CONCLUSIONS of a Meeting of the Cabinet held at Chequers on FRIDAY 20 JUNE 1975 at 10.00 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

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 Eric Varley MP Secretary of State for Industry

The Rt Hon Roy Mason MP Secretary of State for Defence

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

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

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

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

The Rt Hon Peter Shore MP Secretary of State for Trade

The Rt Hon William Ross MP Secretary of State for Scotland

The Rt Hon Merlyn Rees MP Secretary of State for Northern Ireland
The Rt Hon Fred Peart MP
Minister of Agriculture, Fisheries
and Food

The Rt Hon Lord Shepherd
Lord Privy Seal

The Rt Hon Reginald Prentice MP
Minister for Overseas Development

The Rt Hon Harold Lever MP
Chancellor of the Duchy of Lancaster

The Rt Hon Fred Mulley MP
Secretary of State for Education and
Science

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 J A Hamilton
Mr J A Marshall
Mr A M Macpherson

SUBJECT

ECONOMIC STRATEGY
The Cabinet discussed Economic Strategy. Their discussion and the conclusions reached are recorded separately.

Cabinet Office

23 June 1975
ECONOMIC STRATEGY

The Cabinet had before them memoranda by the Secretary of State for Employment (C(75) 66 and 67), a note by the Secretary of the Cabinet (C(75) 70) and a note by the Chancellor of the Exchequer (C(75) 72).

THE PRIME MINISTER said that there were three major Cabinets on economic matters in prospect. The present meeting was concerned with the economic situation generally, concentrating on inflation and pay policy. There would be a discussion in early July on the Medium Term Economic Assessment, leading to broad decisions on the allocation of resources between public expenditure and private consumption. And there would be a meeting on 25 July about public expenditure priorities in the light of which the public expenditure survey would then continue, leading to final decisions on public expenditure in the autumn. The purpose of the present meeting was not to reach final decisions on how to deal with inflation, but to provide an opportunity for a frank exchange of views so that the Cabinet could reach a consensus about a solution which the country and the trades unions would find acceptable.

