CABINET

CONCLUSIONS of a Meeting of the Cabinet held at 10 Downing Street, S.W. 1, on Sunday, 5th January, 1958, at 6.30 p.m.

Present:

The Right Hon. HAROLD MACMILLAN, M.P., Prime Minister.


The Right Hon. SELWYN LLOYD, Q.C., M.P., Secretary of State for Foreign Affairs.

The Right Hon. The EARL OF HOME, Secretary of State for Commonwealth Relations.

The Right Hon. JOHN MACLAY, M.P., Secretary of State for Scotland.

The Right Hon. DUNCAN SANDYS, M.P., Minister of Defence.

The Right Hon. IAIN MACLEOD, M.P., Minister of Labour and National Service.

The Right Hon. LORD MILLS, Minister of Power.

The Right Hon. GEOFFREY LLOYD, M.P., Minister of Education.

The Right Hon. VISCOUNT KILMUIR, Lord Chancellor.

The Right Hon. PETER THORNEYCROFT, M.P., Chancellor of the Exchequer.

The Right Hon. ALAN LENNOX-BOYD, M.P., Secretary of State for the Colonies.

The Right Hon. VISCOUNT HAILSHAM, Q.C., Lord President of the Council.

The Right Hon. D. HEATHCOAT AMORY, M.P., Minister of Agriculture, Fisheries and Food.

The Right Hon. HENRY BROOKE, M.P., Minister of Housing and Local Government and Minister for Welsh Affairs.

The Right Hon. HABOLD WATKINSON, M.P., Minister of Transport and Civil Aviation.

Dr. The Right Hon. CHARLES HILL, M.P., Chancellor of the Duchy of Lancaster.

The Right Hon. REGINALD MAULDING, M.P., Paymaster-General.

Also present:

The Right Hon. EDWARD HEATH, M.P., Parliamentary Secretary, Treasury.

Secretariat:

The Right Hon. Sir NORMAN BROOK.
Mr. B. ST. J. TREND.
Subject

Government Expenditure

The Prime Minister said that the Cabinet must now seek to formulate a collective view on the two main aspects of the problem which confronted them—first, the extent to which they should seek to impose on the Government's own expenditure a discipline no less rigorous than that to which public investment and the private sector had been subjected; second, the methods by which the necessary economies would best be achieved.

The Chancellor of the Exchequer said that, as regards the first of these questions, he remained convinced that the cardinal objective of the Government must be to maintain the strength of sterling both at home and abroad. If the Government failed to realise this objective, they would fail in every other aspect of their policy. The measures to this end which they had adopted in the autumn of 1957 had been unpopular and had been imposed only with great difficulty. Even so, they had proved barely sufficient to sustain sterling. Moreover, in view of the growth of international illiquidity and the acceleration in the rate at which the holders of sterling balances were drawing them down, sterling would face renewed pressure in 1958. It would be impossible for the Government to withstand this pressure unless they could convince public opinion, both at home and abroad, that they were adhering unreservedly to their disinflationary policy and were determined to subject their own expenditure to the same measures of control as those which they had imposed on the rest of the economy. It was, therefore, essential for the Cabinet to decide whether they were prepared to take a firm decision substantially to eliminate the £153 millions which represented the probable excess of Government expenditure in 1958–59 over the level of 1957–58.

In discussion there was unanimous agreement on the importance of curtailing Government expenditure by all possible means. But it was emphasised that the Government would be unwise to appear to reject the policy of an expanding economy by insisting that in no circumstances should the level of Government expenditure rise. Nor was there a unique significance in reducing Government expenditure in 1958–59 to precisely the same level as in 1957–58. In view of the extent to which this expenditure was determined by factors outside the control of the Government—e.g., the increase in the numbers of schoolchildren and old people—a moderate increase in its level could be convincingly defended to public opinion, and the additional purchasing power which it would generate would be less damaging to the economy than the renewal of inflated wage claims which would certainly be provoked by reductions in the welfare services. Even further reductions in capital investment would be preferable to imposing on Government expenditure so arbitrary a limit as to jeopardise the wage stability which must remain the Government's main objective.

The discussion then turned to the individual measures which it was proposed to introduce.

