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CC(76) 9th
Conclusions

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CABINET

CONCLUSIONS of a Meeting of the Cabinet
held at 10 Downing Street on

THURSDAY 11 MARCH 1976

at 10.30 am

PRESENT

The Rt Hon Harold Wilson MP
Prime Minister

The Rt Hon Edward Short MP
Lord President of the Council
(In the Chair for Item 5)

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 Fred Peart MP
Minister of Agriculture, Fisheries and Food

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 Harold Lever MP
Chancellor of the Duchy of Lancaster

The Rt Hon Lord Shepherd
Lord Privy Seal

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

The Rt Hon Reginald Prentice MP
Minister for Overseas Development

The Rt Hon Robert Mellish MP
Parliamentary Secretary, Treasury

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

ALSO PRESENT

The Rt Hon Joel Barnett MP
Chief Secretary, Treasury (Items 3 and 4)

SECRETARIAT

Sir John Hunt	
Mr G R Denman	(Items 1, 2 and 5)
Mr J A Hamilton	(Items 3 and 4)
Mr T F Brenchley	(Item 2)
Mr W I McIndoe	(Item 1)
Mr E J G Smith	(Items 1, 2 and 5)
Mr J A Marshall	(Items 3 and 4)

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PARLIAMENTARY AFFAIRS

Economic Policies: Vote of Confidence

1. The Cabinet considered the implications of the Government's defeat the previous evening in the House of Commons, following the debate on Public Expenditure, on a motion relating to its economic policies. It was generally agreed that it was essential to demonstrate without delay that the Government had support for these policies. It was procedurally impossible, however, to table a specific motion of confidence for debate that day. The options open to the Government, therefore, were to carry a vote on the adjournment that evening, having previously made it plain that this would be regarded as a vote of confidence in the Government's economic and financial policies; or to put down a specific motion of confidence for debate the following day or on Monday. A specific motion of confidence would have the advantage that those of the Government's supporters who had voted against the Government motion the previous evening would be obliged, if they wished to avoid a General Election, to vote expressly in favour of the Government's economic policies to which the Parliamentary Labour Party as a whole were committed. Without such a vote, they might continue to feel free, on future occasions, to dissociate themselves from these policies. On the other hand there could be adverse effects on international confidence if, as a result of tabling a motion for debate on Friday or Monday, Government business had to be suspended in the meantime and the media highlighted the supposed political uncertainty. There was a precedent in 1940 for treating an adjournment motion as a motion of confidence and, in present circumstances, this appeared to be the best way of dealing with the immediate situation.

THE PRIME MINISTER, summing up the discussion, said that the Cabinet agreed that the motion for the adjournment that evening should be treated as a motion of confidence in the Government's economic and financial policies and that a brief Press statement to that effect, with an explanation of the procedural reasons for adopting this course, should be issued forthwith. The Chief Whip would inform the Opposition before the statement was issued.

The Cabinet -

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

The Cabinet were informed of the business to be taken in the House of Commons during the following week.

FOREIGN AFFAIRS

Rhodesia

Previous Reference: CC(76) 8th Conclusions Minute 2

2. THE FOREIGN AND COMMONWEALTH SECRETARY said that he had decided to see the two white Rhodesian businessmen who had recently visited London, reportedly with proposals from Mr Smith. The proposition they had advanced was quite unacceptable: it was that the Government should appoint three wise men, preferably representatives from the House of Lords of the three main Parties, to go to Rhodesia and make recommendations about its future constitution. He had told them that the time for proposals of this kind was long past. He was however himself preparing, on a contingent basis only, a statement of the elements necessary for a total settlement in Rhodesia, covering such points as the transition to majority rule, an aid programme, provision for Civil Service pensions, etc. It would however not be right to produce such a package until Mr Smith had accepted not only the principle of majority rule but also an early date for its introduction. He had met the Foreign Minister of Zambia that week and was likely soon to meet the Mozambican Foreign Minister. The Zambian Foreign Minister would be asking President Kaunda to suggest to President Nyerere of Tanzania that the latter should invite Mr Callaghan to go to Tanzania for talks with him. The four African Presidents were the key to the situation because of their influence on the guerillas.

