament's remuneration to the Review Body. Is that reference to cover Ministerial salaries as well?
ii. The Cabinet will shortly be asked to take decisions on the Review Body's recommendations on top salaries in the public services - senior civil servants, senior officers in the Armed Forces, the judiciary, and chairmen and board members of nationalised industries. Before we consider the various courses open to us for dealing with those recommendations we should know where we stand on Ministerial salaries.

12. On Ministerial salaries we need to decide between three courses:

i. To forgo a certain proportion of our (Cabinet Ministers') salaries for a specified period, and to refrain from referring Ministerial salaries to the Review Body when we refer the remuneration of Members of Parliament.

ii. Not to reduce Ministerial salaries, but not to refer them to the Review Body with the remuneration of Members of Parliament.

iii. Not to reduce Ministerial salaries, and to include Ministerial salaries together with the remuneration of Members of Parliament in the reference to the Review Body - retaining our freedom not to act, or to postpone action, on its recommendations.

If we decided on the first course, we should need to consider further the amount to be forgone; the period for which it was to be forgone; and the consequentials (if any) for other Ministerial salaries; but those questions would need to be considered in the context of our discussion in due course of the Review Body's recommendations for top salaries in the public services.

H W

10 Downing Street

19 November 1974
1. In the spring, we agreed that we should keep open our options over the Channel Tunnel by reintroducing the hybrid Channel Tunnel Bill (CC(74) 7th Conclusions, Minute).

2. This entails no commitment beyond the present Phase II of the project, and when we introduced the Bill last April we made it absolutely clear that before Parliament was asked next year to decide whether to proceed with actually constructing the Tunnel (Phase III), a full reassessment would be made. Phase II provides for such a reassessment and this is being augmented by advice from a group of independent advisers chaired by Sir Alec Cairncross.

3. Owing to the General Election the Bill did not complete its passage through Parliament. But on Monday of last week Parliament approved Motions enabling us to reintroduce it while preserving its completed stages.

THE RAIL LINK

4. But one major change has occurred since our discussions last spring. A rail link between London and the coastal terminal of the Tunnel has always been an integral part of the scheme - without it, indeed, the Tunnel would do nothing to help the British railway system in the way that most of us desire.

5. Unfortunately the cost of the rail link has increased significantly. Last year, it was estimated to cost £123 million at February 1973 prices. British Rail have recently informed us of an increase in this estimate to £373 million at May 1974 prices, or more than double in real terms. This estimate excludes additional environmental works which I may well have to concede in Surrey and Kent; the greater part of the cost of compensation for injurious affection under the Land Compensation Act 1973; and the cost of enabling the link to carry freight which was admittedly not previously envisaged. It is clearly impossible to contemplate an investment of this magnitude in the rail link. British Rail are exploring the prospects of
negotiating with the Continental railway administrations, who still stand to benefit considerably from the traffic arising from the link, a joint approach to financing it which might restore its viability. But I do not believe that the negotiations will produce capital assistance which would make the burden on the Exchequer tolerable.

6. More to the point, British Rail are investigating urgently the feasibility of a lower-cost rail option, and my Department has commissioned a parallel study.

7. The other change since last spring is that our Parliamentary back-bench opinion has turned more strongly against the Tunnel, though more for emotional than for rational reasons.

OPTIONS OPEN

8. One option, obviously tempting, would be to seize the opportunity to cancel the Tunnel now. I am strongly opposed to this for the following reasons:

1. It would give the impression that we were meekly submitting to (largely ill-informed) back-bench pressure.

2. It would make nonsense of the concept of the Cairncross study.

3. It would not mean any significant financial saving.

4. It would be a grossly irresponsible way of conducting Government business and taking major investment decisions. As opposed to the rail link, the cost of constructing the Tunnel itself seems likely to hold reasonably steady in real terms. Therefore, many intelligent observers still think that a Tunnel, combined with a lower-cost rail link, would make economic sense. (That is, that it would cost less, in terms of economic resources, than the alternative investment in more ferries, hovercraft, port facilities, expensive roads, aircraft and airport facilities; for we have somehow to carry the prospective increase in freight and passengers across the Channel. In other words (to put the argument in its currently popular form), we could ultimately afford more houses and schools and hospitals if we built the Tunnel than if we spent even more on alternative forms of transport investment).

5. I do not know if this is true, which is why I still have an open mind. This is precisely what the Phase II studies are about and what the Cairncross Group is set up to advise upon. It would in my view be quite wrong to cancel unilaterally before we have this further advice.
PROPOSED COURSE OF ACTION

9. Quite apart from the Cairncross report, 1976 or some later year could well (given the need to investigate alternative and cheaper rail options) be a more propitious year in which to start building the Tunnel than 1975 looks like being. I therefore propose the following course of action. We should approach our French partners and tell them that we have been taken aback by the new estimate for the rail link and do not see how we can proceed with a link of the kind envisaged in the Treaty. We are, however, investigating with British Rail the feasibility of a lower-cost rail option. This will mean delay of a year (and preferably longer) from next summer before any decision is taken about whether to proceed with Phase III (which is the final and critical decision). I cannot predict the outcome of these negotiations; it will not be easy to persuade either the French Government or the companies to accept postponement without commitment to going ahead with Phase III by a specific date.

10. I would immediately announce in Parliament that we are not proceeding with the high speed rail link for which we have been planning, and are having discussions with the French Government about a new timetable for the project. But in order to keep our options open, we shall, subject to anything unexpected which emerges from negotiations with the French, need to go ahead with the remaining stages of the Channel Tunnel Bill so that the Treaty can be ratified as early as possible in 1975. (Strictly speaking, the Treaty must be ratified by the end of the year, but the French Government will, in all likelihood, not be unduly disturbed about a slightly later date, provided that we are visibly seeking the requisite Parliamentary authority for ratification).

11. I would then bring the matter back to Cabinet some time next year for further consideration when we have harder information about:

   a. The reaction of the French to our request for a delay of a year or more.

   b. The preliminary results of the investigation of alternative low-cost rail options.

   c. The report of the Cairncross Group.

12. British Governments in the past have taken decisions on major investment projects in a frivolous and insouciant spirit (for example Concorde and Maplin). I hope and propose that we should do better in the case of the Tunnel. It will be tiresome to stand firm until we have more up-to-date evidence for or against. But I am prepared to accept this; and, I hope, so will the unfortunate Chief Whip.
CONCLUSIONS

13. I invite my colleagues to agree:

a. That the Channel Tunnel Bill be reintroduced on Report as early as practicable. Before reintroduction, a statement would be made about the Government's attitude to the high speed rail link and our request to the French for a year's delay.

b. That there should be urgent investigation into the feasibility of a lower-cost rail option.

c. That there should be consultations with our partners in the Tunnel project over the implications of the change of plan for the rail link, and we should seek agreement to such delay over decisions about Phase III of the project as may consequently be necessary. I should of course inform the French of our problems in advance of the statement at a.

d. That I should bring the whole matter back to the Cabinet next year.

A C

Department of the Environment

19 November 1974
CABINET

PUBLIC EXPENDITURE PRIORITIES

Memorandum by the Chancellor of the Exchequer

1. The Cabinet on 5 November gave general approval to the approach in my memorandum C(74) 120. I was asked to consult further with the Ministers concerned to see what further adjustments could be made in order to accommodate desired changes within the agreed guidelines, and then to circulate definitive proposals.

2. The framework within which we have to plan our expenditure is this:

i. As regards 1975-76, we face expenditure which is already nearly £3 billion (at constant 1974 Survey prices) higher than the level which our predecessors planned for that year before the price of oil began its five-fold increase. This is due to our increases in housing, social security, subsidies for food and the nationalised industries, debt interest and expenditure in Northern Ireland. I cannot contemplate adding still more to the total in order to restore other programmes to the levels which our predecessors gave in their last White Paper but ineffect withdrew at once following the cuts of December 1973.

ii. As regards the period to 1978-79, we have announced that the increase in public expenditure will be limited to the average annual rate of 2½ per cent in demand terms.

3. In the light of these points and my consultations with my colleagues, I propose that the illustrative scheme in C(74) 120 should be modified to take the form of the table attached. This involves dealing with the outstanding issues in the following way.

4. a. Overseas Aid

I invited my colleagues to consider adding £9 million in 1975-76. The Minister for Overseas Development asked for a further £21 million, making £30 million in all. I am not objecting to this
but in order to avoid a reduction which would otherwise appear in 1976-77 I have suggested that she should distribute it so that £24 million would fall in 1975-76 and £6 million in 1976-77. I am not pressing my suggestion of a reduction of £10 million in 1978-79.

b. Education

This is the programme from which the greatest volume of savings over the period is being secured. I invited my colleagues to consider adding £15 million to the capital programme for education in 1975-76 and £7 million in 1976-77, while the building industry is lightly loaded. Even with these additions the Secretary of State feels that he cannot provide enough nursery school places to honour references in the Manifesto and The Queen's Speech (which he did not advocate). I am prepared to add £3 million for this purpose in 1975-76, provided that the rest of the settlement which I propose in this memorandum is accepted so that I know the extent of my commitment.

c. School Meals

An essential element in the savings on education expenditure is the proposal to increase the charge for school meals by 3p in 1975 and each subsequent year. An increase of 3p would increase the retail price index by 0.1 per cent. I ask my colleagues to agree that the first of these should be introduced from April next, when the family allowances are being increased.

d. Health and Personal Social Services

I have asked for no reductions in the Survey figures for health and I have proposed the addition to the health programme for 1975-76 of £35 million, mainly because of a backlog of maintenance. I can only do this if my other proposals in this memorandum are accepted, I have told the Secretary of State that I cannot meet her further specific requests, which are for £16 million for capital expenditure on health in 1975-76 and £1 million in that year and another £11 million over the rest of the period for personal social services.

e. Social Security

I have provided for the basic pension of £10-£16 this year; a major improvement of disregards for supplementary benefits; regular uprating of pensions in line with earnings (twice next year); uprating of family allowances next year; new benefits for the disabled; introduction of child allowances from April 1977, extended to first children; and introduction of the earnings-related pension scheme from April 1978. The Secretary of State has asked in addition for
extension of family allowances to first children of one-parent families from April 1976 at a net Exchequer cost of up to £7½ million, which in my view would seriously risk increasing the subsequent cost of family endowment for children generally by up to £100 million a year. In view of all the other pressures I am not prepared to accept this or any other extra commitment in this field.

f. Law and Order

I asked the Home Secretary, the Secretary of State for Scotland and the Lord Chancellor to find between them savings of £25 million in 1978-79. They have found £23 million; my discussions with the Lord Chancellor are not yet complete.

g. Defence

A total of £3,700 million for 1975-76 has been agreed. The Secretary of State for Defence would be prepared to accept figures of £3,800 million for each year from 1975-77 to 1978-79, provided they were qualified as provisional pending not only final Defence Review decisions after completion of the process of consultation with our Allies, but also the preparation of the 1975 Defence Long Costings. While for presentational reasons the defence budget figures may need to be described in the Public Expenditure White Paper as provisional until we have established the final outcome of the Defence Review, in my view we need to decide on firm totals for our own planning now, and I do not think I can accommodate any higher figure than £3,750 million in 1978-79 (£138 million above the notional provision in the Survey), with figures in the intervening years of £3,700 million in 1976-77 and £3,750 million in 1977-78.

h. Housing

I invited my colleagues to consider adding £100 million gross (£85 million net) in 1978-79 for lending by local authorities for purchase of houses and £65 million for lending by the Housing Corporation for building of houses. I consider this acceptable subject to securing the offsetting reductions listed in paragraph 5 below.

i. Railways

I suggested a reduction of £50 million in investment plans, but the Secretary of State does not consider it possible to accept this in advance of further examination of the criteria.
j. Minor Items

I noted in table 3 of C(74) 120 a number of minor proposals from my colleagues. I propose that I should now settle these in discussion with the Ministers directly concerned.

5. The net effect of items a. and f. - i. in the previous paragraph would be to add £350 million to the expenditure under my illustrative scheme for 1978-79, and j. a further small amount. The offsets available to set against this are as follows:-

<table>
<thead>
<tr>
<th>Offset Description</th>
<th>£ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>i. Nationalised industries' shortfall - foreshadowed but not scored in C(74) 120</td>
<td>200</td>
</tr>
<tr>
<td>ii. Housing subsidies - differential rates for new houses</td>
<td>35</td>
</tr>
<tr>
<td>iii. Elimination of provision for the rail link for the Channel Tunnel</td>
<td>59</td>
</tr>
</tbody>
</table>

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6. The savings are somewhat less than the additions. Moreover, j. has also to be offset and there is a risk that in the event some provision for the rail link for the Channel Tunnel will have to be reinstated. Nevertheless, overall these changes should not significantly affect public sector demand on resources. I am prepared to accept the balance struck in paragraph 5 as the means of complying with our limit for 1978-79.

CONCLUSIONS

7. I invite my colleagues -

a. To approve my proposals in paragraph 4 for additional expenditure or forgoing of savings, and in paragraph 5 for offsetting savings.

b. To agree that the charge for school meals should be increased by 3p from April 1975 (paragraph 4c).

c. To accept in consequence the attached table as the basis for the Public Expenditure White Paper.

D H

Treasury Chambers

19 November 1974
## Public expenditure, 1974-75, 1975-76 and 1978-79: Summary of proposals

<table>
<thead>
<tr>
<th>Description</th>
<th>1974-75 as in Survey (a)</th>
<th>1975-76 (b)</th>
<th>1978-79 (c)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Social Security</td>
<td>6,764</td>
<td>7,426</td>
<td>7,915</td>
</tr>
<tr>
<td>2. Housing</td>
<td>3,078</td>
<td>3,313</td>
<td>3,671</td>
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<tr>
<td>3. Nationalised industries' capital expenditure</td>
<td>2,236</td>
<td>2,298</td>
<td>2,483</td>
</tr>
<tr>
<td>4. Trade, Industry and Employment</td>
<td>2,142</td>
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<tr>
<td>5. Agriculture, Fisheries &amp; Forestry</td>
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<td>962</td>
<td>737</td>
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<tr>
<td>6. Northern Ireland</td>
<td>931</td>
<td>976</td>
<td>993</td>
</tr>
<tr>
<td>7. Community ownership of land - administration</td>
<td>-</td>
<td>20</td>
<td>35</td>
</tr>
<tr>
<td>8. Health</td>
<td>3,225</td>
<td>3,380</td>
<td>3,623</td>
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<tr>
<td>9. Roads and Transport</td>
<td>1,602</td>
<td>1,772</td>
<td>1,817</td>
</tr>
<tr>
<td>10. Other Environmental Services</td>
<td>1,364</td>
<td>1,555</td>
<td>1,622</td>
</tr>
<tr>
<td>11. Law, Order &amp; Protective Services</td>
<td>1,047</td>
<td>1,115</td>
<td>1,220</td>
</tr>
<tr>
<td>13. Personal Social Services</td>
<td>552</td>
<td>637</td>
<td>662</td>
</tr>
<tr>
<td>15. Overseas Services and Aid</td>
<td>698</td>
<td>690</td>
<td>862</td>
</tr>
<tr>
<td>16. Other Public Services and Common Services</td>
<td>976</td>
<td>1,067</td>
<td>1,118</td>
</tr>
</tbody>
</table>
### Table: £ million at 1974 Survey prices

<table>
<thead>
<tr>
<th>Description</th>
<th>1974-75 as in Survey</th>
<th>1975-76</th>
<th>1978-79</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a)</td>
<td>(b)</td>
<td>(c)</td>
<td></td>
</tr>
<tr>
<td>17. Debt Interest</td>
<td>3,400</td>
<td>3,600</td>
<td>3,400</td>
</tr>
<tr>
<td>18. Shortfall</td>
<td>- 400</td>
<td>- 300</td>
<td>- 300</td>
</tr>
<tr>
<td>19. Contingency Reserve</td>
<td>100</td>
<td>300</td>
<td>1,000</td>
</tr>
<tr>
<td>20. Adjustment for 1974-75 price change</td>
<td>345</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>TOTAL (i) in Expenditure terms</strong></td>
<td><strong>37,107</strong></td>
<td><strong>39,107</strong></td>
<td><strong>40,938/40,988</strong></td>
</tr>
<tr>
<td>(ii) in Demand terms</td>
<td><strong>30,563</strong></td>
<td><strong>32,200</strong></td>
<td><strong>34,050/34,100</strong></td>
</tr>
</tbody>
</table>

**Note:** Column (b) includes the changes to estimated expenditure which the Government have put forward as the basis for the settlement of rate support grant for 1975-76.
1. By direction of the Prime Minister I circulate the draft statement on the Defence Review.