THE SECRETARY OF STATE FOR EMPLOYMENT said that there were three courses between which the Government could choose in framing an incomes policy for the next pay round. They could continue with the present voluntary policy, operating within Trades Union Congress (TUC) guidelines; they could continue with collective bargaining without any guidelines; or they could opt for a statutory incomes policy. He favoured the first of these options since each of the others had obvious disadvantages. A voluntary policy without guidelines ran the risk of being ignored in the private sector; while the Government would attract all the odium associated with applying the policy stringently in the public sector. As for a statutory incomes policy, he believed that it would give rise to very serious difficulties. There would be strong resistance from the trades union movement, despite the findings of recent public opinion polls,
and a rigidly applied statutory policy would almost certainly lead to serious industrial disputes that would deter foreign investors. The TUC had however drawn up proposals of their own on the development of the social contract which he had circulated under cover of C(75) 67. The TUC document had not yet been formally endorsed; it was due to be considered by the General Council on 25 June. The Chancellor of the Exchequer, the Secretary of State for Prices and Consumer Protection and he would be meeting the TUC later in the day to discuss the paper, and he urged that the Cabinet should give their support to the TUC approach. If the Government did not support this initiative, they would have to hammer out a separate policy of their own, and in doing so they would run the risk of damaging their relations with the TUC. The document pointed to the need to get the rate of price inflation down to at least 15 per cent. This target called for a major effort to get average wage increases below 20 per cent early in the next wage round. The document suggested a number of options for achieving this. The Chancellor of the Exchequer had however suggested that the Government's target for reducing the rate of inflation should be a halving of the current rate of inflation by the third quarter of 1976. This would imply a wage norm of 10 per cent for the next round of pay negotiations; the TUC were extremely unlikely to be willing to accept a figure at this level and even if they accepted it would find it almost impossible to ensure compliance from individual unions. He therefore suggested that a more reasonable target would be a wage norm of 15 per cent. If the Government did decide to back the TUC document he hoped that, for the time being, there would be no mention of target figures either for reducing the Retail Price Index (RPI) or for a wages norm. His suggestion was that there should be a Government statement on incomes policy in mid-July covering the Government's overall objectives, the target figures for wage norms and reduction in inflation, higher incomes, and the salaries of Members of Parliament. It might be worth while having a report by officials on top salaries and the effect of Review Body awards. Once a wages increase target had been set, it would be of the highest importance to ensure that there was widespread compliance with this when wage settlements were being made. It must be recognised however that there would be some degree of slippage, and the hopes of compliance over the next pay round had been darkened by the recent decision by the Amalgamated Union of Engineering Workers (AUEW) opposing any form of pay restraint. Nevertheless, the chances of making the social contract work over the next round were better than last year, and if there were a fixed pay norm, this would make matters easier. The TUC were anxious to put their policy across to the country, and the Government should be supporting them in this. One way of doing this would be for the Government to publish a White Paper in July which would set out in simple terms what a particular wage norm would mean in terms of reducing the rate of price inflation. It was essential that the country should have confidence in a policy to bring down the rate of inflation and that workpeople should willingly consent in operating such a policy. He did not believe that the Government could force a harsh prices and incomes policy upon an unwilling country.
THE CHANCELLOR OF THE EXCHEQUER said that the economic situation of the country required the Government to be more drastic in its action than had been suggested. Although the balance of payments situation had improved, and although the United Kingdom was doing better in respect of unemployment and output than other Organisation for Economic Co-operation and Development (OECD) countries, the United Kingdom rate of inflation was double that of OECD as a whole, and unit wage costs in Britain were four times higher than the average in other OECD countries. Foreign funds were still flowing into the country, but this situation could change with dramatic suddenness, and if there were a large-scale outflow of funds later in the summer this would compel the Government to impose drastic emergency measures. These might involve cuts in public expenditure of £1,000 million starting in the current year, which could lead to a rise in unemployment that might leave 2 million people out of work in 12 months. There would inevitably be cuts in real income and in investment. None of these grave measures would in themselves have any effect on inflation, so it would still be necessary for the Government to introduce a statutory wages policy. The urgency of the economic situation required the Government to produce a credible prices and incomes policy by the end of July at the latest. The most dramatic solution would be to freeze wages for a year which would bring down the annual rate of increase in the RPI to 6.6 per cent by late 1976. This would represent a fall in real incomes of 7 per cent, and probably put 60,000 people out of work. There was no chance that such a policy would be acceptable. If the Government were to aim to halve the rate of price inflation by the end of the next pay round, it would be necessary to keep wage increases below 10 per cent, or a flat rate of £5. Even these rates of increase made no allowance for the effects on the economy of a continuing depreciation of the exchange rate, of an oil price rise later in the year, or of increasing deficits in the nationalised industries. The Government had to convince the TUC of the necessity of a tough incomes policy. Admittedly the TUC proposals in the document attached to C(75) 67 were highly significant in that they demonstrated that the TUC were for the first time proposing that wage rises should be related to the following, rather than to the previous year's, price increases. The Government should support the TUC in the line they were proposing, especially since some union leaders might not find it easy to persuade their own unions to accept these proposals. The degree of compliance with whatever wages norm might eventually be agreed was however of fundamental importance; we should aim to achieve better results in this respect than we had done over the past year. He agreed that there would have to be acceptance on the part of the trades union movement; but the Government had to devise policies which would meet the serious situation with which they were confronted and at the same time retain the confidence of the country's foreign creditors. An important aim of any policy should be to prevent public sector employers from paying increases above the agreed wages norm; and
it would thus be necessary to suspend arbitration and the use of review bodies in the public sector and to abandon the principle of comparability. If the Government were to commit themselves to keeping within the agreed guidelines in respect of employees for whose pay they were ultimately responsible, they had to ensure that private employers followed suit, and this would not be easy; but unless they could do so, they would find themselves being pushed into a statutory incomes policy. If the Government could not persuade the trades union movement to accept a voluntary incomes policy with stringently drawn guidelines, they would be driven to economic policies which would have grave effects upon public expenditure and employment. The present rate of high wage settlements was in effect beginning to force a Labour Government to adopt Tory policies. Moreover, he could not afford to introduce any demand reflation in the economy until an effective wages policy was being seen to work.