The Cabinet -

Took note of the statement by the Foreign and Commonwealth Secretary.

STERLING

3. The position of sterling was considered by the Cabinet. Their discussion and the conclusions reached are recorded separately.

PUBLIC EXPENDITURE SURVEY 1976

The Economic Background

4. The Cabinet had before them a memorandum by the Chancellor of the Exchequer (C(76) 25) and a memorandum by the Central Policy Review Staff (C(76) 27) about the medium term economic background for the Public Expenditure Survey 1976.

THE PRIME MINISTER said that he had last year circulated to Cabinet a paper (C(75) 60) on the procedure to be followed for the discussion of public expenditure; the adoption of this, with its provision for preliminary discussion of the economic background and of public expenditure priorities, had led to some easing of the inevitable problems associated with this difficult question. The slightly modified procedure he had proposed for the current year was designed to enable the White Paper on public expenditure to be published in November, and similarly allowed for Ministers to clear their minds on priorities in early discussions before taking firm decisions.

THE CHANCELLOR OF THE EXCHEQUER said that this was the first in the series of discussions which would lead up to a White Paper in the autumn; his memorandum was intended to sketch the general background and to indicate the considerations which would influence the guidelines needed for the 1976 public expenditure Survey. The central economic case presented in the White Paper on public expenditure published in February (Cmnd 6393) assumed an average annual increase in gross domestic product (GDP) between 1974 and 1979 of 3.4 per cent; it was now clear that the likelihood of achieving this increase was much less than had previously been thought, although it was very difficult to interpret the current indicators. The recent unemployment figures were encouraging, but it was not easy to understand the reasons lying behind them: the volume of exports was rather higher than had been expected. With the reduction which had now taken place in the sterling exchange rate, and assuming that the Government were successful in continuing the policy of restricting pay increases to a low level, it should not be too difficult to achieve the assumed growth in GDP, and in the output of manufacturing industry, over the next year. But it was extremely difficult to say whether this rate of growth could be maintained over the following years; much would turn upon the capacity constraints emerging in the first year. On pay, he had made it clear to the Trades Union Congress (TUC) that it was not possible for him finally to settle what he could do in his Budget about increasing domestic demand until he knew what the pay limit in the second round of the counter-inflation policy was going to be. The TUC, conversely, had indicated that their view of what was possible on pay would be in part determined by the content of the forthcoming Budget. It would be possible for him to amend the Finance Bill as late as June in order to provide any tax relief which might follow acceptance of a low pay limit, and he thought that a sensible arrangement could be made with the TUC on that basis. On unemployment the figure of 700,000 by the end of 1979 was not a target; it represented an assumption of what could be done if the Government's other policies were successful. What he had said publicly was that the Government could not set themselves a less ambitious target than this. He had discussed with the TUC their target of 600,000 unemployed by 1978 and had pointed out that, given the lag which occurred between the growth of output and the effect on employment, the achievement of that target would require an increase of 24 per cent in manufacturing output by 1978; this was not impossible but was exceedingly difficult to bring about in any manner consistent with a balance of payments deficit which there would be any prospect of financing. The experience of the last Administration had shown the dangers of trying to grow too fast and running into consequential shortages: it would be preferable to aim for a slower rate of growth which was consistent with the Government's other economic aims. The conclusion he drew from this background was that for the period up to 1979-80, which had been covered in the February White Paper, public expenditure should in total remain broadly unchanged, and he recommended to his colleagues that the guidelines for the forthcoming Survey should be based on this assumption.