2. The statement is due to be made on 3 December and will be discussed at Cabinet on 25 November.
ANNEX

DEFENCE REVIEW: DRAFT PARLIAMENTARY STATEMENT

1. Mr Speaker this statement will be somewhat longer than is normal at this hour. I apologise for this but I am sure that the House will acknowledge the importance of the issue.

2. On 21 March I announced the start of the most extensive and thorough review of our system of defence ever undertaken by a British Government in peacetime. The proposals which I will now outline are the result of a careful study of all the relevant considerations: defence, political, industrial and financial. They are designed for the circumstances which we must expect over the next ten years. They take account of our economic situation: but they also pay full regard to the threat to our national security, the overriding importance of NATO, our position as a leading European power and our responsibilities overseas. They will provide for a modern and effective defence structure and will make a significant contribution to establishing our economic health and thus to strengthening the alliance.

3. The Government has decided that it can reduce defence expenditure as a proportion of GNP from its present level of 5 1/2 per cent to 4 1/2 per cent over the next ten years. The long range estimates of defence expenditure as they stood in March 1974 would have amounted to 6 per cent of GNP in 1978-79 and 5 1/2 per cent in 1983-84. By comparison with those plans, our decision will save £300 million in 1975-76, £475 million a year by 1978-79 and some £750 million a year by 1983-84 - or a total over the whole period up to that date of about £4,600 million. This is fully consistent with our repeated pledges to reduce the cost of defence as a proportion of our national resources.

4. In addition to deciding the general scale of the programme needed to meet our future defence requirements and the level of resources we can devote to defence, the Government has reached provisional conclusions about the force levels involved and the implications for our commitments, for the armed forces and for industry. We are today beginning our consultations with our allies in NATO. These consultations will be thorough and genuine. They are likely to last into the New Year. We are also consulting our Commonwealth partners concerned and the other Governments in other parts of the world who will or might be affected. We shall also now consult both sides of industry.

5. First I will describe the general principles that we have followed in conducting the review. NATO is the linchpin of British security and will remain the first charge on the resources available for defence. We therefore propose to concentrate as a first priority upon those areas in which we believe that we can most effectively contribute to the security of
the Alliance and of the United Kingdom itself. These consist of our contributions of land and air forces in the Central Region of Europe; of sea and air forces to the Eastern Atlantic and Channel areas; and in the defence of the United Kingdom and its immediate approaches. We shall also maintain the effectiveness of our Polaris force.

6. We shall, however, be discussing with our NATO allies all aspects of our contribution, including particularly our force declarations to NATO in the Mediterranean and the specialist reinforcement forces that we committed to the Alliance in 1968. In the NATO area we propose to maintain our land and air contribution to the Allied Command Europe Mobile Force, but to reduce our other NATO declarations of specialised reinforcement forces to an airportable Brigade Group and a Royal Marine Commando Group, with the necessary accompanying sea and air elements. These latter declarations would be available for the Central Region or the Northern Flank of NATO, with the Commando Group specially trained and equipped for arctic warfare.

7. The priority we are giving to our NATO contribution necessarily requires a contraction in our commitments outside the Alliance. We have reviewed these commitments case by case, bearing particularly in mind the decisions taken by the Labour Government in 1968 about the reduction of the British presence East of Suez. We have concluded that substantial reductions in our forces and defence facilities can be made. But we shall not act precipitately and we shall discuss our proposals in detail with our allies and partners in the Commonwealth and elsewhere before taking final decisions, recognising that the timing and method of the changes we propose may be of particular importance.

8. Subject to these provisos I wish to tell the House what we have in mind. We shall, of course, maintain our obligations towards our remaining dependent territories. We intend to keep our forces in Hong Kong, although we propose to make some reductions in them and to seek from the Hong Kong Government a larger percentage of their cost when the present cost-sharing agreement runs out in 1976. In accordance with the military facilities agreement concluded in 1972 with the Government of Malta, we shall remain there until 1979. In Cyprus, we propose to make some early reductions, particularly in our air forces stationed there. We propose to withdraw our forces stationed under the Five Power Defence Agreement in South East Asia with the exception of a small group which we shall continue to contribute to the Integrated Air Defence System. The consultative provisions of the Five Power Defence Agreement would however remain in force and it would certainly be our intention to maintain close links with the armed forces and defence authorities of our partners. We would, of course, maintain our membership of CENTO and SEATO but without declaring specific forces to either. We propose to withdraw from Brunei the Gurkha Battalion at present stationed there. We would withdraw our forces from Gan and Mauritius. We do not think it would be right in
present circumstances to make any changes in the arrangements we have with the Sultan of Oman. We intend to enter into negotiations with the South African Government with a view to terminating the Simonstown Agreement.

9. Given the effects of these decisions in the Indian Ocean area and the Soviet naval presence there, we have decided to agree to proposals from the United States Government for a relatively modest expansion of the facilities on the island of Diego Garcia which they enjoy, jointly with us, under an existing agreement with Her Majesty's Government. Their use of the facilities other than for routine purposes will however be a matter for joint decision of the two Governments. We and the United States Government have also agreed to pursue consultations with the aim of developing realistic progress towards arms limitation in the Indian Ocean.

10. In working out the implications of these principles in terms of force levels and their effects on the three Services, priority has been given to maintaining as far as possible the level and quality of our front-line forces. We shall equip them in a manner commensurate with their roles and responsibilities, and restructure and reduce the support area to match the new size and shape of the front-line. The effects of our proposals on the forward plans of the three Services as they stood in March 1974 would be broadly as follows.

11. The Royal Navy's planned numbers of frigates, destroyers and mine countermeasures vessels would be reduced by about a seventh; of conventional submarines by a quarter; and of afloat support by a third. Planned new ship construction would be reduced accordingly, including the abandonment of plans to replace our amphibious ships with new purpose-built vessels; and all ship refitting would be concentrated on the Royal Dockyards, all of which will be retained. The nuclear submarine and the cruiser programmes would be maintained. We would reduce the numbers of the Royal Marines by one-seventh, disbanding one Commando in due course.

12. The Army's re-equipment plans would be substantially modified to reduce the growth of their cost. Measures would include the cancellation of the Vixen wheeled reconnaissance vehicle; withdrawal from the collaborative RS80 project for long-range rocket artillery; and reductions in the planned purchases of light helicopters and reconnaissance vehicles.

13. The Government attaches great importance to the negotiations between NATO and the Warsaw Pact countries on the mutual reduction of forces and armaments in Central Europe. We are committed to seeking an outcome which, while preserving undiminished security for all the countries concerned, would help to create a more stable relationship in the area at a lower level of forces. We hope that the negotiations will be
successful in achieving this objective. We do not propose, however, in advance of mutual and balanced force reductions, to reduce the forces which we maintain in Germany in accordance with our Brussels Treaty obligations. In adjusting the size and shape of the Army to meet the framework of priorities I have described and the demands of economy, the Government will make every effort to avoid a significant impact on the regimental system with its historic loyalties and traditions. The Brigade of Gurkhas will be retained, mainly serving in Hong Kong. We shall maintain the size and roles of the Territorial and Army Volunteer Reserve.

14. In the case of the Royal Air Force, we intend to preserve, and in some instances improve, the combat air forces committed to NATO on the Continent and in the United Kingdom, and to continue with the MRCA collaborative programme, though we may have to make a reduction in the planned rate of deliveries over the period. However, in accordance with the revised tasks envisaged there would be some reduction in maritime patrol aircraft, the RAF transport force would be progressively reduced by a half; and the planned helicopter force by a quarter. There would also be some reduction in the RAF Regiment; and some twelve RAF Stations in the United Kingdom would be closed.

15. We shall reduce planned expenditure on research and development by some 10 per cent and continue vigorously to support the efforts being made within the Alliance to increase standardisation in equipment and eliminate duplication in research and development.

16. Our proposals would involve reducing manpower by about 35,000 Servicemen as compared with the strength in April this year; and by about 30,000 directly employed civilians, about half of whom would be civilians locally entered abroad. In the interests of efficiency, and equally of the well-being and morale of the forces themselves, the changes we propose will be carefully planned and introduced progressively over the next few years. Reductions will be achieved by normal wastage as far as possible; but some redundancies, both Service and civilian, will be unavoidable if the Services and the headquarters and outstations of the Ministry of Defence are to be adapted to the new range of commitments, and if the balance of ranks and ages necessary for a satisfactory career structure is to be preserved. Those who have to be made redundant will be offered fair terms, and time in which to plan their future employment. We shall be examining ways in which the Government can help with resettlement into civilian life.

17. The reductions in the planned defence programme are likely to reduce employment in the defence industries by only some 10,000 or 4 per cent over the period up to 1978-79 but there will be problems in certain areas and for certain firms. But the changes in our equipment programme will be made as smoothly as possible and with the maximum of notice to enable industry to adjust its plans. I am confident that these
problems are manageable; and I am in close touch with my Rt Hon Friends, the Secretary of State for Employment and the Secretary of State for Industry, on these aspects of the review. The views of both sides of industry will of course be taken fully into consideration.

18. Our decisions will, I repeat, save £300 million in 1975-76, £475 million a year by 1978-79 and some £750 million a year by 1983-84. But in conclusion I wish to emphasise one point. No such process of adaptation by the Armed Forces, or any other organisation, to a modified range of commitments and capabilities with a lower level of resources can be made without difficulty. But after we have completed the process of consultations on this thorough and wide-ranging review, and taken our final decisions, I am confident that Britain will continue to play her full part in preserving the strategy and cohesion of the NATO Alliance, and in meeting effectively her remaining commitments outside NATO. The Royal Navy, the Army, and the Royal Air Force will remain highly effective forces, equipped to the highest standards as required by their front-line NATO tasks; and the Services and the Ministry of Defence, despite the changes we will be making, will continue to offer a wide range of fine career opportunities in the years ahead.

19. Early next year, when our consultations with our allies have been concluded, I will publish for Parliamentary consideration a White Paper setting out our decisions in detail and saying how they are to be put into effect. But before this we wish not only to consult our allies and partners but to learn the views of Rt Hon and Hon Members upon these matters; and the Government will be ready to arrange through the usual channels for an early debate.

21 November 1974
1. There is one issue arising out of the Chancellor's memorandum C(74) 136 which I must put before my colleagues. It is about cash provision for children.

2. It has been agreed that family allowances should be increased next April from £1 (90p for the second child) to £1.50. For those families not paying tax or drawing benefit, this is less than enough to restore the value which the allowances had when last increased in 1968. After tax the value will be restored but with little to spare. I reluctantly agreed that our new scheme of child cash allowances including the first child should be postponed until April 1977. I agreed with the Chancellor that the rate of the new allowances need not be settled now, but accepted for planning purposes that provision should be made for public expenditure consistent with a rate of £2.16 per child. For some families paying tax this rate would barely cover the net value in cash terms of the family allowance of £1.50 (for children after the first) and the current child tax allowances, though poorer families would get some benefit; as would smaller families because of the new allowance for the first child. On the assumptions which underly the figures which I have accepted for planning purposes the total cash support for families would be appreciably less in real terms in 1977 than in 1975.

3. This is the starting point. Cabinet now proposes reducing food subsidies, pressing ahead as quickly as we can with realistic pricing of fuel and increasing the charges for school meals by 15p a week each year. All these are on top of the general rise in prices and particularly affect the poorer families who are not drawing benefit or receiving free school meals. Much of the value of the higher family allowances will be swept away long before we provide higher cash provision for families in April 1977. Even then, on the Chancellor's proposals, the improvement will be modest, though that is a matter to be settled later.
4. Against this background we will come under mounting criticism if nothing more is done for families until 1977. The postponement till that date of extension of Family Allowance to the first child will be a severe disappointment to our own side and will further weaken our defence against the complaint that we are doing nothing for one-parent families. (A Private Members' Motion calling "attention to the problems of one-parent families" is likely to be debated on 29 November). It would however be possible at least to take a step in the direction of including the first child in Family Allowances. My proposal for doing this is discussed in the Annex. It is to provide in 1976-77 for the first child of single-parent families only a family allowance at the same rate, and subject to the same tax and "clawback" arrangements, as for other children in advance of our new child allowance scheme. This will not do much, as the modest cost of my proposal shows, but in the absence of any general improvement in family support between 1975 and 1977 it will at least show our concern and that we are not standing idle.

5. The proposal would add £15 million to public expenditure in 1976-77, though the net Exchequer cost, which more nearly represents the demand effect, is £7½ million. Something like 500 staff would be needed for the duration of the scheme, at an administrative cost of £1½ million bringing the total Exchequer cost to £9 million.

6. The Chancellor fears that my proposal may put up the subsequent cost of our family endowment scheme by up to £100 million a year. He considers that the new benefit would set a fresh standard for the first child and that after one-parent families had been singled out in 1976 there would be pressure to ensure that they were not worse off in real terms in 1977. If child allowances were introduced at a rate sufficient to do this for one-parent families it would cost an extra £100 million.

7. I think the Chancellor's fear is misplaced. If the scheme of child benefit is introduced on the principle that no normal family should have less provision in cash terms than in 1975, the absorption of the benefit for the first child of lone parents into the child allowance scheme would, in my view, mean increasing the rate from £2.16 to only £2.20, at a cost of £16 million. We need not however, be committed to that expenditure, since it would be possible in the alternative either to maintain some preference for single-parent families after 1977 (which would be a step towards implementing the recommendations of the Finer Committee) or to accept that some families must be a few pence worse off in 1977 than in 1976. I accept that there would be pressure to ensure that families were not worse off in real terms in 1977 than in 1976 but I think that would arise whether or not special help is given to one-parent families in 1976. It is a weakness in the rate of £2.16 at present allowed for in public expenditure and this is a matter which we have to settle later. It would, I think, be unfair to attribute this extra cost to my proposal about one-parent families.
CONCLUSION

8. I ask my colleagues to agree that, if we can overcome the practical difficulties, and in particular secure the necessary temporary accommodation, we should provide a family allowance of £1.50, subject to the usual tax and "clawback" arrangements, for the first (or only) child in one-parent families from April 1976 until the new scheme of child allowances is introduced in 1977.

B A C

Department of Health and Social Security

22 November 1974
OUTLINE SCHEMES FOR HELPING THE FIRST CHILD OF POOR FAMILIES

1. The proposal is to pay a special family allowance for the first children in one parent families from April 1976 before child allowances come in. Excluding those widowed mothers whose first children are already covered by the child's element in widowed mother's allowance this would cover some half million single parents, including 100,000 fathers. Over 200,000 of these families are on supplementary benefit. These would normally gain nothing in financial terms, but importance is attached both generally and by the Finer Committee to reducing the extent of dependence on supplementary benefit. And it does of course help to reduce the cost.

