CONCLUSIONS of a Meeting of the Cabinet
held at 10 Downing Street on
THURSDAY 27 FEBRUARY 1975
at 10.30 am

PRESENT

The Rt Hon Harold Wilson MP
Prime Minister

The Rt Hon Edward Short MP
Lord President of the Council

The Rt Hon Lord Elwyn-Jones
Lord Chancellor (Items 1-4)

The Rt Hon Denis Healey MP
Chancellor of the Exchequer

The Rt Hon Michael Foot MP
Secretary of State for Employment

The Rt Hon Shirley Williams MP
Secretary of State for Prices and Consumer Protection

The Rt Hon Anthony Wedgwood Benn MP
Secretary of State for Industry

The Rt Hon Reginald Prentice MP
Secretary of State for Education and Science

The Rt Hon John Morris QC MP
Secretary of State for Wales

The Rt Hon James Callaghan MP
Secretary of State for Foreign and Commonwealth Affairs

The Rt Hon Roy Jenkins MP
Secretary of State for the Home Department (Items 1-4)

The Rt Hon Anthony Crosland MP
Secretary of State for the Environment

The Rt Hon Eric Varley MP
Secretary of State for Energy

The Rt Hon Barbara Castle MP
Secretary of State for Social Services

The Rt Hon Roy Mason MP
Secretary of State for Defence

The Rt Hon William Ross MP
Secretary of State for Scotland

The Rt Hon Merlyn Rees MP
Secretary of State for Northern Ireland
SECRET

The Rt Hon Fred Peart MP
Minister of Agriculture, Fisheries and Food

The Rt Hon Harold Lever MP
Chancellor of the Duchy of Lancaster (Items 1-4)

The Rt Hon Lord Shepherd
Lord Privy Seal

The Rt Hon Robert Mellish MP
Parliamentary Secretary, Treasury

The Rt Hon John Silkin MP
Minister for Planning and Local Government

SECRETARIAT

Sir John Hunt
Mr P D Nairne (Item 4)
Mr B C Cubbon (Item 4)
Mr H F T Smith (Items 1, 2 and 5)
Mr P Benner (Item 1)
Mr J Roberts (Item 5)
Mr R J O'Neill (Items 2-4)

CONTENTS

<table>
<thead>
<tr>
<th>Item</th>
<th>Subject</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>PARLIAMENTARY AFFAIRS</td>
<td>1</td>
</tr>
<tr>
<td>2</td>
<td>FOREIGN AFFAIRS</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>The Chilean Debt</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>COUNTER-INFLATION POLICY</td>
<td>3</td>
</tr>
<tr>
<td>4</td>
<td>EEC RENEGOTIATION</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td>Regional Aids and Steel</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>STATEMENT ON THE DEFENCE ESTIMATES 1975</td>
<td>10</td>
</tr>
</tbody>
</table>
PARLIAMENTARY AFFAIRS

1. The Cabinet were informed of the business to be taken in the House of Commons during the following week. It would be necessary to maintain a running three-line Whip throughout the proceedings on the Report Stage of the Finance Bill, which would be occupying the House from 3 to 6 March. It was essential that the Bill should reach the Statute Book not later than 14 March; but it was uncertain how far the goodwill of the Opposition could now be relied on and therefore the timetable might prove very difficult. It was reported that it would be desirable to find time for the Commons consideration of the Lords' amendments to the Social Security Benefits Bill. Until these had been dealt with it would not be possible to finalise the Social Security Consolidation measure although this ought to be published in advance of the Second Reading of the Better Pensions Bill, which, for operational reasons, should not take place later than the week beginning 10 March. The Cabinet were however informed that there would be great difficulty in finding the necessary time during the following week; moreover, there were signs that some rearrangement of the business tentatively planned for the week beginning 10 March might prove necessary.
2. THE CHANCELLOR OF THE EXCHEQUER said that in the previous year the Cabinet had agreed to the conclusion of an arrangement to reschedule Chile’s debts for 1973 and 1974. He proposed that we should refuse to follow a similar course this year. Inflation in Chile appeared recently to have been running at about 600 per cent a year. The Chilean regime were concerned about international views of their credit-worthiness. If we could persuade some of the other Western creditors, particularly Germany, to join us in refusing to enter into a rescheduling agreement this year, Chile’s credit would be affected in the eyes of the World Bank and other international organisations. This could provide us with a means of pressure on the Chilean regime to amend their oppressive domestic policies. The amount of money we would forgo in the current year would be only of the order of £1 million. We would not be precluded from resuming rescheduling arrangements next year if this then seemed desirable.