In discussion it was argued that the Government's present economic policy was too critically dependent upon events outside their control. So far, the forecasts about the upturn in world trade had not been fulfilled; but the Government was still waiting for the economy to be rescued from its present difficulties by an improvement in economic activity in other countries. If this did not take place, or were unduly delayed, the prospects for our economy would be even worse than were now assumed and the Government would come under increasing criticism that there was nothing in its policies of a self-generated character to improve the situation. The central case in the White Paper, postulating a growth of 8½ per cent in manufacturing output for three successive years, was highly improbable. The volume of exports would rise, but the danger was that this might be offset by an increase in imports, depreciation of sterling having just added 5 per cent to the import bill, while the benefit to exports was delayed through the J-curve effect. It was argued that, while all forecasts were unreliable, those of the Department of Applied Economics at Cambridge showed that policies based on a monetary or devaluation approach would lead to continuing high unemployment and reduction in the real value of wages. Further falls in the value of sterling would unsettle the overseas sterling holders, and, by cutting real wages, have an impact on the Government's ability to achieve a satisfactory wages policy. The TUC Economic Review argued in favour of a strategy of protection, and neither of the papers before Cabinet gave any consideration to this as a possible alternative to present economic policies. If the promised upturn in world trade took place, it could only lead to a flood of imports into the country as activity revived, and after a short boom the resulting imbalance on external account would lead to a situation in which employment would suffer severely. It was essential that Ministers should have an opportunity to discuss seriously an alternative strategey involving the use of import controls as a central element.

On the other hand it was argued that the Cambridge school of economists had been completely wrong in their predictions last year, and the forecasts by other outside institutions - the National Institute and the independent forecast by the Bank of England - were a good deal more optimistic than previously. This optimism was confirmed by the present state of export order books. It was true that the Government's policy depended crucially upon an upturn in world trade; but the truth was that Britain depended very heavily indeed upon world trade for her economic well-being, and there was nothing the Government could do to change this: nor were we alone in this respect. On import controls, it was arguable that not all the leading members of the TUC were equally wedded to such a policy, but they were no doubt anxious to find some means of getting round the balance of payments constraints. It was extremely doubtful whether import controls on the scale suggested would produce the employment effects for which the TUC hoped. Import controls would certainly drive up the cost of living, and any attempt to use them ran the serious risk of a crushing retaliation from other countries which would completely nullify any benefit they might have. However, there was much to be said for a full and searching discussion of the arguments for and against the use of import controls, among Ministers and with the TUC, as well as with the National Executive Committee of the Labour Party (NEC); the joint meeting between the Government and the NEC in the near future would be a most important occasion for this purpose. The anxieties of the TUC and others on this issue must be treated as a serious element in the formulation of policy.

THE PRIME MINISTER, summing up the discussion, said that the Cabinet had surveyed the economic background against which public expenditure Survey plans for 1976 would have to be set. They were content that at this stage the guidelines for the Survey should be based on the assumption that total public expenditure in the years to 1979-80 would broadly reflect the figures which had been published in the previous month's White Paper. The next step would be for the Cabinet to have an opportunity to discuss public expenditure priorities and thereafter to agree the guidelines for the 1976 Survey. There was agreement that the question of general import controls must be examined in depth and the arguments deployed before the TUC and the NEC.

The Cabinet -

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

2. Took note of the paper by the Chancellor of the Exchequer (C(76) 25).

3. Agreed that at this stage the guidelines for the 1976 public expenditure Survey should be framed on the assumption that the total expenditure up to 1979-80 would broadly reflect the published figures, and invited the Chancellor of the Exchequer to put forward specific proposals on this basis.

4. Instructed the Secretary of the Cabinet to arrange for a paper to be circulated on public expenditure priorities.

5. Agreed that there should be collective Ministerial discussion of the arguments relating to import controls and their presentation to the Trades Union Congress and the National Executive Committee of the Labour Party; and invited the Chancellor of the Exchequer to prepare a paper for this purpose.

COMMON AGRICULTURAL POLICY PRICES 1976-77

5. The Cabinet had before them a memorandum by the Minister of Agriculture, Fisheries and Food (C(76) 29) on the decisions on prices under the Common Agricultural Policy (CAP) for 1976-77 which had been reached the previous week by the Council of Ministers (Agriculture) of the European Economic Community (EEC).

THE MINISTER OF AGRICULTURE, FISHERIES AND FOOD said that the meeting of the Council of Ministers had been a very long and difficult one, lasting from Tuesday 2 March until the early hours of Saturday 6 March. All the Ministers present had various national objectives they wished to achieve, and none of them would be satisfied with every aspect of the final package. In his case, within the general policy set by the Ministerial Committee on European Questions (EQ) to settle for the lowest price increases negotiable, he had been faced with problems caused by the fall in the value of sterling which was taking place during the course of the meeting. The EEC's system of monetary compensatory amounts, which acted as Community-financed subsidies on many of our food imports to counterbalance the drop in the value of sterling, would as a result of the decline in the pound during the week cost the Community in the coming year £75 million in addition to the £90 million previously expected. He had come under heavy pressure to devalue the "green pound" so as to reduce the level of these Community subsidies, but had refused to do so. If however, because of dissatisfaction with other elements in the prices package, he had broken off negotiations and resumed them the following week, he might well not have been able to resist that pressure.