2. Like the present family allowances, the rate for the first child would be £1.50. It would be subject to normal income tax and to the normal degree of "clawback" through reduction of the tax allowances.

3. On the introduction of the new scheme of child allowances in 1977, the proposed allowance would be dealt with in one of three ways:
   
   (1) If the rate of child allowance were fixed at £2.20 or more, the proposed allowance could be discontinued without any family being worse off in cash terms.
   
   (2) If the rate of child allowance is not high enough to permit this, one parent families paying tax might be left a bit worse off in cash terms in 1977 than in 1976; or
   
   (3) Some preference for one parent families could be left within the child allowances scheme at a continuing cost of maybe £2-3 million a year.

4. There are some practical problems to solve about the administration of the scheme but, given a simple scheme, it is thought to be operationally feasible if the necessary temporary accommodation can be provided in time. This question is being pursued urgently.

5. The net Exchequer cost of the scheme in 1976-77 will be £7½ million. It is not yet possible to make precise estimates of staff and administrative cost, but the number of staff required for the duration of the scheme is thought likely to be of the order of 500, at an administrative cost of about £1½ million, making an Exchequer cost of £9 million in all.
24 November 1974

CABINET

I.R.A. TERRORISM IN GREAT BRITAIN

Memorandum by the Secretary of State for the Home Department

1. In my statement to the House on 22nd November, following the bomb explosions in Birmingham the previous night, I promised to make a further statement on 25th November about emergency provisions which might be enacted later in the week. The Annex contains an account of the Bill which I hope it may be possible to introduce on Wednesday and pass through all its stages on Thursday.

2. The two main measures which have been discussed since I.R.A. attacks in Great Britain began in March 1973 are provisions to proscribe the I.R.A. and provisions to give more effective control over travel between Ireland and Great Britain. I, like my predecessor, have not hitherto felt that the value to the police of such provisions would be sufficient to justify these exceptional measures and the considerable diversion of effort which they involve. I now think, however, after discussion with the Commissioner of Police of the Metropolis and his senior officers (and his view of this has the support of other chief officers), that we should now legislate on both matters.

3. As regards proscription, it does not significantly assist the police to make it an offence to be a member of a proscribed organisation. There are, as experience in both parts of Ireland has shown, difficulties about proof of membership; and it is a disadvantage, from the point of view of obtaining intelligence, to have to deal with a multitude
of ephemeral bodies instead of one established organisation. It would, moreover, be possible to prohibit the public display of berets, banners and other insignia, and the raising of funds for a proscribed organisation, without making it an offence to be a member of such an organisation. On the other hand, a prohibition on membership would be welcomed by public opinion, and would help in discouraging people from taking the law into their own hands. It would also be difficult to explain why, if an organisation is proscribed, membership of it should not be an offence. My conclusion is that the arguments are strongly in favour of making membership of a proscribed organisation an offence. My colleagues should, however, be aware that the police will be unable to devote a major part of their effort towards the prosecution of individual members.

4. A watertight control over movement between Ireland and Great Britain is not practicable. The attempt to impose it would mean at the least the full apparatus of immigration control, based on passports or other documentation, and it would be both expensive and difficult to justify the diversion of effort for a problematical result. I am, however, persuaded that the hand of the police in examining both incoming and outgoing travellers should be strengthened in order to deal with the movement of terrorists in and out of Great Britain, (whether to or from the Republic or Northern Ireland). The scheme outlined in the Annex would enable comprehensive control to be established if this were ever found advantageous, but the intention is that the system should be worked on a spot-check basis. It will be managed by the police, in the interests of security, to enable them to subject to search and close questioning anyone whom they might suspect of involvement in terrorist activities.

5. Exclusion orders (following the precedent in the Prevention of Violence (Temporary Provisions) Act 1939) will be provided for in the Bill. They will enable preventive action to be taken against people who appear to the Secretary of State to be involved with terrorism (i.e. concerned in the commission, preparation or instigation of acts of terrorism) but against whom it is not possible to bring charges under the present law. Orders can be made both to prevent plotters from coming here and to expel them when found here, but it is not expected that they will be made in large numbers. Provision will be made for representations to the Secretary of State by the person affected. There will be severe penalties for defiance of an exclusion order.
6. As indicated, I see no advantage in aiming at a full passport-type control. Nor do I see advantage in a system of identity cards, which apart from creating difficulties for ordinary people would be extremely expensive and largely ineffective.

7. I find, however, from my discussions with the police that the feature of present arrangements which they find inhibiting is that they cannot lawfully detain people suspected of being involved in terrorism for long enough to check their identity against other evidence available to them as a result of earlier incidents. I therefore propose that the police - throughout the country and not only at ports of entry - should have powers of search and detention in the first place for 48 hours and, on specific Home Office authority, up to 7 days.

8. We are in greater danger of justifiable criticism if we do too little then if we do too much. We must, moreover, take action which is firm enough to pre-empt action by self-appointed vigilantes. It goes almost without saying that we must guard against the danger of being driven to more and more extreme measures involving unwarranted infringement of personal liberty. I am proposing that the Bill should apply only for 6 months, and that renewal should be subject to affirmative resolution. I hope my colleagues, and the House, will agree that with this safeguard my proposals match the situation with which we are faced.

9. Subject to points which may arise in detailed examination of the Bill when it is available, I seek approval to introduce it on Wednesday, 27th November, with a view to it being taken through all stages in both Houses on the following day. The order providing in detail for the control of travel will be brought into effect immediately on Royal Assent.

R H J

Home Office
24th November 1974
PREVENTION OF TERRORISM (TEMPORARY PROVISIONS) BILL

Four main powers are conferred by the Bill.

Power to Proscribe Organisations

1. The Bill gives the Secretary of State power to proscribe organisations which appear to him to be concerned in terrorism in the United Kingdom or in promoting or encouraging it. The Bill itself will specify the I.R.A. but any additional proscriptions will be by order. It will be an offence to belong to a proscribed organisation or to support such an organisation financially or in other ways. The maximum penalty will be six months imprisonment or a £200 fine or both on summary conviction and 5 years imprisonment or an unlimited fine or both on conviction on indictment. As in the Northern Ireland (Emergency Provisions) Act 1973, the possession of documents emanating from a proscribed organisation will be evidence of guilt; the safeguards against abuse of this provision are that the evidence can be rebutted and that prosecutions require the fiat of the Attorney-General.

2. It will be an offence, punishable on summary conviction with a maximum of three months imprisonment or a £200 fine or both, for a person to display in a public place any item of dress or other article in such a way or in such circumstances as to arouse reasonable apprehension that he is a member of or a supporter of a proscribed organisation. It will thus be an offence to wear clothing or armbands which are plainly I.R.A. insignia but which fall short of the requirements for a successful prosecution under the provisions of the Public Order Act 1936, which prohibits the wearing of political uniforms; and it will be an offence to carry banners in support of the I.R.A.

Exclusion Orders

3. This part of the Bill is based on the Prevention of Violence (Temporary Provisions) Act 1939, under which the Secretary of State could make prohibition or expulsion orders prohibiting people from being in or expelling them from Great Britain. Provision is made in the Bill for one type of order (an exclusion order) which would be used both to keep people out of Great Britain and to expel people already here.
The Secretary of State may exercise these powers to prevent acts of terrorism, wherever committed, designed to influence public opinion or Government policy with respect to affairs in Northern Ireland.

4. An exclusion order may be made against a person if it appears to the Secretary of State that he is concerned in the commission, preparation or instigation of acts of terrorism or is attempting or may attempt to enter Great Britain for that purpose, or has harboured such a person or any person against whom an exclusion order has been made. An order cannot be made against a citizen of the United Kingdom or Colonies who is and has been for the last twenty years ordinarily resident in Great Britain. It is to be an offence, subject to the same penalties as membership of a proscribed organisation, for a person to fail to comply with an order which has been served on him or knowingly to facilitate the entry into Great Britain of a person subject to an exclusion order or knowingly to harbour such a person. A person against whom an exclusion order has been made will be able to make representations to the Secretary of State against the Order.

Powers of Arrest or Detention

5. The Bill will empower a constable to arrest without warrant a person who he reasonably suspects to be a person concerned in the commission, preparation or instigation of acts of terrorism, a person subject to an exclusion order, or a person who has knowingly harboured a terrorist. The police will be able to detain for 48 hours (and for five more days with the consent of the Secretary of State) and to fingerprint a person arrested under these powers or for a major offence under the Bill.

6. These powers will, among other things, enable the police to hold a suspected terrorist while they question him, investigate his background and check his fingerprints against their records. Under the law as it stands the police can arrest a person on suspicion that he has committed a specific arrestable offence but there are limits (not clearly defined) to the length of time which they can hold him. The new power, enabling a man to be detained for up to seven days on general suspicion of involvement in terrorism, is unprecedented in peacetime in Great Britain.
Control Over Travel

7. The Bill empowers the Secretary of State to make an order providing for the control of travel into and out of Great Britain and for the appointment of examining officers (who would in practice generally be police officers, but who could also be immigration officers) to operate the control. The order would confer powers of arrest, detention and search on examining officers.

8. The practical effect of this part of the Bill is to give the police powers to exercise a security control over all passengers entering and leaving Great Britain for Ireland. At present they exercise surveillance at the ports concerned but they have no special powers to question or search travellers. The new powers, which are modelled on those in the Immigration Act 1971, will, in the first instance at any rate be exercised selectively.

Duration of the Act

9. The Bill provides for the expiry of the provisions six months after they become law but the Secretary of State may provide, by order, which is to be subject to affirmative resolution, for them to continue in force for further periods of six months.
CABINET

ENERGY SAVING

Memorandum by the Secretary of State for Energy

1. I presented an interim package of possible non-budgetary energy savings to the Economic Strategy Committee on 4 November and the subject was further discussed at Chequers on 17 November. In consequence I now attach a draft statement which I would propose to make to the House.

2. The package embodied in the draft statement represents, I believe, about the minimum that would be likely to be acceptable to opinion at home and abroad as a serious response to the situation in which we now find ourselves. Taken together with the Budget measures and the savings that have already been achieved it can be presented as a significant step towards the international goal of a reduction of oil imports by the industrialised countries in 1975 and subsequently.

3. The statement does not attempt to quantify the total savings to be expected from the present package. Many of the effects are cumulative over time, and much depends on the response we secure in industry, commerce and the home. But I am satisfied that, provided we follow up in specific decisions the intention to eliminate subsidies in the nationalised energy industries, the total saving should exceed the target set by the Economic Strategy Committee of saving at least £100 million a year on the balance of payments. Looking forward, our aim over the next few years is to save 10 per cent of our total energy consumption. If this were achieved it would amount to £700 million on our oil import bill. The bulk of this will have to come - as the £150 million already saved has come - from the decisions of individual consumers helped and advised by the Government as necessary. This is a task in which my Advisory Council will have a significant part to play.

4. The main issues which were in dispute in our earlier discussion were:-
i. Lead content of petrol

I would have preferred a reversal of the step taken lowering the lead content in petrol from 1 November 1974. I believe that the medical evidence for reduction is not conclusive and in view of the cost to the balance of payments (£13 million a year), I would have preferred to return to our earlier standard, believing that this would demonstrate our resolve in the drive to conserve energy. However, I have accepted my colleagues' view that it might cause difficulty both politically and practically. We are in any event agreed that further reductions in lead content should be deferred pending a thorough review of the medical and economic implications involved in proceeding with the programme.

ii. Speed limits

The proposals in the statement - no change on motorways, 60 mph on dual carriageways, 50 mph on single carriageways - have been agreed with the Minister for Transport. These limits can be supported by road safety arguments and by consideration of public acceptability over an extended period. They will offer some saving in imports (possibly of the broad order to £10 million a year) but the main benefits to fuel saving will be psychological.

5. As compared with my earlier proposals I have toughened up the statement on two points:

a. First, I now propose to use the powers contained in the Fuel and Electricity (Control) Act to impose maximum heating standards on all buildings other than living accommodation. I would of course also provide blanket exemptions for the sick and disabled, for young children, the aged and for preserving materials and equipment.

b. Second, I propose similarly to use statutory powers to prohibit floodlighting of buildings, statues, bridges, etc at all times and to restrict electricity for external advertising and external display lighting during daylight hours. Both restrictions would come into force in the New Year.

6. Neither move will make much difference to energy supplies - the former, even as a voluntary scheme, is largely self-enforcing and the latter represents a very minor use of electricity. Nevertheless, both moves reflect a public mood and will carry conviction.

7. At the Chequers meeting on Government strategy, I was asked to examine urgently the question of a two-tier price system for petrol with a low-priced 'ration' and a high price for further supplies. Work on this is in hand interdepartmentally but the issues are complex and it is in any case
clear that we could not introduce such a scheme, as a going concern, for some months. I will bring a paper to my colleagues as soon as possible but believe firmly that the present statement should not be delayed while we make up our minds on further steps. In the meantime I would propose to say, if asked, that the possibility of a scheme of this kind is under consideration. I could also, if my colleagues wished, refer specifically to the scheme in the statement as being a possibility under consideration.

8. I invite my colleagues:

a. To agree to the proposed public stand on lead in petrol.

b. To agree to the proposed new speed limits.

c. To agree that statutory powers should be used to set maximum heating standards in industrial and commercial premises.

d. To agree that conspicuous forms of public lighting should be restricted in the way proposed.

e. To decide whether a reference to the possibility of a two-tier price system for petrol should be included in my statement.

f. To endorse my statement generally and to approve its early delivery to the House.

EGV

Department of Energy

2 December 1974
ENERGY SAVING: DRAFT STATEMENT

With permission Mr Speaker I would like to make a statement on energy saving.

2 As the House knows our import bill for oil this year is likely to exceed £3½ billion. By the end of the present decade we should no longer be net importers of energy. We are the only major industrial country in the Western World which has this prospect.

3 Despite this the need to reduce our import bill is acute.

4 Progress has of course already been made. It is estimated for example that voluntary conservation measures this year have already saved about 2% of our normal energy consumption - worth about £150 million at current import prices.

5 These savings are a good beginning. But we need to do much more in the years ahead.

6 My rt Hon Friend, the Chancellor of the Exchequer, made it plain in his budget statement that the Government intends to ensure that energy prices are brought as quickly as possible to a level which reflects true costs. The best advice we have is that a move to such prices might save at least £50 million - and perhaps a good deal more - on our import bill in a full year.

7 To rely on the price mechanism alone however is not enough. The Government have therefore considered what further steps it can take to reinforce the pressures of price.

8 My Advisory Council of Energy Conservation has already produced a number of suggestions for the Government to consider and its work will grow and develop over the months and years ahead. The measures and proposals I announce today therefore must be regarded as an interim package.

9 The measures the Government has decided to adopt now are:-

First: To introduce a loan scheme which will provide a source of finance for energy saving investment in industry, to ensure that such investments are not held back by cash flow problems. Loans will be at favourable rates of interest. Any expenditure in this financial year will be covered by a late spring supplementary. I expect to make available £3m a year for this purpose. Full details of the scheme will be announced shortly.

Second: The Government will use its powers to ensure that the next round of oil price increases bears more heavily on motor spirit than on other oil products. This move will seek further to discourage imports of motor spirit and crude oil used to produce motor spirit, which currently cost us about £500m a year. Details will be announced when the Price Commission has finished
its work on the present round of company applications for price increases. The House will also wish to know that the Government are considering the possibility of introducing a two-tier price system for petrol with a basic ration available at one price and additional supplies available at much higher prices. I would welcome views on this proposition.