The Minister of Labour said that, after discussion with the Minister of Pensions and National Insurance and the Minister of Health, he remained of the opinion that it would be unwise to abolish the family allowance for the second child and that the imposition of an increased charge for school milk would encounter serious opposition from the school teachers. The introduction of a hospital boarding charge would involve the employment of 1,000 additional clerical staff, whom it would be difficult to recruit at a time when the Government had recently refused an increase of pay to the grades...
concerned. Nor would the hospital authorities themselves be willing to face the administrative difficulties of introducing a charge of this kind in a period when they were being denied an expansion of the facilities which they regarded as essential. The abolition of the supplementary ophthalmic service would be no more palatable. The Government had given repeated pledges that this service would be maintained; and its suspension would in any case yield additional income of little more than £41 millions a year. An increase in the charge for welfare milk to 6d. a pint might perhaps deserve further consideration; but it would be condemned by public opinion as a measure directed against the family and would be liable to provoke a critical reaction from organised labour. If all these measures were rejected, there remained only the possibility of increasing that element in the National Insurance contribution which was attributable to the National Health Service. It would be unfortunate to announce an increase of this nature at the time when the civil Estimates were published, since it would then coincide with the date on which the latest increase in the National Insurance contribution would come into effect. It would be preferable that it should be deferred for announcement in the Budget speech, where it could be presented in its proper context, even although its implementation would be correspondingly delayed.

In discussion it was suggested that the Chancellor of the Exchequer had, if anything, understated the gravity of the threat to sterling, which was liable to increase in intensity in the months ahead. In order to overcome this threat the Government must pursue a threefold policy. They should seek to reduce Government expenditure, to ensure wage stability and to maintain their own political position. An increase in Government expenditure of the order of £150 millions would be very damaging to the prospects of sterling. On the other hand the abolition of the family allowance for the second child would be no less damaging to the prospect of maintaining wage stability. Of the other measures envisaged which affected the welfare services only the increase in the National Health Service contribution appeared to be practicable, particularly if it was presented as a means of imposing an upper limit on the Exchequer contribution to the National Health Service. If, at the same time, the emerging deficit of some £14 millions on the National Insurance fund was written off by realisation of part of the fund’s invested balances, the charge for welfare milk was raised by 2d. a pint and further economies were secured on Service Votes, Government expenditure in 1958–59 might be reduced to a level which would be politically acceptable and publicly defensible. But it would be unwise to seek to secure further economies in the welfare services at the cost of provoking industrial unrest which foreign opinion would regard as being at least as damaging to the potential recovery of sterling as a marginal increase in Government expenditure. Nor was it reasonable that, for the sake of a relatively trivial sum, sterling should be exposed to the fresh pressure which would follow the fall of the Government or the resignation of the Chancellor of the Exchequer.

The Minister of Defence said that, in consultation with the Service Ministers, he had made a fresh attempt to secure the further savings, amounting to £7 millions, for which the Chancellor of the Exchequer had asked. It was clear, however, that an economy of this magnitude could not be achieved within the Service Estimates otherwise than by some modification of the new scheme of Service pay and allowances. Any form of postponement of this scheme would be dangerous. In the absence of a sufficient improvement in the statistics of recruitment the Government would have no alternative to introducing legislation, towards the end of the present Parliament, to enable some form of compulsory National Service to continue. The only hope of avoiding this was to introduce the new scheme of pay and allowances at the earliest possible date. The Service Ministers
had reluctantly accepted one deferment of the scheme in the autumn of the previous year; they could not accept any further postponement.

In discussion it was suggested that it would nevertheless be reasonable and consistent with the Government's wages policy that the new scheme should be announced when the Defence White Paper was published but that its implementation should be postponed for a short period. Alternatively, the improvements in pay might be introduced forthwith, the improvements in allowances being deferred until, say, 1st October. Either course, combined with the economies in the welfare services which might prove, on further examination, to be practicable, would reduce the increase in Government expenditure to the defensible figure of about £40 millions. On the other hand, it was the announcement of the new scheme which would be liable to react adversely on the pending wage claims; the deferment of its implementation would be relatively unimportant from this point of view, while it would impose a fatal check on the new campaign of recruitment.

The Chancellor of the Exchequer said that he conceived it to be his duty not to accept Departmental Estimates foreshadowing an increase of Government expenditure in 1958–59 over the level of 1957–58. The course of the discussion had shown that the Cabinet were not agreed, as he had hoped, on the importance of eliminating this increase. Reductions in the welfare services could, admittedly, be defended only if the Government were wholly determined to press through their disinflationary policy. But, given that determination, a combination of possible measures could be devised. As regards defence expenditure he agreed that it would be impossible to announce the new scheme of pay and allowances but to defer its implementation. It would be reasonable, however, to introduce only the improved allowances, deferring any improvement in pay until after the Grigg Committee had reported. On these hypotheses, the cut of £76 millions which had already been secured would be increased by savings of £30 millions on the welfare services and a further reduction of some £22 millions on Service Votes. The total of nearly £130 millions would represent an approximation to his purpose of eliminating the whole of the £153 millions increase in expenditure; but he would still require the support of the Cabinet in searching, over the whole range of the remaining civil Estimates, for further economies in an effort to approach still more closely to this objective.

At this point The Prime Minister adjourned the meeting in order to enable Ministers to give further consideration to the issues involved.