On individual items the introduction of fully variable premiums for beef, equivalent to our previous system of deficiency payments, had been a major break-through. In addition the Council would consider during the year whether the system should be more widely adopted throughout the Community. In his view the hostility to the system which he had experienced the previous year was now much reduced. On milk, target price increases averaging 6 per cent over the year had been agreed, which were somewhat higher than the Commission's proposals; though for the major milk producers the price increases would in fact work out at only 3 per cent for France and 2 per cent for Germany - a sharp reduction in real terms. There would be no rise in the retail price of milk in this country before 1 January 1977, and the milk subsidy would be reduced by £70 million. In addition the Council had accepted a firm commitment to the principle of producer co-responsibility for milk surpluses. These decisions would reinforce the returning confidence in the dairy sector of British farming, which also provided two-thirds of our beef. On cereals the prices finally agreed were lower than the Commission's proposals. Overall the effect of the price changes agreed at the meeting would add about 1¼ per cent to our retail food prices by the end of the year (approximately the same as the effect of the Commission's original proposals), which would be additional to the

1 per cent increase in prices caused by our next transitional step to the full level of EEC prices. He had admittedly been attacked in the House of Commons for agreeing to this price settlement, but many of the attacks had come from Members who would not have accepted any settlement reached in Brussels.

In discussion there was general recognition that the Minister of Agriculture had fought hard in very difficult circumstances; but the extent to which the final outcome had fallen short of our objectives emphasised the need for a more fundamental examination both of the machinery for settling farm prices in the EEC and of the agricultural policy which we wished the EEC to follow. As to the machinery, there was a marked contrast between the way in which such decisions were taken by the British Government, in which the interests of all parties involved could be advocated, and the EEC practice, where the decisions were taken by the Council of Ministers (Agriculture) almost all of the members of which were solely concerned with farming interests. Similarly it was noted that often in this area the Commission put forward proposals advocated by the Commissioner responsible for agriculture, even though they were resisted by Commissioners with other responsibilities. It might be desirable for the Prime Minister to raise, at the European Council meeting on 1-2 April, the question of the machinery by which these decisions were taken. An urgent study should therefore be put in hand, for example, of whether farm prices should be decided by Finance and Agriculture Ministers meeting jointly in Council, so that the Cabinet could decide during the course of its whole-day discussion of European matters planned for 26 March whether such a proposal should be put forward. Similarly the Government's machinery for taking such decisions needed examination. The misunderstanding that had arisen during a telephone conversation the previous Friday between the Minister of Agriculture in Brussels and the Secretary of State for Prices and Consumer Protection in London on whether or not negotiations were being broken off for further consideration showed the difficulties inherent in present procedures. It might be desirable for a Minister from the Treasury or the Department of Prices and Consumer Protection to be added to the British team for negotiations on farm prices. EQ should take as precise decisions as possible on the negotiating limits, and the circumstances in which reference back was required. It was noticeable that other countries were not averse to breaking off negotiations for a period if they considered it in their national interest to do so.