Third: The Government has reviewed the programme for reducing the lead content of petrol. The reduction which took effect on 1 November has added more than £10m a year to our import bill and further stages of the programme could be very much more expensive than this. We do not intend to go back on what has been done so far but have decided that further progress should be deferred until a thorough review of all the medical and economic implications of proceeding with the programme has been undertaken.

Fourth: About 3 million tons of coal equivalent a year is used in Government, civil and defence buildings. The Property Services Agency are planning to spend up to £5m a year over the next few years on improved control equipment, draught proofing and additional insulation. These and other measures aim to achieve eventually savings of around £20m a year or more than 20% of current expenditure in this area.

Fifth: Public authorities other than Government, for example, local authorities, use some 17 million tons of coal equivalent a year. And a further 20 million tons is estimated to be used in public sector housing. The Government are opening urgent discussions with local authorities and others concerned to see how far and in what ways savings can be achieved in this important area of our life.

Sixth: Speed Limits: excessive speed wastes petrol, as well as costing lives. The Government have therefore decided to reduce the maximum speed limits on single carriageway roads to 50 mph and on dual carriageways other than motorways to 60 mph. Speed limits on motorways will remain unchanged. My right Hon Friend the Minister of Transport will make a further statement on this later today.

Seventh: Sir we will introduce compulsory limits on heating levels in buildings other than living accommodation and a limited range of further exemptions designed to protect the young, the old, the sick, the disabled and certain types of material and equipment. These standards will involve a maximum heating level of 68°F - 20°C. Government offices already work to a minimum standard of 65°F and my right Hon Friend the Secretary of State for the Environment and I will be considering with the interested parties, including the National Whitley Council Staff Side, how savings can be secured by closer adherence to this standard as well as by sustained savings efforts.

I have rejected imposing compulsory limits on private households but savings in the home are as valuable as those elsewhere. I appeal for the maximum voluntary savings.
Eighth: In all areas of our national life greater attention needs to be focussed on the careful use of energy. My Advisory Council has suggested that company annual reports should state the expenditure incurred on fuel and the steps taken to save energy. The possibility of including this provision in future legislation is being considered. Meanwhile Boards of Directors should voluntarily demonstrate their public spirit and their good stewardship by implementing this suggestion.

Ninth: As a corollary of eight, all Boards should make clear within their firms their commitment to energy saving and should make someone specifically responsible for achieving it.

Tenth: Both management and employee representatives engaged in joint consultation in industry and commerce should see that energy saving is made a regular subject for practical discussion leading to early and effective action.

I have written to the CBI asking them to draw the attention of their members to these last three points, and to give them their full support; and I have written similarly to the TUC on the important contribution which union representatives can make through joint consultations.

Eleventh: I have decided to ban all floodlighting of buildings, statues, etc at any time and to restrict the use of electricity for external display and advertising purposes during daylight hours. The necessary orders for this and the proposed heating standards will be laid shortly and will come into effect in the New Year.

Twelfth: Finally, to promote and reinforce action in all these areas, the Government will, over the months ahead, develop a publicity campaign to inform and advise industry and commerce, motorists and households, on how they can help themselves and the nation by using energy more carefully and efficiently. In addition, the heads of the nationalised fuel industries have told me that they will co-ordinate energy saving publicity.

Mr Speaker, it is not possible to estimate with any precision the energy savings which may emerge from this package, not least because many of the effects are cumulative over time. But there is no doubt that substantial savings are possible. Indeed, if we were to be able to save, within the next few years, say, 10% of our total energy consumption - an amount which currently costs about £700 million a year to import - we would have made a major contribution to our national wellbeing and national future.
CABINET

REPORT OF THE TOP SALARIES REVIEW BODY

Memorandum by the Prime Minister

1. The Review Body on Top Salaries (TSRB) (the Chairman of which is Lord Boyle) has now submitted its substantive report on top salaries in the public services: senior civil servants, senior officers in the Armed Forces, the judiciary and the chairmen and board members of nationalised industries. I enclose a copy of a memorandum by officials setting out the background, and listing and discussing the recommendations and various possible courses of action. Copies of the Review Body's Report are being circulated separately.

2. The memorandum by officials lists three options:
   i. to accept and implement the report as it stands;
   ii. to accept the report but stage the increases;
   iii. to reject the report and substitute smaller increases.

There is a fourth option:

iv. to reject the report and make no increases, or different increases at a later date.

3. There are strong arguments, to which we should give due weight, for accepting and implementing the report as it stands. The Review Body system represents a bargain between the Government and those servants of the State who come within the system, into which both sides have entered for mutual advantage and protection. The bargain depends upon the assumption that the Government will honour the Review Body's recommendations; indeed, there is a commitment on the Government to accept recommendations of the Review Bodies unless there are clear and compelling reasons for not doing so. The TSRB's Report, first commissioned in 1971, represents the first substantive review of the salaries concerned since July 1969 (though there have been interim increases.
in the meantime). If the recommendations are implemented, the increases since 1969 (64 per cent overall, or 9.4 per cent a year) will be very much less than the increase in average earnings (105 per cent, or 14.1 per cent a year) or average salaries (98 per cent, or 13.2 per cent a year); and less in almost all cases than increases in comparable outside earnings over the same period. These concerned would no doubt regard it as unfair if we rejected or modified on grounds of redistribution policy recommendations which the Review Body explicitly describes as leaving them in January 1975 in a relatively worse position than in 1969; they would argue - and they would be able to quote the Review Body in support of this view - that redistribution policy should be effected by measures of general application, such as taxation, not by discrimination against the public services in determining salaries. We are pledged not to discriminate against the public sector, and not to retreat from the principle of fair comparison as the basis for settling the pay of the Civil Service. We have not formulated, still less agreed, a "high pay policy" by reference to which we might seek to override these pledges. There are also arguments of recruitment, retention and morale in relation to all the groups of people concerned, which support acceptance and implementation. The arguments vary in detail from group to group, and it is not necessary to rehearse them in this memorandum.

4. On the other hand we have to assess the effect upon the Social Contract of implementing the recommendations in full from the due dates. Whatever the arguments for accepting the increases recommended, increases of the absolute size proposed at these high income levels would be likely to make it more difficult to secure restraint at lower income levels. This problem is especially acute in relation to the possible impact of the increases proposed for chairmen and board members of nationalised industries on negotiations on the pay of those who are employed in those industries.

5. For the future, I believe that these public sector salaries will have to be reviewed every year. Quite apart from the interests of those concerned, there is the fact that, because these salaries have been reviewed relatively infrequently, we and other Governments have been faced time after time with embarrassingly large increases because of the need to catch up with three or four years' movement in the private sector. Whatever we do now, we should in my view try to avoid recreating this problem in a year's time.

6. There are problems of "compression" - narrowing of differentials - to which the memorandum by officials refers. The most crucial of these is in the Civil Service, where the gap between the top of the Assistant Secretary scale (at present £8,850) and the Under-Secretary rate (at present £9,000) is only £150 and the Assistant Secretary scale will rise further from 1 January 1975 as a result of the next pay research round. Whatever we do must allow for these problems.
7. There is also the pension problem. If we were to reject the report and substitute smaller increases, those who retired before there was an opportunity for their salaries to catch up and their widows would suffer a continuing penalty after they had retired. It would be preferable to choose a course under which this continuing penalty could be avoided.

8. One of the options open to us is to accept the report but stage the increases. If we were so to decide in principle, we should have to decide how and over what period to stage. We could stage by two equal instalments; or we could relate the first stage to the movement of the retail price index since 1 January 1974. Either of these bases of staging would need some modification at particular points to deal with the severest problems of compression. If we were not to leave ourselves with a continuing problem of backlog to overtake, we should limit ourselves to two instalments, the first payable on 1 January 1975, the second six (or possibly nine) months later. I am advised that pensions could be protected under a staging operation, if the full recommended rates were promulgated as being the "true" ones, with the staged rates substituted de facto for the true rates during the period of the staging.

9. There is one other option which we should consider in conjunction with the options listed in the memorandum by officials and in paragraph 2 of this memorandum. That is to deal with the Review Body's recommendations in the context of a wider-ranging package which would also include a call for restraint at the higher income levels in the private sector, as well as in other parts of the public sector. Such a package might be on the following lines:

i. We agree to implement the Review Body's recommendations in full from the due date.

ii. We invite those covered by the recommendations not to draw part of their increases for a certain period, the length of which should take account of the consideration which I have mentioned in paragraph 6 of this memorandum.

iii. We invite other people on correspondingly high incomes, in the private sector as well as in the public sector, not to draw a corresponding proportion of their incomes for a similar period.

To this we could add (if Ministers so decided) an announcement that Ministers had agreed to forgo a corresponding proportion of their salaries for a similar period.

10. I have set out in a separate memorandum (C(74) 134) the considerations which we have to take into account in deciding about Ministerial salaries. There is of course no necessary connection between Ministerial salaries and public service salaries covered by this
TSRB Report (other than that both groups of salaries fall within the Review Body's general remit), and we could proceed with the sort of package I have outlined without adding to it anything on Ministerial salaries, which have remained unchanged since April 1972. But an appeal to high income earners, in the private as well as in the public sector, not to draw part of their incomes for a period would clearly have greater authority if we ourselves were taking similar action in relation to our own salaries.

11. So far as those covered by the TSRB Report were concerned, the package I have described would be in essence a request for a voluntary agreement to stage their increases; it would thus be (so far as they were concerned) a variant of staging, extended to cover other incomes at corresponding levels. We should have to decide what form this voluntary self-denial should take, from what level of incomes it should operate, and for what period it should run.

12. I am personally less interested in penalising those concerned in the public services - whose incomes are generally speaking well below those of their counterparts in the private sector and who do not enjoy comparable fringe benefits - than in getting a significant degree of restraint and self-denial from those on the highest income levels in the private sector. Those people often have the backing of capital as well as sizeable fringe benefits; and the levels of their incomes, and the amounts of increases in them, are especially provocative. I should therefore like to see not only the absolute amount but the percentage amount of salary forgone increase with the level of income. This would suggest that we might call upon people to forgo for six months (or perhaps nine months) - the period suggested reflects the need not to build into whatever we do a further backlog to be overtaken next year - a certain proportion of the amount by which their income exceeded, say, £10,000 - which we have to remember is equivalent in terms of purchasing power to less than £6,000 five years ago. If we decided that Cabinet Ministers would also forgo part of their salaries, a formula on these lines would provide a basis for fixing the size of a much smaller consequential reduction for Ministers of State; Parliamentary Secretaries' salaries would not be affected. The table annexed to this memorandum illustrates the consequences of fixing the proportion of income in excess of £10,000 figure at a. 10 per cent, b. 20 per cent, and c. 25 per cent.

13. So far as the groups covered by the Review Body's Report are concerned, this formula could be regarded as fairer than either of the staging proposals mentioned in paragraph 8 of this memorandum, since it would operate on the level of salary recommended by the Review Body rather than being based on existing salary. The result would be that those who stand to gain most from the recommendations - those who have been most out of line - would get larger "first instalments" than under either of the staging proposals, while those who stand to gain least would get smaller "first instalments".
14. The advantages of an arrangement of this kind would be that it would deal with the problem of protecting the pension rights of those in the public services on the point of retirement (see paragraph 7 above); that it would overcome the problems of compression (see paragraph 6 above); that it would be non-discriminatory as between the public and private sectors; that, being voluntary, an appeal on these lines would be better received by those covered by the Boyle Report than some compulsory modification or staging of the Boyle recommendations, and would stand a very good chance of a positive response from them; that highly paid people in other parts of the public sector and in the private sector would feel morally obliged to follow suit: and that the whole package, covering not only "top salaries" in the public services but also high income earners generally, would make a bigger impact on trade unions and on work-people than merely staging the "top salary" increases in the public services. The disadvantage of such a package would be that it would look less decisive than an imposed staging (or other modification) for those covered by the Review Body's Report, since it would leave the decision to individual consciences.

15. We need now to take decisions in principle upon:

a. our choice between the five options available to us for dealing with the Review Body's Report:

i. accept and implement in full:

ii. accept and implement in stages;

iii. reject and substitute smaller increases;

iv. reject and make no increases, or different increases at a later date;

v. use it as a basis for inviting all high income earners, in the private sector as well as in the public sector, to forgo part of their incomes for a period.

b. what we do about Ministerial salaries, our options on which are set out in paragraph 12 of C(74) 134.

In the light of our discussion on these various courses we can then commission detailed work on the implementation and presentation of what we have decided.

H W

10 Downing Street

3 December 1974
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§ Present salaries shown in brackets

SECRET
The Top Salaries Review Body (TSRB) submitted to the Prime Minister on 18 October its first substantive report on the groups within its standing terms of reference. This paper is intended to assist Ministers in reaching decisions on the question of implementation.

2. A note on the status, functions and recent history of the Review Body is at Annex A.

Background
3. Since the last substantive reviews of these groups which were related to conditions in 1969, there have been growing difficulties both in terms of recruitment and retention and the compression of salary differentials. The former are most clearly seen in the increasingly difficult task of manning nationalised industry boards with individuals of appropriate calibre; but they are not confined to the nationalised industries. The compression effect appears most acutely in the Civil Service - as shown in Annex B; as from 7 November this year - following the second stage of the 1973 'anomalies award' to Assistant Secretaries - the differential between the Assistant Secretary and Under Secretary grades will be down to £150. Compression problems are also reflected at certain points in the judicial structure (where there are definite links or relativities with the Civil Service), and in the nationalised industries the problems of recruitment and retention at senior staff levels are compounded by the lack of 'headroom' in relation to board salaries (in some cases senior staff salaries overlap those of board members). Compression at present is not so severe in the Armed Forces, but could rapidly become so in the event, as expected, of substantial increases for ranks below the TSRB levels emerging from the current Armed Forces review - due to take effect from April 1975.

4. There is no doubt that salaries in some cases have fallen seriously behind those of comparable groups in other parts of the economy, and this in turn has correspondingly depressed pensions which are directly tied to the level of salary. This is a permanent disadvantage to those now retiring. For example, public servants who retired 2 years ago on salaries of around £15,000 have benefited from successive cost-of-living pension increases with the result that after 1 December next they will receive pensions up to £2,000 higher than those currently retiring at the same levels.
5. There have been signs of growing unease among the groups concerned over the delay in the appearance of the TSRB's substantive report. The National Staff Side for the Civil Service - the only case in which there is representational machinery - has expressed its deep anxiety about the implications for the Civil Service not only at these but also at lower levels, and the First Division Association has made representations on a number of occasions both nationally and at departmental level; but dissatisfaction is by no means confined to the Civil Service. Against this background, pressure will mount for the Government to declare its intentions. It is therefore a matter of urgency that the Government should reach decisions about the report's implementation.

The Contents of the Report

A. General principles

6. The report is based on a massive quantity of evidence and the results of special studies (documented in appendices to the report), including detailed job comparison and evaluation exercises - carried out with assistance from management consultants, studies to compare superannuation benefits and degrees of job security, and special surveys of salaries and earnings in relevant areas. In the end however, as they acknowledge, they have had to exercise their independent judgment on the facts before them; in doing so they have been guided by certain general principles of pay determination.

7. Three principles receive particular emphasis in the report: comparability, the need for adequate differentials and the need to have regard to the 'total remuneration package' (i.e. to take account in making comparisons of the relative weight of benefits other than basic salary - pensions, cars, etc).

8. The Review Body says that it does not attempt to match the highest salary levels outside. It takes the view that in any case comparisons become increasingly dubious at the higher levels; the best that can be done is to take comparison as far up as it will go and then concentrate on setting reasonable differentials.