THE FOREIGN AND COMMONWEALTH SECRETARY said that the United States was unlikely to join us in the policy we proposed; and if Chilean hopes of a substantial loan from Iran were realised, the action which it was proposed we should take would have little effect on Chile’s credit-worthiness. He nevertheless supported the proposal and if it were approved he would encourage other Western creditors to take a similar line.

THE PRIME MINISTER, summing up a brief discussion, said that the Cabinet agreed that we should not take part in rescheduling Chile’s debts in the current year, and that the Foreign and Commonwealth Secretary would seek the support of other Western creditors.

The Cabinet -

Took note, with approval, of the Prime Minister’s summing up of their discussion,
3. THE PRIME MINISTER said that earlier in the week the Ministerial Committee on Economic Strategy had reviewed the Government’s counter-inflation policy and had agreed upon a new drive to get down the rate of pay increases. This posture, which was consistent with the freedom of collective bargaining implied by the Social Contract, meant that the Government would have to give more leadership on pay, taking a rather bigger part of the responsibility it already shared with the Trades Union Congress (TUC). Ministers would need to make renewed reference in public speeches to the dangers of excessive pay increases for employment at home and competitiveness abroad. The Government would have to insist that the TUC guidelines should be honoured in the spirit as well as in the letter; in particular the exceptions allowed by the guidelines should not be used to make nonsense of their main principle that any general settlements, including thresholds, should be sufficient only to cover the increase in the Retail Price Index in the preceding 12 months. The Chancellor of the Exchequer, in agreement with the Secretary of State for Employment, was preparing background notes on which Ministers could draw for their speeches and would send these to the Lord President in good time for the weekend. It was important however that, in speaking on this subject, Ministers should avoid any speculation as to what the Government would do if their appeal went unheeded and settlements continued at too high a rate. Suggestions were appearing in the Press that some Ministers favoured an alternative policy; but no such alternative policy was in sight. A statutory policy had been shown not to work and massive deflation was unacceptable. There was also the fact that speculation about alternative fallback policies led inevitably to attempts to forestall them. This applied both to talk of a statutory incomes policy which encouraged unions to put in large claims now and to arguments for import deposits which stimulated imports in the short run. Ministers should therefore adhere strictly to emphasising the Government’s existing policies and should not speculate about alternative ones; if any Minister wished to go further than the notes being provided by the Chancellor he should clear his speech with the latter.

In discussion the following points were made -

a. It would be helpful to the Government’s new posture if it were pointed out that the breakdown of the Social Contract would lead inevitably to increased unemployment and a statutory policy. On the other hand if this point were made explicitly it would encourage speculation of the kind mentioned. It should be possible to talk positively about the problem of inflation and the Government’s efforts to deal with it without seeming to envisage alternative and unacceptable solutions.
b. There should be similar restraint from speculation about the form which the Budget would take. The latter could raise major issues of economic strategy and Ministers would have an opportunity of discussing them collectively: but this discussion must be kept within Government.

c. In conducting their new drive to get down the rate of pay increases Ministers would need to avoid appearing to criticise the efforts which the TUC were making to secure adherence to the Social Contract. The Government had in fact recently had an excellent meeting with the TUC in the Liaison Committee: and there was real evidence that some major union leaders were now actively lending their support to the General Secretary's efforts.

d. The distinction and the relationship between the short-term problem of pay inflation and the longer term problem of insufficient investment had to be borne carefully in mind: and the role of the National Enterprise Board could be usefully stressed here.