THE SECRETARY OF STATE FOR PRICES AND CONSUMER PROTECTION stressing the gravity of the economic situation, said that the control of events could be wrested out of the Government's hand at any moment. She thought that the timetable put forward by the Chancellor of the Exchequer was too relaxed; the Government must have a clear policy by the end of June. The cardinal aim of the Government's policy should be to get the rate of inflation down to a single figure year-on-year by the autumn of 1976; even this rate of inflation would still present grave difficulties and the ultimate target must be a zero rate. To achieve such a target, an incomes norm of 15 per cent for the next pay year was much too high. The figures provided by the Treasury suggested that the country could not afford a wages increase norm higher than 10 per cent. To achieve this would call for some very hard decisions, and it would not be possible to hold to such a norm unless an independent body - which might be set up jointly by the TUC and Confederation of British Industry (CBI) - were set up to monitor and report on whether individual wage settlements did or did not conform to whatever norm or guidelines were adopted. The degree of compliance would be crucial to the success of the policy. One way of encouraging both employers and employees in the public and private sectors to comply with an agreed incomes norm might be to prevent costs incurred in making wage settlements above the norm from being passed on in prices. In the public sector, no increases in public expenditure would therefore be sanctioned to cover the excess, nor would price or fare increases be allowed. Any wage settlements above the norm would thus need to be financed by savings from other parts of the annual budgets of the Department or nationalised industry concerned. Similar action would be needed in the private sector, though there would be greater difficulties there. She did not believe that price increases to finance inflationary wage rises should be passed on automatically to the public. Frequently it was the poorer sections of the community who had to bear the brunt of such increases. She appreciated that there would be pressure to match tougher control of incomes by
tougher control of prices, but she did not believe that profit margins in many industries could be squeezed very much further. Many firms were already only just remaining profitable and no more, and it would be difficult to place severe restraint on the prices of essential goods unless firms were convinced that an effective incomes policy could be secured. Any thought of a price freeze was an illusion; the TUC did not understand this and the Government should make it clear to them. If it were felt that the trades union movement would not be prepared to go along with a 10 per cent incomes norm over the next pay round, it might be possible to achieve the same effect on inflation with a larger wages norm if payments were staged at 6 monthly intervals. The net effect over the whole round might still bring the RPI down to single figures by late 1976. If the policy were actually seen to be working it might be possible to achieve some degree of selective price stabilisation starting in, say, the first quarter of 1976. So far as compliance was concerned, it would be worth while examining the possibility of synchronising wage settlements and long-term agreements. She was sceptical of the chances of a voluntary policy succeeding but she agreed that this, rather than a statutory scheme, was the right starting point.

In the course of discussion it was argued that too little account had been taken of the extremely precarious nature of the present situation. Even the timescale suggested by the Chancellor of the Exchequer - to have a credible policy by the end of July at the latest - was probably unduly long. At any moment the Government's hand could be forced by a run on the pound which would lead to national disaster. At the latest the Government must have a policy by the middle of July. This should include wage settlements at 10 per cent, and there should be some kind of sanction even if it were kept in the background. Failing this, the policy would not work and the Government might well face a collapse of sterling in August. While it was difficult to find satisfactory sanctions, psychologically it was important that the force of law should lie behind the policy in order to secure general acceptance. The escalation of the public sector borrowing requirement was gravely damaging to the economy and incompatible with an effective anti-inflationary policy. Stringent public expenditure cuts would be needed to get it under control, but these would involve grave damage to public services and could only be faced if they were backed by an effective incomes policy. The control of public expenditure in constant price terms had been disastrous, and ceilings in money terms would be essential. There should be a review of all the main social programmes, on an interdepartmental basis, and to the same depth as had been the case with the defence review.
There was general support for the view that the problem was one of great urgency. It was suggested that overseas observers had expected the announcement of a firm policy immediately after the referendum on the European Community. It would be necessary to present a package to Parliament before the end of July, and this should include both an incomes policy and cuts in public expenditure. There was agreement on the need to achieve a consensus. A voluntary policy had no chance at all unless the Government could give a clear assurance that those who settled in the early part of the wage round would not be any worse off than those who settled later. The Government must make clear its implacable determination to ensure that the necessary policies would be carried through.

In further discussion the view was expressed that a statutory policy would have to be introduced within a matter of weeks, in spite of the enormous difficulties it involved, because the results of any other policy would be even worse. It would of course be preferable if an improved voluntary policy could be allowed to run on for some months in order to assess its success, but it was argued that there was insufficient time for this. The TUC paper already recognised that settlements must be below the going rate of increase in the RPI. It was not credible that settlements below the RPI could be achieved on a voluntary basis; nor was it fair to ask trades union leaders to attempt to operate such a policy. That was the responsibility of the Government. A statutory policy would be opposed by the TUC and would lead to a severe strain upon the Government's relations with the trades union movement; but there were millions of trades unionists awaiting a lead in the form of a policy which would apply to everybody. The Government should appeal to the rank and file in the unions over the heads of their leaders. It was true that any adoption of a statutory policy would be a breach of the election Manifesto; but the same was true of all the available alternative courses. If it were argued that the miners' attitude would be a fatal obstacle to a statutory policy, the answer was that the position was no different with a voluntary policy, since in either case the Government would have to face up to strikes. It would be worth while considering some form of flexibly-applied permanent statutory policy which could be used to move towards a more egalitarian society.