9. The comparative approach is in fact applied more fully in the case of the nationalised industries than in the other three groups. In the nationalised industries the Review Body recognises - albeit with some qualifications - the similarities with other parts of industry and the frequent need to recruit and retain people at top level from the private sector.
10. In the three more traditional public services on the other hand, comparability is diluted by reference to a number of elements: differences in the nature of accountability and therefore of decision-making (taking into account the nature of Ministerial responsibility); the extent of resources controlled; the emphasis on internal promotion and the relatively small amount of recruitment at the more senior levels; 'tradition and convention' (eg of lower pay in the public service). Some weight is given to greater job security. The report also touches on the relative degree of 'net job satisfaction' (including status and prestige) offered by the public service, but simply concludes that no one sector has the monopoly of this.

11. The Review Body say that since their work began, the problems of pay structure and disparities with outside remuneration have become even more acute. They "believe that it is of great importance to take this present opportunity to rectify the situation and in particular to establish a reasonable relationship between the public and private sectors". They also comment that: "There will no doubt be those who regard any large increase in top salaries at the present time as inappropriate. But whatever views may be held about the treatment of income and capital distribution as a matter of overall national policy, we do not believe that it would be either practicable or desirable for any Government to lead a movement towards greater equality from the public sector on its own".

B. The Recommendations for each Group

12. The increases recommended are tabulated in cash and percentage terms in Annex C.

i. The Civil Service

13. The recommendations here are relatively uncomplicated. If implemented, they would bring about some widening of differentials at any rate for the time being, particularly at the lower end of the grades covered, where they have been over-compressed. The next round of pay research increases for Assistant Secretaries could however again bite deeply into the Assistant Secretary/Under Secretary differential, and any scheme for staging would almost certainly entail a continuing compression problem which it would be essential to resolve.

14. The increases recommended range from £3,000 (for Under Secretaries) to £5,650 (top Permanent Secretary posts), or in rounded percentages from 24% (Second Permanent Secretary) to 35% (Deputy Secretary). The overall weighted average increase on present salaries (ie based on number in post) would be 33%.
ii. Armed Forces
15. The report says that the salaries for senior officers in the armed forces and those for the Civil Service should continue to be related, and the recommendations therefore simply reflect those for Civil Service grades; it is also recommended that certain special payments, generally of a minor character, should be withdrawn.

16. The increases range from £2,650 (Major General) to £6,650 (Field Marshal), or in percentages from 27% (Major General) to 41% (General). Overall the weighted average increases would amount to 31%.

iii. The Judiciary
17. The Review Body has paid particular attention to rationalising the structural framework of judicial salaries. They regard it as wrong that the Lord Chancellor's salary - in spite of his formal role as head of the judiciary - should continue to act as a ceiling on judicial salaries. In their view the Lord Chancellor's salary should be determined in the context of Ministerial salaries (as it was in 1971). This has enabled them, in line with their assessments of job weight, to pull out the upper end of the structure - from High Court Judge to Lord Chief Justice - including the introduction of a differential for judges promoted to the Court of Appeal. Commensurate increases are proposed for the senior Scottish judges. Although they find no incontrovertible reason why the salary of the High Court Judge should be on a par with that of the Permanent Secretary, they have considered it right to preserve this relationship. In contrast to this pulling out at the higher levels, the lower part of the pay structure (from Circuit Judge downwards) has been somewhat compressed. The Review Body makes it clear that in determining judicial salaries generally, they have regarded levels of earnings at the Bar only as a cross-check and have recognised the very substantial value of the judicial pension.

18. The increases range widely from £1,400 (Recorder of London) to £8,150 (Lord President of the Court of Session), and from 10% (Recorder of London) to 51% (Lord Chief Justice of Northern Ireland). The overall weighted average increase would be 23%.

iv. Nationalised Industries
19. The Review Body has abandoned the formal banding of industries into three groups, on the basis of the scale of assets, as introduced by the NBPI. They
point out that complexity as well as size needs to be taken into account, and have adopted a more refined ranking according to their evaluation of the Chairman's job in each case. It is open to question whether they have not indeed attempted to be over-precise.

20. There are some changes in the relative positions of particular boards, but in general no unacceptable violence is done to the present ranking. So far as the level of increases is concerned, the most significant movements arise among those boards in the upper part of the structure. For the Chairman of the present 'group A' boards (British Rail, National Coal Board, etc), an increase of £11,900 is recommended, producing a new salary level of £35,000 and enlarging the lead over 'group B' Chairmen from £3,500 to £11,000. The increase for board members in this 'A group' - £4,900 - is also considerable. It is recommended that the board of the British Steel Corporation should receive increases of the same order - the same in fact for the Chairman, i.e. £11,900, giving a new salary of £40,000, and rather more, around £5,400, for board members - thus maintaining its special lead (though the NBI had envisaged that it would eventually be brought into line with the general run of 'A boards!'). The Post Office board - in recognition of the size and complexity of its operations - is promoted for the first time to the same level as British Steel, thereby occasioning the largest increases in the report: £16,900 for the Chairman and around £9,400 for board members. Among lower-placed boards, the increases recommended are considerably more modest and in a few cases (eg British Waterways Board) reductions are proposed - subject to the maintenance of present salaries for existing incumbents. The overall effect is not that bigger average increases are recommended for the nationalised industries than for the other groups but that the spread between the top and bottom of the nationalised industry structure will become considerably wider than it has been. The range and variation of increases is thus very wide indeed, giving a weighted average increase of approximately 32%.

21. The report recommends ranges of pay - in contrast to flat rates - for all appointments below the level of Chairman, and that Chairmen themselves should have greater freedom to position board members within the ranges. It is suggested that this latter recommendation, together with other secondary recommendations - such as that on the length of board appointments - should be left for separate consideration after Ministers have decided on the main body of the report.

C. Overall Effects
22. The overall average increase on present salaries resulting from the recommendations for all groups would be just under 31%, costing just over £5 million in a full year.
23. In view of the central objective stated in the TUC guidelines of ensuring that real incomes are maintained, it is of interest to compare the overall size of the increases recommended with the movement of the Retail Price Index. This is shown in Annex D together with comparisons of movements in average earnings and salaries. As from 1 January 1974, the recommendations amount to an overall average increase of approximately 31%, compared to an estimated movement in the RPI for the year to 1 January 1975 of 17.18%. A similar comparison as from 1 January 1972 - the effective date of the TSRB's first interim report, which was intended to be a stopgap pending completion of the substantive report - yields figures of 38% (average salary increase) and 42% (RPI). But if the movements from 1 July 1969 (the base year for the last substantive reviews) are considered, the figures are respectively 64% (average salary increase) and 71% (RPI). It will also be seen that if the recommendations are implemented the increases for these groups since 1969 (64% overall) would still be very much less than the general increase in average earnings (105%) or in average salaries (98%).

24. As can be seen from Annex C, the increases are at these levels very significantly reduced by taxation; but any suggestion that the effect of tax should be presented as a justification for increases could have widespread inflationary effects, since other groups, accepting increases in line with the TUC recommendation are likely to suffer some fall in their real income net of tax.

The Options

25. The main options available for dealing with the report are:

i. to accept and implement the report as it stands;
ii. to accept the report but stage the increases;
iii. to reject the report in favour of lesser increases.

Taking these options in turn:

i. Accept and implement the report as it stands

26. In favour of this course it can be argued that:

- the recommendations are justified by a comprehensive study carried out by an independent body specially created for this purpose, and there is a commitment to accept them in the absence of clear and compelling reasons to the contrary;

- the increases are necessary to establish reasonable relationships with levels of remuneration outside these public services, which have increasingly fallen behind since their last substantive reviews dating back to 1969; more
over, the Government has declared that there shall be no discrimination against the public service as compared with other sectors and has endorsed the principle of fair comparison; thus any other course but acceptance would call into question the Government's good faith as an employer;

- the increases are necessary in the face of growing recruitment and retention problems, particularly in the nationalised industries (where there will be more posts to be filled with the creation of additional boards, eg BNOC), and of salary compression problems in the Civil Service and other groups;

- the increases are broadly consistent with the TUC guideline priority of compensating for rises in the cost of living since the last settlement on the basis that the last substantive settlement in 1969 is the relevant one for this purpose; they in any case represent the results of a basic revaluation on which the TSRB has continued to work with the approval of successive governments;

- rejection would almost certainly lead to the resignation of the Review Body and thus to an awkward vacuum in this and other areas where negotiation is not appropriate or not feasible (including the review of the pay and allowances of Members of Parliament).

27. Against acceptance of the report as it stands it can be argued that:

- most of the increases cannot be reconciled with the TUC guidelines (excluding any argument based on restructuring) if measured against the movement in the RPI since the last (interim) increase which took effect from the beginning of 1974 (the overall percentage increase would exceed the estimated movement in the RPI for a full twelve months by about 13%);

- the very large cash increases involved could well have an adverse effect on the willingness of trade unions and workpeople to observe the social contract or exercise restraint generally;

- increases of this order might in particular add to the Government's difficulties in securing restraint in the rate of movement among low-paid workers towards the TUC's low pay target of £30 a week.

ii. Accept the report but stage the increases

28. In the current circumstances of high inflation, and given the acute salary compression existing at certain points in the Civil Service and elsewhere, it is
extremely doubtful whether it would be practicable to extend staging over more than a year with two instalments. The option is assessed on this assumption.

29. In favour it could be argued that staging would:

- retain the advantages of basic acceptance while assisting the public presentation of the report;
- tend to reduce the adverse effect on the adherence of other groups to the TUC guidelines.

30. Against are the arguments that under staging:

- increases would still be large and the presentational advantage would be correspondingly limited;
- some resentment would no doubt be aroused among those affected and staged without a definite commitment to implement the outstanding amounts a year later would probably be regarded as equivalent to an actual cut in the recommendations;
- there would be problems of dealing with a possible second wave or large increases in, say, a year's time in an uncertain policy context;
- the likely reactions of the TSRB itself to staging are also uncertain.

31. Any scheme for staging would need to allow for a solution to the Assistant Secretary/Under Secretary differential problem if a serious clash with the National Staff Side was to be avoided. Provision would also need to be made to protect pensions of those retiring during the staging period.

iii. Reject the report in favour of lesser increases

32. If the report is rejected, it will be necessary to formulate alternative proposals for increases to take effect on the next due dates; to withhold increases from these groups altogether would - apart from other considerations - be untenable in the absence of a general policy disallowing increases at the higher salary levels. A selective approach to the report on the other hand, involving rejection of substantial areas of the report, would be regarded as a major challenge to the Review Body's independent judgment on the merits of particular cases, since they make it clear that they have looked at the groups concerned as a whole and in
relation to each other as well as comparing them with outside groups. The most
defensible approach therefore, in the event of rejection, would probably be to
determine lesser increases on the basis of some constraint which might be held
to be justifiable in terms of the current economic situation.

33. This approach might take one of many forms of which the following three
are illustrations:

i. limit the increases to the percentage justified by the rise in the
cost-of-living over the last twelve months, thus putting beyond question
conformity with the TUC guidelines;

ii. as in i. but the percentage increase to be applied only up to a specified
level of salary, eg the first £15,000;

iii. no pay increase at all for those earning more than some specified figure.

34. In general the arguments for and against the substitution of lesser increases
are essentially the obverse of those for and against accepting the report as it
stands (paragraphs 26 and 27 above), and in any event it would be necessary to give
special consideration to the protection of pensions. More particularly however
it would be difficult, against the background of certain other public sector pay
settlements since the emergence of the TUC guidelines, to modify the recommendations
except on high pay grounds. Since the guidelines themselves are silent on high pay,
it would therefore be necessary to devise and launch a new policy covering high
pay in order to justify the Government's decision on the report. This would be
open to serious challenge on the grounds:

- that if there is to be a specific policy on high pay it should be developed
as one of universal application, preferably on the basis of a Royal
Commission Report, after taking account of all the complex factors involved,
including the role of taxation as the obvious method of income redistrib-
ution;

- that in the meantime a decision not to implement the Report's recommendations
on high pay grounds would amount to discrimination against the public sector
groups affected; and that their pay should be put on a proper basis and only
then be subject to any universal high pay policy operating effectively
throughout the community as a whole.
35. Ministers are invited to consider the options set out in this paper. In the light of their decision, it is suggested that officials should then be asked to formulate more detailed proposals, either for the presentation of the report — if it is decided to accept it as it stands — or for pursuing one or other of the further options.
THE STATUS, FUNCTIONS AND RECENT HISTORY OF THE TOP SALARIES REVIEW BODY

1. The TSRB, whose Chairman is Lord Boyle, is one of three independent review bodies set up in 1971 to make recommendations on the remuneration of certain groups not covered by normal negotiating arrangements (the other two being those for doctors and dentists and for the armed forces); it is serviced in common with the other review bodies by the Office of Manpower Economics. Its terms of reference are:

"To advise the Prime Minister on the remuneration of the Chairmen and members of the boards of nationalised industries; the higher judiciary; senior civil servants; senior officers of the armed forces and other groups which may be referred to it."

In addition to the groups directly within these terms of reference, there is a wide range of public boards, generally of a non-commercial character, with salaries related to those for one or other of the TSRB groups and which receive consequential increases following the implementation of TSRB increases.

2. As its first task following the appointment of members in May 1971, the Review Body was in fact asked to review the emoluments, allowances and expenses of Ministers and MPs, on which it reported in December 1971, and this somewhat delayed the start of its work on the top salaries group. Following another ad hoc reference, the Review Body also reported on MPs' allowances in June 1974, and would be the expected instrument for any further reviews of the remuneration of Ministers and MPs (the possibility of a standing reference has been mooted in Ministerial discussions).

3. This report represents the first substantive - as distinct from interim - review of the remuneration of civil servants and of Chairmen and members of nationalised
industries since 1969, when the increases recommended respectively in the last report of the Standing Advisory Committee on Higher Civil Service Pay under Lord Flowden and report No 107 of the National Board for Prices and Incomes, were spread over three stages, the final instalments not becoming payable until 1 January 1971. Moreover, although substantive increases were introduced for the higher judiciary in 1970 (staged in two parts to January 1971), and for senior officers of the armed forces from January 1971, these were designed to reflect the increases already awarded to senior civil servants in 1969.

4. The Review Body has however produced three interim reports, resulting in increases from 1 January 1972, 1973 and 1974 (but from July of each year for certain judges). The first interim report recommended increases ranging from £1,500 to £2,500, which the TSRB regarded as the minimum required to prevent the remuneration of these groups falling too far behind that of comparable occupations pending completion of its substantive report. The Review Body at that time expected the substantive review to be complete within a year (i.e. by mid-1975), but this proved to be optimistic and further interim increases became necessary under the Stage 2 and Stage 3 statutory pay limits: i.e. a general increase of £250 in 1973, and of £350 in 1974. (The Secretaries also received an additional £150 in view of extreme salary compression) plus threshold payments. The recommendations now made in the substantive report are of course not intended to take effect before 1975.

5. So far as the status of review body recommendations concerned, the Secretary of State for Employment at the time the setting up of the review bodies was announced (Mr Michael Carr) said in the House of Commons on 2 November 1970: "The recommendations of the bodies will be accepted by the Government unless there are clear and compelling reasons not doing so" - and the TSRB itself recorded this.
declaration of intent in its first interim report. In a meeting with the three Chairmen on 21 June 1974, the Prime Minister said that the Government believed that review bodies had a useful and important part to play in providing certain groups of employees with the assurance that their remuneration was fairly and authoritatively determined; though the problem remained that they had to take their decisions against the background of the economic problems facing the country. Lord Boyle for his part acknowledged that the review bodies, though independent, existed within the matrix of whatever economic and incomes policy the Government of the day was following. The Prime Minister went on to say that the Government recognised the urgency of the TSRB's work, and hoped that the TSRB would complete its substantive report so that the results could be implemented from 1 January 1975.