THE PRIME MINISTER, summing up the discussion, said that the Cabinet endorsed the decision of the Ministerial Committee on Economic Strategy and encouraged Ministers to speak publicly on the need to get down the rate of pay increases subject to clearing with the Chancellor of the Exchequer any points not covered in the notes which he was providing and to avoiding speculation about any alternative policies.

The Cabinet -

Took note, with approval, of the Prime Minister's summing up of their discussion.
4. The Cabinet had before them a memorandum by the Prime Minister (C(75) 23) on the issues of regional aids and steel in the renegotiation of the terms of British membership of the European Economic Community (EEC).

THE PRIME MINISTER said that the Committee on European Community Strategy (ECS) had reviewed the progress made in respect of regional aids and the steel industry in pursuing the Government's renegotiation objective of "the retention by Parliament of those powers over the British economy needed to pursue effective regional, industrial and fiscal policies". The Cabinet had decided in September 1974 that Community rules for the co-ordination of national regional aids were in our interest, provided that they were compatible with the need to be free to follow the regional policies we required. The Cabinet had laid down five specific principles which the Community rules should satisfy. We had held intensive discussions with the EEC Commission on the new rules, and these had been adopted by the Commission on the previous day. Member Governments would shortly be invited to record their agreement to a Communication setting out the rules, by passing a resolution in the Council of Ministers. The new rules met the five principles on which the Cabinet had agreed. We must accept that the EEC Treaty gave the Commission certain formal powers in respect of regional aid systems; but in their Communication the Commission declared that there would in practice be no interference with the regional policies the Government needed to pursue, and for these the Government would remain wholly answerable to Parliament. The political reality was that the member States in the Council of Ministers could determine the effective substance of Community control over regional aids and other questions. The majority of ECS accordingly took the view that the Manifesto aim had been met in relation to regional policies, and that the Commission's Communication should accordingly be accepted in the Council of Ministers, subject to the need for prior Parliamentary debates, which should take place on "take note" motions.

The issue of control over steel presented special difficulty, because the relevant Community rules rested almost entirely on the provisions of the European Coal and Steel Community (ECSC) Treaty, which gave to the Commission the role of acting as the custodian of the Treaty provisions. From the pragmatic angle our experience of the ECSC Treaty had been to some extent reassuring. We had been able to influence the British Steel Corporation (BSC) over price increases. We had also had experience of several cases involving the Commission's consent under the Treaty to merger cases in the steel industry, but judgment on the operation of the Treaty in the mergers field must be reserved until the current case of Johnson, Firth, Brown had been completed.
satisfactorily. There was no doubt that the Community accepted the principle of nationalisation as such. Control over investment in the public sector presented no problem, but it appeared that the Treaty would not permit us to reassume the powers which had been contained in section 15 of the Iron and Steel Act 1967 to control investment in the private sector. The Government therefore did not have the power, and nor had the Commission, to ban any private steel project which might be judged undesirable. At the outset of renegotiation the Government had made clear that they would feel free to propose Treaty amendments if it emerged that these were necessary. It was clear that we needed an overhaul of the ECSC Treaty, going wider than the investment provisions. We could not hope to reach agreement in the Community on revision of the Treaty within the renegotiation timescale, and the other member Governments would not be ready to commit themselves to this process until they knew that the United Kingdom was remaining in the Community. The majority of ECS had therefore concluded that we should give notice now to the other Governments that if, as a result of the referendum, the United Kingdom stayed in the EEC, we should press for an overhaul of the ECSC Treaty, particularly in relation to the issues which had concerned us.