When the discussion was resumed, The Prime Minister said that the Cabinet must seek to share with the Chancellor of the Exchequer the heavy burden of managing an economy which, though potentially prosperous, was precariously balanced. The demands upon that economy, both as the source of livelihood for the citizens of the United Kingdom and as the centre of a major international system of trade and finance, were unparalleled; and the Chancellor was entitled to ask his colleagues to give convincing evidence of their determination to support him in giving effect to the disinflationary policy which alone would enable the Government to discharge their manifold responsibilities. But disinflation, if enforced to the point at which it created a stagnant economy or provoked a new outbreak of industrial unrest, would defeat its own ends; and, if the individual measures proposed by the Chancellor had been criticised, this criticism was evidence of the concern of other members of the Cabinet that a gain in respect of one aspect of the Government's policies should not be offset by a loss in respect of others.
The Cabinet could, and should, pledge themselves to achieve as nearly as possible the Chancellor's objective of ensuring by all possible means that Government expenditure in 1958–59 should not substantially exceed its level in 1957–58. But it was doubtful whether the Government could hope to achieve a precise arithmetical equilibrium without injury to their other purposes. It was also arguable whether, if some relatively small increase in expenditure persisted, sterling would be seriously weakened. But the Cabinet should spare no effort to eliminate the £153 millions as far as possible, being resolved to give the maximum of support to the Chancellor and believing that it should be practicable substantially to achieve his objective by legitimate means without provoking industrial unrest.

As regards the individual measures to this end, it was unreasonable that Ministers should be expected, at very short notice, to give a firm undertaking to enforce economies of £30 millions in the welfare services together with further unspecified economies on the other civil Votes. To abolish the family allowance for the second child was neither politically nor socially desirable. It would be contrary to the tradition of the Conservative Party; it would represent to three million households a reduction of 5 per cent, in their weekly income; and it would give, to those elements of public opinion which were seeking a legitimate occasion for the formulation of fresh wage demands, a genuine and concrete issue on which to base their claims. The imposition of a hospital boarding charge and the abolition of the supplementary ophthalmic service were open to serious objection. An increase in the charge for welfare milk would also be unpalatable, although it should be regarded as a possible contribution to the necessary economies if no better alternative could be found. An increase in the National Health Service element of the National Insurance contribution could hardly be made at the moment when the latest increase in that contribution took effect, although it could perhaps be adopted in the context of the Budget when it might be possible and desirable to discuss in greater detail the Government's future policy towards the social services as a whole. For these reasons it was impossible for the Cabinet to undertake to enforce savings of £30 millions in the welfare services. But they could certainly resolve to increase the total of savings from £76 millions to at least £100 millions and possibly more, provided that the whole range of civil Estimates was regarded as available for this purpose and that Ministers were given a little more time in which to consider how the further economies could be effected with least damage.

The defence Estimates had already been severely cut, and it was doubtful whether they could properly and safely be expected to suffer any further reductions. Of the opportunities which lay before the Government the termination of National Service was not the least valuable, in terms both of political advantage and of the genuine relief to the economy which a system of voluntary recruitment should yield. Nevertheless, if it proved possible, by further scrutiny of the civil Estimates, to reduce the level of Government expenditure in 1958–59 by £100 millions or rather more, it would be reasonable to require the Minister of Defence to re-examine the Service Estimates yet once again, with a view to securing further savings of some £7 millions whether by adjustments in the new scheme of Service pay and allowances or by some other means.

In short, the Chancellor of the Exchequer could feel assured of the wholehearted determination of his colleagues to support him in his disinflationary policy. If it proved possible to reduce Government expenditure by £100 millions and perhaps more, the residue of the increase would represent a rise of no more than 1 per cent, in the outlay of the Exchequer. An increase of this order, largely attributable to factors over which the Government had no control, could not fairly be represented as indicating any weakening in the Government's resolve to resist inflation and to support sterling by all possible means. At the same time the economies which would have
been adopted would be the least likely to provoke industrial discontent or to imperil the wage stability which must remain the primary objective of the Government's economic policies as a whole.

The Government would be condemned, both by their own supporters and by world opinion, if, as the result not of some untoward disaster but of their own failure to agree on the approach which he had suggested to resolve a minimal difference of opinion, they faltered in their course and failed to carry through the great enterprise on which they had embarked only a year before. Ministers should therefore weigh the issues, as he had summarised them, with a full sense of their collective responsibility. In doing so, they should bear it in mind that it was only the balance of the methods to be employed which was in question and that, on the fundamental policy involved, the Cabinet were pledged to give the Chancellor of the Exchequer their unreserved support.

The Chancellor of the Exchequer said that he had never wavered in his view that Government expenditure in 1958-59 should not substantially exceed the level in 1957-58 and that, although he was well aware of the difficulties entailed by some of the measures to this end which he had proposed, he must now consider his own position in the light of the Prime Minister's summary of the issues at stake.

Cabinet Office, S.W. 1,
9th January, 1958.