6. More recently, the standing of the TSRB (as well as of the Doctors and Dentists Review Body) has been the subject of some attention in the context of the recent reference on higher incomes to the Royal Commission on the Distribution of Income and Wealth. The press statement released with the reference pointed out that the Government wished to make it absolutely clear that the Royal Commission would have a quite separate and distinct function from that of the review bodies. While the Commission would be concerned with a broad analytical study of the facts regarding higher incomes both in the public and private sectors, the review bodies, "on the other hand, have been charged by the Government with the specific responsibility of advising them on the appropriate remuneration for particular groups within the public sector. There is no question, therefore, of the Royal Commission taking over any of the functions of the review bodies, nor of the review bodies' recommendations.
being referred to it or voted by it. Their functions, independence and relationship with the Government and the professions they deal with will be quite unchanged."
CIVIL SERVICE COMPRESSION PROBLEMS

Severe management problems arise from the interface of two separate systems for pay determination at the Assistant Secretary/Under Secretary level. The Assistant Secretary, in common with other grades in the Administration Group, is the subject of Pay Research and his pay is therefore determined by what is paid for comparable work outside. The Under Secretary on the other hand is within the terms of reference of the Top Salaries Review Body.

2. The effect of the two distinct systems, and their timing, has been:

<table>
<thead>
<tr>
<th>Date</th>
<th>Assistant Secretary maximum</th>
<th>Under Secretary rate</th>
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</thead>
<tbody>
<tr>
<td>1.1.1971</td>
<td>£6800 indicated by Pay Research</td>
<td>£6500</td>
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<tr>
<td></td>
<td>£6300 actually paid</td>
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<tr>
<td>1.1.1972</td>
<td>£7276 (£6800 + 7% CPI)</td>
<td>£8250 (TSRB interim)</td>
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<tr>
<td>1.1.1973</td>
<td>£8500 indicated by Pay Research (£7476 actually paid from 1 April under Stage 2; £7988 paid from 7.11.73)</td>
<td>£8500 (TSRB Stage 2 paid from 1 April)</td>
</tr>
<tr>
<td>1.1.1974</td>
<td>£8850 (Stage 3) (£8338 actually paid from 1.1.74, £8650 from 7.11.74)</td>
<td>£9000 (TSRB Stage 3)</td>
</tr>
</tbody>
</table>

3. The last two Pay Research rounds (1971 and 1973) have indicated large increases for the Assistant Secretary, and there is reason to expect that similar increases will be shown to be due from 1 January 1975. Unless, therefore,
there is a very substantial improvement in the Under Secretary rate, the severe compression problem which has existed more or less continuously for the last 4 years will continue. From management's point of view, these problems may be summarised as follows:

a. Assistant Secretary pay is consistently held behind what is known to be indicated by the accepted fair comparison principle;

b. to the extent that the promulgated rate is held back, there is a permanent loss for those retired since their final pension is based on a lower figure than is known to be justified;

c. there is no adequate pay reflection of the responsibilities of the two grades;

d. there are a considerable number of posts and grades which lie between the Assistant Secretary maximum and the Under Secretary rate; at present, these managerial hierarchies are seriously distorted with differentials of the order of on £60–£70;

e. some pay-related groups are very sensitive to market pressures, giving rise to recruitment difficulties while Civil Service rates are consistently seriously out of line.

4. In 1971 and 1973 it was possible to reach agreement with the Staff Side on arrangements for holding back Assistant Secretary pay since the root cause lay in the lack of a report by the TSRB. Now, the TSRB report has provided for headroom for an Assistant Secretary pay
review. If the Government decides not to implement this recommendation, it would be an act of policy be removing indefinitely the possibility of effective negotiations on Assistant Secretary pay.

5. Disputes on the results of Pay Research for the Assistant Secretary cannot be taken to arbitration by the Staff Side except by agreement. The general understanding is that this agreement will not be unreasonably withheld; but it would be difficult to allow a dispute to go to arbitration where essentially what was in issue was management's right to preserve a differential between clearly distinguished levels of responsibility in the same hierarchy. It is accepted that the primary principle of pay determination for the Assistant Secretary is fair comparisons as established by Pay Research, and the Priestley Royal Commission recommended that internal relativities, though relevant, should not be allowed to override this principle. In practice, Ministers would be unlikely to find it possible to have Assistant Secretaries paid more than Under Secretaries; without the headroom recommended by the TSRA the Pay Research evidence is likely to justify that situation; and there would therefore be little alternative to overriding the Pay Research evidence (either absolutely as in 1971 or by staging as in 1975), and bluntly refusing arbitration which could confidently be expected to award for the Staff Side. Such a course would almost certainly be taken up by the Staff Side as a whole as an issue of confidence in the fair comparison principle. What has proved possible in the past merely aggravates present feelings.
### Civil Service

<table>
<thead>
<tr>
<th>No in post</th>
<th>Salary at 1.1.1974</th>
<th>Recommended salary</th>
<th>£ Net of tax (b)</th>
<th>%</th>
<th>Change in salary (a)</th>
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### Armed Forces

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<th>%</th>
<th>Change in salary (a)</th>
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### Medical and Dental

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<th>£ Net of tax (b)</th>
<th>%</th>
<th>Change in salary (a)</th>
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<td>3</td>
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<td>15,000</td>
<td>3,650</td>
<td>1,333</td>
<td>32.2</td>
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<td>18</td>
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6) Threshold payments are not taken into account.

6) Assuming married man's allowance (£865, £1,135 other allowances (mortgage/bank/etc) to total allowances of £2,000.
<table>
<thead>
<tr>
<th>Appointment</th>
<th>No in post</th>
<th>Salary at 1.1.1974</th>
<th>Recommended salary</th>
<th>Change in salary (a)</th>
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<tr>
<td>1st Chancellor</td>
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<td>£19,100</td>
<td>£27,000</td>
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<td>£17,850</td>
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<td>£24,500</td>
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<td>1st President of the Court of Session</td>
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<td>£23,500</td>
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<td>£22,500</td>
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<td>£14,350</td>
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<td>£14,688</td>
<td>£4,900, £1,468, 34.8</td>
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<td>£14,688</td>
<td>£4,900, £1,468, 34.8</td>
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<td>£16,000</td>
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(a) Threshold payments are not taken into account.
(b) Includes Circuit Judge for Inner London (1) and of Liverpool and Manchester (2), Additional Judge of the Central Criminal Court (12) with present salaries of £11,000. Official Referees (3) with present salary of £10,850; Assistant Judge, Mayor's and City of London Court (2) with present salary of £10,350.
(c) Assuming married man's allowance (265) + £1,135. other allowances (mortgage/bank interest etc) is total allowance of £2,000.
### Nationalised Industry: Present and Recommended Salaries

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(a) Where salary ranges or individual flat rate salaries apply increases have been calculated on threshold payments are not taken into account.

(b) Figures are notional as salaries are fixed by the Board.
### ANNEX C (iii)

#### Salary at 1.1.1974

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<tr>
<th>Post</th>
<th>No in Post</th>
<th>Salary at 1.1.1974</th>
<th>Recommended Salary</th>
<th>Change in Salary (e)</th>
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Salary increases have been calculated on a mid-point or average basis respectively.

The Board.
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<tr>
<td>3</td>
<td>10,100-14,100</td>
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<tr>
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<td>9,600-11,100</td>
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<td>9,100-11,100</td>
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<tr>
<td>4</td>
<td>17,600(15,600)</td>
<td>18,000</td>
<td>400(2,400)</td>
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<tr>
<td>1</td>
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<tr>
<td>2</td>
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<td>9,000</td>
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<tr>
<td></td>
<td>5,000-7,500</td>
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</table>

Notes: All the figures have been calculated on a mid-point or average basis respectively.
REASONS SINCE 1969 IN PERCENTAGE TERMS

**Recommended increases in top salaries** (a) **and increases in average earnings, salaries and prices as**

<table>
<thead>
<tr>
<th></th>
<th>1 July 1969 (b) - 1 January 1975</th>
<th>1 January 1972 - 1 January 1975</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Percentage increase</td>
<td>Annual rate of increase</td>
</tr>
<tr>
<td>Civil Service</td>
<td>71.9</td>
<td>10.3</td>
</tr>
<tr>
<td>Armed Forces</td>
<td>65.0</td>
<td>9.5</td>
</tr>
<tr>
<td>Judiciary (c)</td>
<td>96.9</td>
<td>8.5</td>
</tr>
<tr>
<td>Nationalised Industry</td>
<td>56.5</td>
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<tr>
<td>Overall</td>
<td>64.1</td>
<td>9.4</td>
</tr>
<tr>
<td>Average earnings (d)</td>
<td>104.6</td>
<td>13.9</td>
</tr>
<tr>
<td>Average salaries (e)</td>
<td>97.7</td>
<td>13.2</td>
</tr>
<tr>
<td>Retail prices (f)</td>
<td>70.9</td>
<td>10.2</td>
</tr>
</tbody>
</table>

**Notes:**

(a) Averages based on numbers of posts in October 1974.

(b) Recommended levels. These were introduced in 3 stages between 1.7.69 and 1.1.71 for Civil Service or 1.4.69 and 1.1.71 for the Nationalised Industries. These increases for the HJ stages on 29.5.70 and 1.1.71, whereas, the Armed Forces senior officers received increases on 1.4.70 and 1.1.71. The final instalment was voluntarily deferred for the most senior levels in all groups.

(c) For the Higher Judiciary and Metropolitan Magistrates the periods covered are about 6 months.

(d) Movements in DE Monthly Index of Earnings (wages and salaries). The estimate for 4 January 1975 is based on the assumption that wages rose rather more by 18.4 per cent as for wages and salaries.

(e) Movements in DE annual Index of Average Salaries using interpolations based on their N. The estimate for 1 January 1975 is based on the assumption that salaries rose rather more by 18.4 per cent as for wages and salaries.

(f) The January 1975 forecast is based on that for consumer prices as in the National Institute August 1974.

December 1974
in average earnings, salaries and prices since 1969 (in percentage terms)

<table>
<thead>
<tr>
<th>Rate case</th>
<th>1 January 1972 - 1 January 1975</th>
<th>1 January 1974 - 1 January 1975</th>
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<tbody>
<tr>
<td></td>
<td>Percentage increase</td>
<td>Annual rate of increase</td>
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<tr>
<td>1</td>
<td>%</td>
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<tr>
<td>2</td>
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<tr>
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<td>16.1</td>
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<tr>
<td>8</td>
<td>49.8</td>
<td>14.4</td>
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<tr>
<td>9</td>
<td>42.0</td>
<td>12.4</td>
</tr>
</tbody>
</table>

February 1974.

Wages and salaries in 3 stages between 1.7.69 and 1.1.71 for the Higher Civil Service and Listed Industries. These increases for the Higher Judiciary were paid in 2 stages. Armed Forces senior officers received increases (reflecting those in the武装部队高级军官) and the final instalment was voluntarily deferred by a further 6 months for the periods covered are about 6 months later than those shown.

Magistrates the periods covered are about 6 months later than those shown.

The estimate for 1 January 1975 is based on an estimate in the National Institute Economic Review, August 1974.

For consumer prices as in the National Institute Economic Review,
CABINET

FREEDOM OF THE PRESS

Memorandum by the Secretary of State for Employment

1. At meetings on 14 and 21 November the Cabinet discussed the anxieties expressed by newspaper editors about the provisions of the Trade Union and Labour Relations (Amendment) Bill. I was invited, with the Secretary of State for Trade, to consider what action might be taken and report back (CC(74) 46th Conclusions, Item 3).

THE BILL

2. The Bill does not require the establishment of closed shops, nor the inclusion of editors in closed shop agreements where these exist or are introduced. All it does is to fit the provisions on unfair dismissal to the realities of the closed shop by making it fair in a closed shop to dismiss an employee who refuses to join the union, except for religious objectors.

3. The editors have pressed for the Bill to be amended to put editorial staff in the same position in effect as religious objectors.

4. Their reasons are:-

a. Inclusion in a closed shop would be incompatible with their managerial functions and their freedom to get out the paper during a strike; but this is not an adequate ground for legislation.

b. It would encourage the National Union of Journalists' (NUJ) attempts to regulate contributions to the Press by non-professionals. This again is not a matter in which the law should intervene.
c. It would leave editors vulnerable to attempts by the NUJ to interfere with editorial policy. But such action would be clearly contrary to the union's Code of Conduct; we ought not to legislate on the assumption that the NUJ will fail to live up to its own rules.

5. To bring forward an amendment on the lines the editors want would immediately expose us to pressure to widen it. The fact is that there is a general problem of potential conflict between professional ethics and union loyalty, but it is one in which we should be very wary of intruding the law.

6. Whether or not editors and editorial staff are included in closed shop agreements should be settled not by legislation but by discussion and sensible agreements between the parties. This view has been strongly put to me by the Trades Union Congress who are opposed to any amendments of the Bill.

7. The NUJ share this view and have in fact now proposed discussion with the employers and editors. I reproduce the NUJ's letter in the Annex.

THE ROYAL COMMISSION

8. The closed shop and other union practices with a bearing on editorial independence are squarely within the Royal Commission's terms of reference. The only question which arises is whether we should request the Commission to produce an interim report on editorial independence.

9. I think this would be unwise. I have consulted the Secretary of State for Trade and there may be some difference of emphasis between us, but in my view a request for an interim report would be seen as an admission that the Bill has put editors in a new and dangerous situation. It would intensify pressure for amendment of the Bill to exempt editors pending the Commission's report, and undermine the case for resisting such pressure. It would also be seen as a condemnation of the union's tactics in the recent dispute (not yet resolved) and would stultify the NUJ's proposal for talks with the employers and editors.

CONCLUSION

10. I invite my colleagues to agree that we should not bring forward any amendments to the Bill directed to the position of editors; that I should take this line in the further meeting with the editors to which I am committed; and that we should not request any interim report on these matters from the Royal Commission.

M F

Department of Employment
3 December 1974

CONFIDENTIAL
COPY OF LETTER DATED 2 DECEMBER 1974 FROM GENERAL SECRETARY OF NATIONAL UNION OF JOURNALISTS TO:

Douglas Lowndes Esq, Director
The Newspaper Society;

John Le Page Esq, NPA;

C Gordon Page Esq, Secretary
Guild of British Newspaper Editors;

Alastair Hetherington Esq, Editor
The Guardian;

C D Hamilton Esq, Editor-in-Chief
Times Newspapers Limited.

I am sure you will not be surprised that the NUJ has noted the anxieties expressed by editors about the provisions of the Trade Union and Labour Relations (Amendment) Bill on unfair dismissals. It fully shares the concern of editors for the safeguarding of free expression and indeed this concern is fully reflected in the union's Code of Professional Conduct.

Editors' expressed anxieties appear to centre round closed shop agreements. The union believes that these anxieties are misplaced, but it would welcome discussion with the other organisations concerned about what safeguards might be embodied in any such agreements and the principles which should govern the application of such agreements to editors.

In particular the union would propose adoption of a model clause for such agreements which might provide that the parties subscribe to the principle of the freedom of the Press and other media in relation to the collection of information and the expression of comment and criticism, the need to eliminate distortion, news suppression and censorship, and to ensure that dissemination is fair and accurate, avoiding any expression of comment and conjecture as established fact and falsification by distortion, selection or misrepresentation; and that the parties should undertake to observe these principles fully in the conduct of their relations with all editorial staff.