In discussion it was maintained that the new rules formulated by the Commission would leave all existing forms and levels of aid in the United Kingdom untouched, with the single exception of certain aids granted in Scotland by the Highlands and Islands Development Board for which the Commission had already undertaken to grant us a derogation. The purpose of the new rules was not to prevent the United Kingdom or other Governments from granting assistance where required to their least favoured regions, but to control the level of subsidies granted in the more favoured areas of the Community and to prevent multinational companies from playing off one Government against another in order to obtain subsidies for investment. The experience of the other member countries of the Community over the past 17 years was that they had been able to continue to follow their own chosen regional policies, and the Labour Party as an Internationalist Party should welcome any arrangements which helped the economic development of any disadvantaged area of the Community, such as southern Italy. If the United Kingdom left the Community, it was probable that, in any future trading agreement with the EEC, we should be obliged to accept rules concerning the level of state aids, but that, so far from being able to influence these rules as we had been able to do as a Community member, they would be imposed on us. In the circumstances of the world today national sovereignty was no longer absolute; some surrender of sovereignty was inevitable within the Community, and there was nothing objectionable in itself in the enforceability of common rules. The decisive test was not what
the text of the EEC Treaty might say about the powers of the Commission, but the way in which the Community operated in practice. From that aspect we could be confident that effective power would continue to rest through the Council of Ministers with member Governments, which would remain answerable to their national Parliaments.

On the other hand, it was argued that it could not be maintained that we could disregard the text of the EEC Treaty on the grounds that its rules and provisions were not in fact observed. This was not the true situation, and the record of a recent conversation between the Minister of State for Foreign and Commonwealth Affairs and a German Minister confirmed that we were at the mercy of the Commission whenever they chose to exercise their powers. Under the Treaty, any power of Parliamentary control over the Commission lay not with national Parliaments but with the European Assembly. The new rules, which were temporary in character, did not conflict with our present regional aid policies, but they did nothing to restore in this area the sovereignty of Parliament, which the Government had pledged themselves to regain in their February 1974 Manifesto. This had serious implications for the continuation of democracy. The issue at stake was whether Governments were to remain, not the "best judges", as the Commission's document suggested but the supreme judges of the policies they needed to implement. The new rules could not be accepted as satisfactory unless it was established that both in substance and in law the last word did not remain with the Commission.

In further discussion it was suggested that, while the new rules for the co-ordination of regional aids raised questions of major importance in renegotiation, this was not the occasion for the general discussion of the issue of sovereignty which the Cabinet would be having in due course. This issue was at present under consideration by the Legislation Committee. At the same time the Cabinet could not decide whether the renegotiation issue of regional policy had been satisfactorily settled in advance of the general consideration of whether renegotiation as a whole had been successful; and the Parliamentary debates on the new co-ordination rules should also be deferred. The Foreign and Commonwealth Secretary would be expected to take up a position in the Council of Ministers, particularly because of the connection which some countries saw between the co-ordination rules and the provision of money for the Regional Development Fund. But a final decision would not be taken by the Council of Ministers until their April meeting.
The discussion then turned to the issue of steel. It was suggested that it was most unsatisfactory that this question had been left unresolved until so late in the process of renegotiation. The renegotiation of our terms of membership could not be regarded as complete until the problem of steel had been solved. But it was pointed out that the issue of steel had been drawn specifically to the attention of other EEC Governments as a renegotiation objective, for example by the Prime Minister at the meeting of Heads of Government in Paris in December 1974. They were therefore already on notice that we had requirements.

The greatest difficulty concerned the power to control private sector steel investment, and one solution would be for the Government to inform Parliament at an early date that they proposed to re-assume through legislation powers equivalent to those in section 15 of the Iron and Steel Act 1967. An alternative course might be for us to put the other EEC Governments on notice, not that we should necessarily wish to amend the Treaty, but that we proposed to re-assume powers to control investment in the private sector. They might acknowledge that this would require amendment of the Treaty, or they might be ready to find some alternative method of meeting our wishes which would not require Treaty amendment. Until this approach was made it was impossible to demonstrate that an attempt had been made to secure the Manifesto objective. Other EEC Governments, for example, appeared to have been successful in preventing undesirable investment despite the Treaty.