If a voluntary incomes policy were to be successful, the Government in its role as employer would have to hold a hard line; this would be seen by public sector employees as discriminatory and equivalent to a statutory policy. There would be industrial disputes with the risk that much public administration would collapse, especially in the field of social security. It was doubtful, therefore, whether a voluntary policy could be delivered even by the Government, who would be forced to make concessions going beyond the guidelines simply in order to keep essential administration going. If this were
so, then a statutory policy was the only alternative, providing some system could be found to penalise excessive settlements. A voluntary policy would not be convincing either at home or abroad; and the urgency was such as to leave no time for gradualism.

Against this it was argued that no satisfactory sanctions could be devised to enforce compliance with a statutory policy. One form which these might take would be to make it illegal for employers to pay more than the level laid down in the guidelines; but it was admitted that this had the serious disadvantage of leaving the employer exposed to strikes causing him severe financial damage when he was simply seeking to comply with the law (although it might be possible to devise a scheme for reimbursing firms from Government funds for losses arising from standing firm against a wage claim in excess of the statutory limit). Under the previous statutory policy no prosecution had ever taken place; and had a prosecution been brought and fines imposed but not paid, it was difficult to envisage what would have followed thereafter. Legal sanctions through the Courts were not a productive way of proceeding. A statutory policy was not a way out: it would require consent just as much as a voluntary policy, and in this connection the TUC document was a remarkable step forward. To get consent the Government had to win the argument. This was not something the Government could leave to the TUC. It was for the Government to win support for the kind of policy the TUC were now considering. This called for an orchestrated effort on the part of all Ministers. Sanctions of a legal kind were useless. The true sanctions on failure - rising unemployment, public expenditure cuts - had already arrived. What was necessary was to make the ordinary worker feel that he would be worse off simply chasing paper increases in his pay. He must realise the danger that unemployment could hit him, that he would lose part of the social wage, or that continuing inflation would render any wage increases he could get useless. A statutory policy which would split the Party and require Opposition support to get it through Parliament would not work and was the route to coalition; but a voluntary policy needed consent which the Government would have to win.

In further discussion it was argued that it was crucial that the policy adopted should be a joint Government/TUC/CBI policy. There should be a numerical target for price inflation and some clear way of measuring whether any particular settlement was within or outside the guidelines needed to achieve that target. An independent body was needed to ensure that such judgments were quite unambiguous. There might also be a need for an independent body to deal with anomalies. It might be that such a body could be allowed to authorise settlements beyond the guidelines, up to some previously fixed total for the country as a whole; and it might also provide a degree of cover for the Government when, as might well be necessary in some cases, a compromise had to be reached.
It should be made clear to the TUC that if after 6 months, say, their policy was not succeeding then the Government might be forced to bring forward a statutory scheme. They would also have to allow a massive increase in unemployment although on recent experience it was far from clear what level of higher unemployment, and for how long, would be needed to have the required influence upon wage settlements. Against this it was maintained that unemployment was not an alternative to an effective incomes policy. Unemployment was an effect of inflation, and it was not conceivable that any short term level of unemployment would have the effect upon pay settlements which was required. There should be no question of the Government presiding over a policy of unlimited unemployment. As in the 1930s, the country was facing a slump; but it was doing so at a time when people were no longer prepared to accept the consequences of a slump in terms of unemployment, and a policy which relied upon rising unemployment was not acceptable.

In continuing discussion the following main points were made -

a. One difficulty was that the British people, even if they appreciated intellectually the effects which inflation could and would have, did not have the same emotional involvement as was the case in Germany: the reverse was true of unemployment. For this reason it would be difficult to get the consent which was essential if a satisfactory policy were to be followed. One possibility which might make a flat rate cash sum more acceptable as a norm would be to announce that it would be tax free, while any payment in excess of that flat rate would be taxable in the ordinary way.

b. The Government and the nation had to recognise that there had been a shift of power to the trades unions and to multi-national companies. In time, as these transfers of power became formalised, the Government would have to come to terms not just with the TUC but with the shop stewards. What trades unionists wanted was, not just wages, but a full and active part in the management of industry; and the survival of the Government depended upon a creative relationship with the trades unions right down to the shop floor level.