As to the agricultural policy we wished the EEC to adopt, EQ had decided that these negotiations would not be a good occasion to make a major general stand of principle against those elements of the CAP which we found distasteful. It had however agreed that in the autumn there should be a thorough review of the situation, with a view to mounting an attack on those elements in the context of the next price negotiations. At present we appeared to be losing ground gained in renegotiation, for example on the need to avoid the creation of surpluses and on a fundamental stocktaking of the CAP. This trend would be bound to strengthen feeling against the Community. It was however pointed out that the difficulties of insisting on a CAP designed to meet our wishes should not be under-estimated. It would be a mistake to threaten strong action if we could not carry it through. We had to recognise we were just one country of Nine, and that while our economy was weak our voice in Europe would be correspondingly weak. We needed also to be clear on our own objectives - there was at present a certain ambivalence between our desire for food as cheap as possible and our wish to stimulate food production from our own resources. On the decisions reached by the Council of Ministers (Agriculture) the previous week, it was pointed out that the increase in food prices involved would cause difficulties in reaching agreement with the trades unions on a continued counter-inflation policy, and it might be necessary for the Government to reconsider its policy on food subsidies. We appeared to have had to pay a negotiating price to obtain a continuance of variable premiums on beef, even though we had understood that this had been agreed in renegotiation, and it was important that we should not pay again the following year. In the milk sector we had not seized the chance of insisting, as had been agreed at EQ, on the need to prevent the perpetuation of arrangements which built up surpluses. Even Mr Lardinois, the EEC Commissioner for agriculture, had been very worried about continuing dairy surpluses. However, we had accepted an increase in milk prices considerably higher than the Commission had proposed, and would inevitably as a result be faced with even bigger surpluses.

THE LORD PRESIDENT, summing up the discussion, said that the Cabinet recognised that the Minister of Agriculture, Fisheries and Food had negotiated under very difficult circumstances. No-one could say that a better result was in fact negotiable, or whether he would have been able to obtain this result if he had insisted on suspending the negotiations while he reported back to Cabinet. However, for counter-inflation policy reasons, it was important that the results should be presented carefully from the consumer point of view, and the Minister of Agriculture and the Secretary of State for Prices and Consumer Protection should consult about this. The Minister of Agriculture should report in detail to EQ on the results of the negotiations, and make proposals for the handling of those matters not yet decided. EQ should undertake an urgent study of the question of the Community's machinery for deciding farm prices, and report to Cabinet. The Committee should also pursue in the autumn its further study of the stocktaking of the CAP. It would be desirable for EQ to be as precise as possible about negotiating limits when giving guidance to negotiations about farm prices, and the extent to which reference back might be required.

The Cabinet -

Took note, with approval, of the Lord President's summing up of their discussion.

Cabinet Office

11 March 1976

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LIMITED CIRCULATION ANNEX

CC(76) 9th Conclusions, Minute 3

Thursday 11 March 1976 at 10.30 am

STERLING

THE CHANCELLOR OF THE EXCHEQUER said that he wished to emphasise to his colleagues that none of them should make any public comments whatsoever on the exchange rate without prior clearance from him of what they wished to say; and he would prefer them to avoid any reference to the exchange rate at all. In view of the events of the last few days in the exchange market, he was preparing a brief comment which the Prime Minister might include in his speech to the House of Commons that afternoon. Since the decision to introduce a floating exchange rate in 1972, the Government had not intervened in the market to try to counteract movements which genuinely arose from such economic circumstances as the faster rate of inflation in the United Kingdom than in other countries. Intervention had been confined to smoothing what otherwise would have been erratic movements. As a result, the sterling exchange rate had moved down over the last four years; but since last November, because of the success of the £6 pay limit and the reduction in the rate of inflation, the rate had remained virtually unchanged until the previous week. On Thursday 4 March the Bank of England had sold some sterling to smooth the market, and this, combined with an unfounded rumour that Nigeria was selling her sterling, led the market to conclude that the Government was trying to bring the rate down. This view was reinforced on Friday 5 March, when the Minimum Lending Rate was reduced by one-quarter per cent (a change which it was beyond the power of the Government to prevent after lunchtime on Thursday). The reports on the British economy on Monday by the Organisation for Economic Co-operation and Development that the sterling rate would need to fall, and on Tuesday by the National Institute for Economic and Social Research that the pound should be depreciated by 5 per cent, had exacerbated the unsettled state of the markets, although he thought that their effect was now spent. Since Thursday 4 March the pound had suffered a depreciation of around 4 per cent; and although some would argue that there were advantages in a movement of this kind, the stabilisation of the market in sterling had cost a considerable sum from the reserves. It had to be remembered that a 5 per cent fall in the rate added something like 1 per cent to the Retail Price Index. However, the

Treasury's forecast had assumed a fall in the rate of this order, and as long as there was no further slide there would be no need to amend the forecasts.

The Cabinet -

Took note of the statement by the Chancellor of the Exchequer.

Cabinet Office

11 March 1976