I feel sure that your organisation and others involved, to whom I have written, would similarly welcome discussion on these lines. I would appreciate your comments.
PAY OF NATIONAL HEALTH SERVICE CONSULTANTS
Memorandum by the Secretary of State for Social Services

1. Consultants in the National Health Service (NHS) are seriously disaffected. They have for some years been seeking a better contract and when we took office in February were already threatening industrial action unless we were willing to examine their complaints. This we agreed to do provided the examination also included the phasing of pay beds out of NHS hospitals in keeping with our Manifesto commitments.

A BETTER CONTRACT

2. At present those consultants who do not commit themselves wholly to the NHS are allowed to do private practice in return for a reduction in pay. In the case of the maximum part-time contract of 11 sessions the deduction is 2/11ths. Moreover a sum of £10 million is currently distributed in the form of distinction awards which are allocated secretly by an independent medical body and which go largely to those already heavily engaged in private practice i.e. those working in the most popular specialities and in the most favoured parts of the Service such as the London teaching hospitals.

3. This situation has serious drawbacks for the NHS as well as the consultants. At present there is no means of policing the extent to which the part-timer discharges his obligations. Some with large private practices subordinate their NHS patients to their private ones. Others, with only a small number of private patients or none at all, work long hours in the NHS well beyond their 11-session commitment and they get no reward for this extra work. The result is that consultants are discouraged from going to difficult areas where there is a heavy work-load and shortage of staff. The phasing of pay beds out of NHS hospitals will lead to a loss of private practice in certain areas. In others it could encourage consultants to go wholly outside the Service unless a contract can be agreed which encourages a greater commitment to the NHS.
4. The discussions with the consultant representatives have been difficult and without commitment on our side. It is possible that agreement will not be reached. In that case it is essential that we should be seen publicly to have made a reasonable offer. The British Medical Association (BMA) have already circularised their members concerned inviting them to join "locum agencies" from which the Association could offer their services back to hospitals after their resignation from the NHS. If this proposal were to get off the ground health authorities would be faced with the need to re-engage consultants on a purely sessional basis without our having achieved the safeguards for the NHS which we are seeking.

5. I therefore ask my colleagues to allow me to offer consultants firm proposals for a new contract which I have outlined in the Annex. It meets their demand that extra effort and a fuller commitment to the NHS should be rewarded while maintaining the present differential in favour of the whole-timer who foregoes private practice to make himself totally available. In my view it offers the only basis on which agreement - now or later - can be reached while at the same time enabling us to fulfil the aims of our Manifesto.

COST

6. Through these new contract proposals we are rightly seeking to overcome some major defects in the compromises made when the NHS was introduced. This is a restructuring which is bound to require some additional money and consultants are expecting this.

7. The Doctors' and Dentists' Review Body are due to review substantively doctors pay for April 1975. They are currently considering an application from the BMA for an interim increase and whether or not to recommend a breach of the 12 month rule. In any event, the outcome of the April review will be a recommendation for a major increase for all grades. Its size is difficult to predict but it is likely to be of the order of 25-30 per cent and the consultants are likely to be awarded a good share of this.

8. We would argue to the Review Body that the total cost of restructuring and in particular paying for extra work not previously remunerated should be offset against the general increase, especially for shortfall, for this group. They will be asked to price the totality of the contract at a fair new level overall. I hope therefore that the total increase on the present consultants' annual pay bill can be kept below the rough estimate (mentioned to EC(P)) of £33 million, of which about £15.5 million would be in any case recommended to us by the Review Body; and that the element for restructuring as such might be well within £20 million.
9. The increase in the pay bill will secure additional service estimated at about £5 million: I am prepared to meet that part of the cost from offsetting savings.

10. To the extent that the balance has to count as expenditure in real terms, I have suggested that the sum - probably a maximum of about £12 million - might be met from the contingency reserve.

11. The increased pay bill cost needs to be clearly distinguished from the loss of charges as private beds are phased out. I propose to phase out over a period of years and to deal in the meantime with queue jumping by means of common waiting lists for private and NHS beds. The loss of charges, ultimately £20 million per annum, will be felt gradually and given a three-year phasing out need be no more than about £6 million in 1975-76, and will similarly require an increase in my programme to be met from the contingency reserve.

REPERCUSSIONS

12. I recognise that some of my colleagues may find it difficult to accept that large increases for one of the more highly paid groups will not have serious repercussions.

13. Neither the general practitioners however nor the junior doctors have a similar case for a major pay restructuring. As for wider repercussions, the most serious danger may be that payment for extra sessions is represented as a kind of overtime for a highly paid group. But the extra sessions will be identified and contracted for in advance as part of the individual contract which each consultant makes with his employing authority. This is, I believe, a unique feature and unlikely to be paralleled elsewhere. There will be no clocking up of odd half hours or hours of overtime after the end of a day. If I do not meet the consultants on their work-load point, they will take industrial action, withdraw the substantial "overtime" they are now doing and expect us to buy them back.

14. In sum, I believe that my proposals taken as a whole fall within the scope of the social contract. They meet our Manifesto commitment and will help to attract doctors to staff the NHS whole-time rather than expand private practice outside the NHS hospitals. Those consultants who secure considerable increases will be those who work the hardest, and by committing themselves to the NHS rely on us for their total income.

TIMING

15. In the light of the EC(P) discussion on Tuesday the BMA have been told we are not ready yet to present Government proposals. I will report their reactions to Cabinet, orally. Clearly, it is now essential to reveal the Government's proposals to the consultants and the public.
There is no need, however, to discuss at this stage the pricing of the contract; this will be for the Review Body to whom it would not be sent until the New Year.

SUMMARY

16. I ask my colleagues to agree to a Government offer in principle of the new contract proposals which would be published and in due course submitted to the Review Body for pricing. I would submit to my colleagues the line of evidence I propose to offer to the Review Body.

B A C

Department of Health and Social Security

4 December 1974
1. There are the equivalent of about 11,500 consultants in Great Britain, of whom about 5,200 have whole-time salaried contracts. Of the remainder, the majority have maximum part-time contracts which require them to work virtually full-time in the NHS, but allow them to practice independently using NHS pay beds or facilities elsewhere. Maximum part-timers receive 9/11 of the whole-time pay, but their contracts are otherwise substantially the same.

PRESENT CONTRACT

2. The main features of the present consultant contract are:

a. basic commitment - 11 sessions a week covering clinical and related administrative work, and clinical teaching of medical students;

b. hours - no precise hours of duty each week; sessions are assessed roughly in terms of "notional half days" of 3½ hours each, but consultants work such hours as are necessary, including night and week end work;

c. private practice is not permitted to whole-timers;

d. salary scale - £5,433 x 9 increments to £7,947 (wef £ 4,74) covers all work (apart from that referred to at e. below);

e. domiciliary visits, exceptional consultations, lectures to non-medical staff, and work on the District Management Team - excluded from the assessment under b. and paid for by item or allowance;

f. distinction awards - values are £1,506 for a C (2914 awards); £3,540 for a B (1311 awards); £6,030 for an A (453 awards) and £7,947 for an A+ (124 awards).

Awards are recommended by an independent committee. One third of consultants hold an award at any one time: about 50% of consultants receive an award during their career. The total annual cost of the awards is about £10m. DHSS does not have recent details of the distribution of awards between those with whole-time and those with part-time contracts. However, it is known that a high proportion of awards go to consultants in those specialities where the proportion of whole-timers is relatively low (eg 50 per cent of consultant surgeons and physicians have awards; and 88 per cent of surgeons and 68 per cent of physicians do private practice). Awards of up to £6,500 may thus be paid to those whose private earnings may be anything up to £20,000.

Only part-timers are permitted to engage in private practice: there are two groups:

(i) "maximum part-timers" have an 11 session commitment but only get paid 9/11 of salary and distinction award;

(ii) other part-timers have lesser sessional commitments and get paid pro rata to sessions performed, eg 5/11 for 5 sessions.
PROPOSALS FOR THE NEW CONTRACT

Sessional commitment

1. The consultant's obligation to NHS work will be defined as normally a 10 session Monday to Friday contract. For the first time ever this will give the NHS as the employing authority the ability to require the regular presence of all consultants at the hospital, instead of a notional commitment. In future, if the consultant wants to do private practice he will have to opt for an 8 + 2 session contract; his private bed work will be outside the NHS hospital and outside NHS sessions, not, as at present, inside the hospital and at a time chosen by him whether it coincides with the NHS sessions or not. The authority will also be able to review the consultant's ability to provide the additional 2 sessions and withdraw them on reasonable grounds, for example, if his private practice commitment affects his NHS work.

2. Where there is a need consultants may be engaged for additional sessions over the 10 (or over the 8 + 2). Hitherto extra effort of this kind by consultants in the NHS has attracted no extra reward, although extra effort devoted to private practice has brought extra income. This proposal will reward extra effort for the NHS and will even up the relative position of the whole-timer who will have preference on the additional sessions. A joint survey has shown that much work is done at evenings and week ends and that the average hours consultants work, whether whole or maximum part-time, may often be 60 or more per week.

Emergency and administrative work

3. Consultants taking the new contracts will also receive extra remuneration for emergency calls to the hospital and for some extra kinds of administrative NHS work.

Differential

4. It is essential to continue to have a differential on basic remuneration in favour of the whole-timer in order to encourage whole-time commitment to the NHS. At present 2/11ths is deducted if a consultant wishes to engage in private practice, although still devoting substantially all his time to the NHS. The Government should maintain its right to impose a differential, although I would be prepared to accept if driven to it that it is no larger than at present.

Distinction Awards

5. The present system of secret distinction awards is quite unsuitable. Important specialities like geriatric and psychiatry do relatively badly, and the system does nothing to encourage a healthy distribution of consultants. A very large proportion of the awards go to consultants who have private practice. This system should be abolished except that those who opt to retain their old contracts would keep their present awards; no new higher awards would be given.
6. To replace the inegalitarian distinction awards, costing £10m a year, I propose two classes of career structure payments. The larger, which would quickly build up to about £5m, would be at the disposal of NHS authorities to pay service supplements to consultants who for example tackle the building up of NHS services in unattractive areas, or cope with shortages in geriatric, psychiatric and similar fields. The smaller class, which would be £1-2 millions, would be for medical progress supplements, to reward innovation of special value to the NHS.

7. Distribution of service supplements in particular would tend to favour the whole-timer, who tends to work in, say, geriatrics or in under-privileged cities. There can certainly be no justification for paying either class of supplement in addition to large private earnings, so that I would not make them available to those with less than a regular 10 session commitment to the NHS; also those with private practice if awarded a supplement would receive only that part, if any, by which the supplement exceeded their private earnings.

8. The career structure supplements would not include awards for seniority (such as general practitioners currently get and for which in effect some at least of the present distinction awards is arguably spent) but it is proposed to replace the present incremental scale by a scale of fewer, larger steps over longer intervals; this would help younger consultants whose current dissatisfaction is strong.
CABINET

NATIONAL HEALTH SERVICE CONSULTANTS: NEW CONTRACT PROPOSALS

Memorandum by the Chancellor of the Exchequer

1. The proposals by the Secretary of State for Social Services for new contracts for National Health Service (NHS) consultants (C(74) 143) have very difficult implications for incomes policy and for public expenditure.

INCOMES POLICY

2. The double objective of phasing out private beds and getting more consultants to commit themselves wholly to the NHS involves paying more in real terms for the same amount of work: for example, a whole-time NHS consultant who now gets just over £9,500 would get just over £14,000 for no extra effort or responsibility. And this is at 1974 levels; the Doctors' and Dentists' Review Body might well award something around 20 per cent anyway from next April for the 1975 pay review. It will be seen that these proposals go some way beyond simply compensating those consultants who give up private practice for the loss of that income - hence, to some extent, the extra cost.

3. Extra pay of this order can be expected to have repercussions within the NHS on General Practitioners and Junior Hospital Doctors at the very least. Moreover, increases on this scale for the relatively highly paid would be outside the Trades Union Congress (TUC) guidelines on pay; it cannot credibly be argued that the reference in the guidelines to restructuring is meant to accommodate this sort of thing.

4. Some features of these proposals could have repercussions outside the Health Service; for example, they could encourage demands for overtime payments by public sector staff who do not get them now, even at salary levels considerably below those of consultants.

5. There is also the position of the Doctors' and Dentists' Review Body. It is dangerous, and has implications for the whole Review Body system, to depart from the principle that it is they, rather than the Government, who deal with actual pay levels in this area, merely because the consultants are in a strong negotiating position and are prepared to be militant.
6. There is also the risk of pre-empting the decisions we have to take on top salaries.

PUBLIC EXPENDITURE

7. If adopted, the Secretary of State's proposals would also raise a substantial issue of public expenditure. Their immediate cost, previously estimated at £20 million and now at £17 million a year, would in practice amount to an equivalent addition to the total expenditure at constant prices on the NHS (as distinct from "straight" pay increases for which the doctors have been promised the necessary extra finance). No account was taken of this in the Cabinet's decisions on 25 November on expenditure and priorities and allocations to individual programmes. The whole of the additional expenditure entailed in the present proposals therefore represents a new view of NHS priorities, and would need to be accommodated within the overall limits for expenditure set by the Cabinet. This would have to be done by one or more of three means - by offsetting reductions to expenditure within the health programme as decided on 25 November; by offsetting reductions to other programmes; or by charging it to the Contingency Reserve for each year, thereby reducing availability of that reserve for all other purposes. The Secretary of State offers to accommodate by the first of these methods that element of the cost, estimated at not more than £5 million, which is expected to result from consultants opting to work full-time in the NHS instead of part-time, and from acceptance by consultants generally of extra obligations. She proposes that the remaining £12 - 15 million a year of the immediate cost should be found from the Contingency Reserve - i.e. that potential claims on the Contingency Reserve for all programmes should be foregone to the same extent.

8. These figures leave out of account the further cost of at least £20 million a year which would arise from phasing out pay beds themselves, in consequence of the loss of income from charges for these beds. They also leave out of account the cost of repercussions on pay elsewhere in the public sector of the present proposals, which cannot at present be quantified, but could be large.

CONCLUSION

9. I sympathise with the Secretary of State's objectives. But by seeking to achieve them in this way we risk paying too much and prejudicing our wider policies. The public will think that the main beneficiaries are the consultants, not the sick. We must consider very seriously the implications for the Social Contract and the TUC guidelines. And even if we conclude that they can be accepted, I must ask my colleagues to consider whether the expenditure consequences are acceptable also, and to what extent they should be offset from within the expenditure programme for the NHS rather than the Contingency Reserve.

DH

Treasury Chambers

4 December 1974
10 December 1974

CABINET

TOP SALARIES, HOSPITAL CONSULTANTS AND THE SOCIAL CONTRACT

Memorandum by the Secretary of State for Employment

1. We shall without any doubt immensely increase our and the Trades Union Congress's (TUC) present difficulties in sustaining the social contract on pay if we give 30-40 per cent increases to the Top Salaries Review Body (TSRB) posts and the hospital consultants.

2. The TSRB recommendations are not consistent with the TUC pay guidelines. Nor are the proposed increases for consultants. If we pretend that they are - by talking about cost of living compensation over several years or about restructuring - we shall not command conviction. We shall only weaken respect for the guidelines among other groups.

3. In any case people are not entitled to whatever the TUC guidelines appear to justify. Many low paid people are still not going to be able to reach the TUC £30 low pay target, while even a straight cost of living increase for the last year would yield gross increases of £40 a week and more at these top salary levels - more than many people earn as a whole in a week. It compares, for example, with the extra £3.43 a week that the local authority manuals have just secured in getting to the £30 minimum.