c. It was crucially important to get the truth of the present situation across to the country. To achieve this it would be necessary to establish a high-powered public relations unit to plan a publicity campaign so as to make clear what would happen to unemployment, investment, the social wage and living standards generally if an excessive level of wage increases continued, and what benefits restraint would bring. Such a unit could organise speeches, graphical material, draft a White Paper and so on. This would help to create the attitude of mind amongst the public which would be receptive to the tough policies needed.
d. There should be a stringent control of top salaries. The Government had been mistaken in its acceptance of the last proposals by the Top Salaries Review Body.

e. One difficulty of a voluntary policy would be the problem of the low paid. The first test of such a policy would in fact come with the first two large groups in the next pay round, the Local Authority manuals and the National Health Service ancillaries, all of whom were affected by the TUC low pay minimum target. If this meant settling at, say 30 per cent, this would set the tone for the whole of the subsequent round - even though in later settlements the low pay element was absent. It might be that low pay could not be satisfactorily dealt with through collective bargaining, and it was worth considering whether the Government should not undertake to deal with the low pay problem - for example by means of family allowances - leaving collective bargaining to settle normal increases.

f. On timing, it was noted that in the first week of July the national conference of the National Union of Mineworkers would take place. Mr McGahey had already endorsed the claim of £100 a week, equivalent to a 63 per cent pay claim, and this could easily become the official union claim. It was therefore urgent to put the gravity of the situation to the TUC at once; they must be made aware that excessive wage claims could lead to the closure of uneconomic pits.

g. If there were to be a serious run on sterling brought about by inflationary wage settlements for the more powerful groups of workers, then the result would be unemployment amongst the poorer sections of the community with less bargaining power.

h. Even the TUC document showed signs that the authors did not yet fully comprehend the difficulties of the present situation. Thus, it said that not enough had yet been done on prices, whereas the Secretary of State for Prices and Consumer Protection had made it clear that there was no room to squeeze prices further. The document looked for further improvements in the social wage, and for improvements in the operation of the national insurance and supplementary benefit rules, all of which could only lead to higher public expenditure, which was equally unacceptable; and it called for defence cuts going beyond those the Government had recently decided to be the maximum possible. All of this was wanted as the price for a 15 per cent norm which was itself probably too high.
j. While the case against a statutory policy was a powerful one, the possibility of a run on sterling was such that a contingency plan for a statutory policy should be prepared so as to be available for use as necessary.

Finally it was argued that presentation of the choice as between a statutory and a voluntary policy tended both to polarise and to over-simplify the argument. The Government must try to reach agreement with the TUC but in the last resort could not shrink from taking whatever action was necessary. If however adequate sanctions could be found (eg through cash limits, suspension of the review bodies, the price code etc, even though some of these might themselves require legislation) it might be possible to provide sufficient back-up for a policy which was itself based on collective bargaining.

THE PRIME MINISTER, summing up the discussion, said that, although final decisions could not be taken at this meeting, there seemed to be a consensus in the Cabinet that the aim should be to achieve a wages norm of 10 per cent (or its equivalent) from the beginning of the next pay round. A statutory policy would be highly divisive and there was strong support for a determined effort to make a voluntary policy work. This meant the Government playing an active role along with the TUC, but the TUC must be warned of the consequences if a voluntary policy did not succeed. It would be important to use Ministerial speeches, perhaps a White Paper, and other forms of publicity to bring home frankly to the country what the situation was; and also to indicate what might be done by positive Government action to stimulate industrial investment if only inflation were checked. If a voluntary policy were to be successful, the Government would have to accept its responsibilities in relation to the public sector. This could involve eg the temporary suspension of pay comparability and the review bodies in respect of their own employees and the introduction of cash control of wages for other public sector bodies. In this connection some means would need to be found of putting discipline upon local authorities. A voluntary policy would certainly need some monitoring arrangement whereby individual settlements could be seen to be within or beyond whatever general guidelines or norm might be adopted: this might be discussed with the CBI and the TUC. The time within which a new policy had to be devised and agreed was severely limited. At the moment the onus lay primarily on the TUC, and they should be asked what kind of supporting action they wanted from the Government; but if the TUC failed to agree upon an effective policy, then the Government would have to consider unilateral action as a matter of urgency.
The Cabinet -

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

2. Invited the Chancellor of the Exchequer, and the Secretaries of State for Employment and for Prices and Consumer Protection to be guided accordingly in their meeting with representatives of the Trades Union Congress later in the day.

Cabinet Office

24 June 1975