Consideration of the changes we might want in the Treaty should also extend to the basing point system for establishing steel prices; at some time in the future this could threaten the interests of those parts of the United Kingdom distant from steel manufacturing plants in the event of steel closures, for example in Scotland.

THE PRIME MINISTER, summing up the discussion, said that the Council of Ministers would not be taking a final decision on regional aids at their next meeting. The Foreign and Commonwealth Secretary could indicate that he was content with the Communication from the Commission as an element in the total renegotiation package on which the Government still had to take a decision.

The same line would be taken at the meeting of the European Council at Dublin on 10-11 March. Following that meeting, the Cabinet would resume their consideration of regional aids in the context of a general stocktaking of renegotiation, together with the conclusions reached by the Legislation Committee on the general issue of the sovereignty of Parliament. The co-ordination rules should not be debated until after this further Cabinet discussion, although the debates would have to take place before the April meeting of the Council of Ministers at which Governments would be expected to give their approval to the rules by a Council Resolution. On steel, the Cabinet were agreed that action was needed to re-assume powers
to control private sector steel investment, and the Foreign and
Commonwealth Secretary should give further consideration in the
light of the discussion to the terms in which our requirements
should be put before other EEC Governments. The Cabinet should
also return to this subject on the basis of a further report by the
Foreign and Commonwealth Secretary, when they reviewed the
outcome of renegotiation after the Dublin meeting.

The Cabinet -

1. Took note, with approval, of the Prime
Minister's summing up of their discussion.

2. Invited the Foreign and Commonwealth
Secretary to be guided accordingly at the Council
of Ministers on the question of the co-ordination
of regional aids.
5. The Cabinet considered a memorandum by the Secretary of State for Defence (C(75) 21) to which was attached a draft of the Statement on the Defence Estimates 1975.

THE SECRETARY OF STATE FOR DEFENCE said that the White Paper was longer than usual because of the need to give full coverage to the Defence Review in the light of the results of consultations with our allies and to give additional information about policy and strategic matters as had been recommended by the Select Committee on Expenditure. Subject to the approval of his colleagues he proposed to publish the Statement on 19 March.

In discussion it was argued that many of the Government's supporters were disappointed that greater savings were not being made in defence expenditure. They would be critical of the implication in the White Paper that firm decisions had been taken on the level of defence expenditure for the next 5 and even 10 years. The possibility of further reductions in public expenditure could not be excluded and the White Paper should describe the Defence Budget figures as interim or provisional. On the other hand it was strongly urged that the White Paper reflected decisions taken by the Cabinet in the context of the Defence Review and of the Public Expenditure Survey. All public expenditure programmes were, of course, liable to review but it would be wrong to single out the defence programme in this context. If the Defence Review decisions were described as provisional it would be widely assumed that a further review was impending and this would have very damaging consequences for the confidence of the Services, of the defence industry, and of our allies who considered that our cuts had already gone too far.

THE PRIME MINISTER, summing up the discussion, said that the Cabinet had approved the Defence Review proposals subject to the outcome of international consultation; this consultation had not shown the need for any change. The Review was therefore confirmed. The Chancellor of the Exchequer had however reminded the Cabinet that it might well become necessary at some point to require further substantial cuts in public expenditure, including defence expenditure.

Continuing, the Prime Minister said that preparation for the publication of the 1975 Statement on the Defence Estimates should proceed as proposed by the Secretary of State for Defence but before it was published further consideration should be given to the question of how the defence expenditure figures should be expressed in the light of the fact that the White Paper on Public Expenditure to 1978-79 (Cmd 5879) had noted that the figures for 1977-78 and 1978-79 were provisional.
The Cabinet -

Took note, with approval, of the Prime Minister's summing up of their discussion.

Cabinet Office

27 February 1975