4. Miners and others will not be slow to draw the moral. If 30-40 per cent is justified for people on five figure salaries, why not for those below? If the TSRB groups can recoup their position since 1969 - even though they have had the highest level of settlement possible in each of the last two years - why should others not look back beyond their last settlement and recoup what they regard as their losses from an earlier date? And why should manual workers believe us when we tell them that the economy is in a grievous state calling for restraint by all if at the same time we raise by thousands of pounds the salaries of some of the highest paid people in the country?

5. I understand, of course, that the time is never ripe for large increases for the more highly paid public servants. But they have their stake too in seeing the social contract succeed and the pace of inflation checked. It will go hard with them as with the rest of our people if the social contract fails.
6. I believe therefore that we must reject the TSRB report. We should allow sufficient increase to those earning less than £10,000 to remove any acute differential problems with those below, but we should give no increase to those above £10,000. We should publicly recognise that these people will be making a special contribution and we should invite all others in the public and private sectors with incomes of £10,000 or more to forgo any increase in their incomes in 1975. The Royal Commission on the Distribution of Incomes will be reporting in the course of next year on top salaries generally and we can take stock then of our general policy in this field.

7. This approach will have to apply to hospital consultants as well, though I fully recognise the great difficulties involved there. And it requires that Cabinet Ministers should accept a cut in their salaries.

8. This approach to their recommendations may lead the TSRB to resign. I would hope not. But if it did, I imagine that it would not be impossible to provide for future changes in the higher salaries in the Civil Service to be related in some way to pay movements lower down the scale, and for the link across to the judiciary and top posts in the Armed Forces to continue. No doubt there would be greater difficulty with the nationalised industries.

9. But such problems seem to me much less serious than those that would flow from acceptance of the present proposals on top salaries. We should then be playing right into the hands of those who are only too anxious to break the TUC guidelines beyond repair.

10. If my colleagues accept the principle of this approach, we should ask officials for detailed proposals for its application.

M F

Department of Employment

10 December 1974
CABINET

TRADE AND INDUSTRY SUB-COMMITTEE OF THE HOUSE OF COMMONS COMMITTEE ON EXPENDITURE

GOVERNMENT OBSERVATIONS ON FIFTH REPORT, SESSION 1973-74; WAGES AND WORKING CONDITIONS OF AFRICAN WORKERS EMPLOYED BY BRITISH FIRMS IN SOUTH AFRICA

Note by the Secretary of State for Trade

1. Attached is a final typescript copy of a Command Paper containing the Government's observations on this report. It has been approved by the Prime Minister and by the Secretaries of State for Foreign and Commonwealth Affairs and Employment and is circulated for the information of Cabinet colleagues.

2. I propose to lay the Command Paper before Parliament in association with the Secretaries of State for Foreign and Commonwealth Affairs and Employment on 18 December.

P.S.

Department of Trade

13 December 1974
WAGES AND WORKING CONDITIONS OF AFRICAN WORKERS EMPLOYED BY BRITISH FIRMS IN SOUTH AFRICA

GOVERNMENT OBSERVATIONS ON THE FIFTH REPORT FROM THE EXPENDITURE COMMITTEE: HOUSE OF COMMONS PAPER 116 SESSION 1973-4

INTRODUCTION

The Government's welcome for this report and acceptance of its main recommendations were announced in the House of Commons by the Secretary of State for Trade on 1 May (Annex 1). The Code of Practice setting out the Committee's guidelines for employment practices by UK companies with interests in South Africa has been widely publicised and sent to chairmen of more than 500 British parent companies with a personal letter from the Secretary of State, urging adoption of the recommended policy and practices to the fullest possible extent.

2 The Government have now considered the remaining recommendations after consulting both sides of industry. The Government's decisions are as follows.

RECOMMENDATION

"That the Embassy and the DTI play an active role in seeking out companies in order to encourage and advise them on improvements in employment practices". (paragraph 189)
3 The Government accept that the Code of Practice should be widely disseminated and that information and general guidance on labour matters should be provided to augment the knowledge of local conditions which responsible parent companies should possess. Accordingly officials in the UK and in the Embassy and Consular Posts in South Africa are seeking opportunities to draw the attention of businessmen to the Code of Practice and to stress the Government's endorsement of it. Officials will also continue to give information to businessmen on request. Supplementary guidance on labour matters in South Africa is being prepared and will be sent to all British companies with affiliates employing Africans in South Africa. Copies will also be available for distribution to business visitors.

RECOMMENDATION

"That companies be invited to submit reports on their practices and on progress concerning African wages and conditions". (paragraph 189)

4 The Government agree with the Select Committee that publication of information on companies' progress towards the objectives of the Code of Practice is an important means of encouraging and persuading others, and that companies should expect continuing publicity for their performance in this field. The Government also believe that Parliament and the public
should have access to information allowing judgements to be made on the progress achieved by companies. Parent companies in this country will accordingly be invited to publish regularly in their annual reports to shareholders, chairman's statement, or in any other convenient form, the information specified in Annex 2 to demonstrate progress in raising non-white wages above PDL rates and towards the MEL.

5. Companies will also be encouraged to report as fully as possible on other important matters covered by the Code of Practice such as the opportunities for African advancement and development of collective bargaining including details of existing channels of consultation on wages and working conditions, the scope of such arrangements and how wages are determined; the names of any African trade unions that are recognised by the company and, if any have applied for recognition, the results of such applications; any employers' associations to which the subsidiaries or associated companies are affiliated. Information on fringe benefits provided for Africans (eg education, medical care, housing, legal assistance, pensions, training, food/meals (especially in respect of mining undertakings), leave and sick leave) could also usefully be included.

RECOMMENDATION

"That a review be undertaken of staff in South Africa and in the DTI whose function it is to provide information, assistance
and advice to companies". (paragraph 189)

6 The Government have reviewed the staff engaged in work relating to the area of the Select Committee's enquiry. Adequate resources are available in the UK to deal with requests from companies for information and to produce and update general guidance to companies on South African labour affairs. The Embassy and Posts in South Africa must also have adequate resources to enable them to keep Departments in London fully and reliably informed on these matters and to provide, when required, information and advice in general terms to South African affiliates of British companies. As already announced the Embassy's staff will be strengthened by the addition of a First Secretary (Labour) so that these functions can be carried out more comprehensively than in the past.

RECOMMENDATION

"That the Inland Revenue should issue public guidance on how the control over the issue of directives to subsidiaries on labour matters renders the subsidiaries liable to UK tax and that if necessary there should be legislative change". (paragraph 191)

7 The Inland Revenue have prepared the statement at Annex 3 which is intended to allay any doubts in the minds of parent companies about the risk of bringing an overseas subsidiary into
liability to UK tax through the issue of policy directives to the subsidiary on wages and conditions of employment. Wide publicity is being given to this statement. The Government are satisfied that there is no need for legislative change and that companies can proceed with confidence in the light of the Inland Revenue guidance to implement the Code of Practice without fear of prejudice to the tax position of their South African affiliates.
STATEMENT BY THE SECRETARY OF STATE FOR TRADE
1 MAY 1974

SOUTH AFRICA (BRITISH FIRMS)

The Secretary of State for Trade and President of the Board of Trade (Mr Peter Shore): With permission I should like to make a statement about the Government's initial views on the recommendations in the Fifth Report of the Expenditure Committee on the wages and conditions of African workers employed by British firms in South Africa.

This was a somewhat unusual field of inquiry for a Select Committee. The whole House will wish to congratulate my hon. Friend the Member for Stockton (Mr Rodgers) and his colleagues on the Trade and Industry Sub-Committee on the thoroughness of this inquiry and the admirable report which they have produced.

We accept the main recommendation that the Government should issue amplified guidance to British firms on the wages and working conditions of African workers. The Report contains an admirably full and clear statement of recommended practices which, if implemented conscientiously, could lead to very real improvements.

As recommended by the Committee, I am now arranging to give the Code of Practice wide publicity. I shall write personally to those British firms with South African interests. My letter and the text will be issued to the Press, as will the list of those to whom I am writing. Naturally we also accept that the guidances should be up-dated when necessary.

Key recommendations in the guidelines are that no British firm in South Africa should pay adult male African employees wages below the appropriate poverty datum level, and that all firms should aim within a set timetable to pay minimum wages equal to the minimum earnings level broadly equivalent to poverty datum level plus 50 per cent. Elsewhere the report rightly stresses the responsibility of parent firms for the employment practices of South African affiliates. These are the basic lessons of the inquiry and it is now for industry to put them into practice.

The report contained a number of other recommendations on informing and advising firms on overseas industrial relations and on monitoring their performance. These proposals are being given urgent and careful study by the Departments concerned as well as consultation with both sides of industry. I shall inform the House of the outcome in due course.

(Hansard Cols 1156-1157)
UK COMPANIES WILL BE ASKED TO PUBLISH THE FOLLOWING INFORMATION ON PROGRESS WITH IMPLEMENTATION OF CODE OF PRACTICE

General
1. Name of UK parent company.
2. South African affiliate (a)
3. Percentage of equity held directly or indirectly in each affiliate (a).

Pay (information required for each affiliate)
4. Total number of African employees in South Africa.
5. Number of Africans in lowest paid grade(s).
6. Wages of lowest paid grade(s) (Rand per month) and hours worked (b).
7. District(s) in which lowest paid are employed.
8. Poverty Datum Line (PDL) and Minimum Effective Level (MEL) used by company. (Rand per month). Source and date of PDL/MEL.
9. Number of African employees below PDL.
10. Number of African employees below MEL.
11. Timetable for achieving the MEL as a minimum wage for all employees. (c)

NOTES
a. Only affiliates in which UK parent holds more than 10% of the equity need be mentioned.

b. Wages should include overtime and other bonuses only if these are guaranteed and certain. The value of any fringe benefits included should be identified separately.

c. Only applicable if some employees are paid below MEL.
TAXATION OF PROFITS OF SUBSIDIARIES OF UNITED KINGDOM COMPANIES

The Inland Revenue have been asked to provide public guidance on the taxation consequences of the exercise of control by parent companies in the United Kingdom over the employment and wages policies of their subsidiaries operating abroad. (Fifth report of the Expenditure Committee, Session 1973-74, Wages and Conditions of African Workers Employed by British firms in South Africa, 22 January 1974.)

The following statement is issued in response to that request.

1. A company is resident in the United Kingdom (and hence liable to United Kingdom corporation tax on its worldwide profits) if the central management and control of its business are exercised in the United Kingdom. (Central management and control is distinct from the voting control exercisable by shareholders.) This rule has to be applied to the facts of each particular case but if for example the meetings of the directors who manage the company's business are held in the United Kingdom the central management and control of the company would normally be regarded as exercised in the United Kingdom and the company would be resident here for tax purposes.

2. Where a company operating overseas is a subsidiary of a United Kingdom resident company, the question to be answered is whether participation in the management and control of the subsidiary company's business by the parent company is of such a character as to indicate that the subsidiary is resident in the United Kingdom. Precise and comprehensive rules cannot be laid down but the following comments may help to clarify matters. Because the question has arisen in the context of guidelines and directives on employment and wages policies these are used as illustrations but they would not be the only factors. All the facts and circumstances would have to be taken into account.

3. Guidance on non-discrimination

The Inland Revenue would not regard a parent company as exercising the central management and control of a subsidiary solely because the parent directed the board of the subsidiary not to discriminate between its employees on racial grounds or to pay its employees at rates above the minimum level.

4. Guidance on employment and wages policy generally

The mere issue by a parent company of general guidelines for the board of the subsidiary on employment and wages policies would in the Inland Revenue's view be unlikely to indicate that it was managing or controlling the subsidiary. Similarly, the issue of specific policies on wages and conditions, specifying such matters as rates of wages to be paid or increases in those rates, as guidelines for the board of the subsidiary, which it was free to follow or ignore, would not of itself be likely to indicate the exercise of the central management and control by the parent company.
5 Directives concerning employment and wages policy

In itself, the issue of directives of a general nature by the parent company laying down employment or wages policies to be followed by the subsidiary would not be regarded as indicating the exercise of central management and control. However, directives specifying particular conditions of employment or wages rates would normally suggest that a degree of central management and control of a subsidiary was being exercised by the parent company but would not necessarily be conclusive evidence that the subsidiary was resident in the United Kingdom.
17 December 1974

CABINET

PAY OF NATIONAL HEALTH SERVICE CONSULTANTS

Memorandum by the Secretary of State for Social Services

1. The decision of Cabinet on top salaries (CC(74) 51st Conclusions, Minute 4) affects my proposals for National Health Service (NHS) consultants.

2. My previous paper (C(74) 143) proposed new contracts, with features to encourage whole-time service and regular extra commitments to the NHS, and to help staffing in difficult areas and specialties. I believe these to be necessary and worthwhile. In particular that part of my proposals which offers a new contract with a firm sessional basis (instead of its present ambiguous open-endedness) is essential to control abuse of consultants' time, to remedy their sense of injustice and by paying fairly for extra sessions to forestall their threat to work to their interpretation of their hours, and make us buy them back again.

3. These new contracts are not affected in principle by our decision on top salaries. I must warn colleagues that despite the fact the constraint appears generous to us the profession's negotiators are likely to reject it. We believe the profession as a whole may be more reasonable if we make a reasonable offer to them.

4. The negotiators object to any differential for whole-time service and to the scheme of career payments being subject to offsetting of private practice earnings; they are also urging a completely new item of service contract to which I am opposed. They want on-call payments and time and a half for extra sessions. I intend to stand firm on the broad principles and only agree to modifications of detail in negotiation.

5. A new contract if agreed would go to the Doctors' and Dentists' Review Body (DDRB) for pricing. The DDRB will anyhow have to reprice the existing contract in the main 1975 review covering all doctors and dentists. I will submit the Departmental evidence to my colleagues.

6. If forced to comment on the relationship of the Government's decision on the Top Salaries Review Body (TSRB) to the findings of the DDRB, I will tell the profession that the Government reserves its right to modify the DDRB recommendations in accordance with the same principles that we are
applying to top salaries in the public sector and our appeal to the private sector, and taking into account the report which we are urgently requesting from the Royal Commission on Incomes Distribution and Wealth and any further action we may take in the private sector. This statement alone may well promote sanctions; a refusal to go to the DDRB; and a demand for direct negotiations. Here again our only hope of preventing widespread disruption is if we have moved some way to meeting them over the principles of the new contract.

PAY BEDS

7. If curbs are to be applied to consultants' increases I may be compelled to postpone the start of phasing out pay beds until 1976-77. In the meantime I would propose to introduce the necessary legislation as quickly as possible; to introduce common waiting lists wherever practicable; and to reduce pay beds where utilisation is well below that of NHS beds. Trades unionists may resume their disruption of services for private patients but the promise of specific legislation should help.

TIMING

8. If Cabinet agrees, I will explain the Government's position on new contracts and the DDRB awards to the doctors whom I am due to meet in the afternoon on Friday 20 December. I should also tell them that the DDRB's report on the doctors' interim claim has been received, as I expect it will have been, and is under consideration. We may be in a position to indicate its contents.

DISRUPTION OF NHS

9. Doctors are in a position to reduce their working time unilaterally and to force us to buy them back for additional sessions. They may decide to do so after I have seen them but in my view will certainly do so if we both reject the new contract and indicate that we intend to stage any repricing of the old contract the DDRB may recommend. I must warn my colleagues we may be in for a long period where medical services are substantially reduced and we will inevitably see a lengthening of waiting lists.

B A C

Department of Health and Social Security

17 December 1974