My colleagues will wish to know of the progress that has been made with the third stage of the development of our policy for prices and incomes.

2. I have discussed with the T.U.C. and with the four national employers' organisations what should be the criteria governing the behaviour of prices and incomes and what should be regarded as the incomes "norm" - i.e. the average annual rate of increase in money incomes which is consistent with the aims of the Joint Statement of Intent and which should be exceeded only in exceptional circumstances. After lengthy and at times quite difficult negotiations, I have reached agreement with the leaders on both sides on the memorandum attached which I circulated to my colleagues on E.D. (P.I.) last week [E.D. (P.I.) (65) 327].

3. This memorandum was discussed at a special meeting of the National Economic Development Council on 22nd March when it was approved (without textual amendment) and the various interests undertook to recommend it for endorsement by their governing bodies.

4. The memorandum will now be submitted for approval by the governing bodies of the Trades Union Congress and the National Association of British Manufacturers on 24th March, and of the Federation of British Industries, the British Employers' Confederation and the Association of British Chambers of Commerce on 7th April. It will also come before a special conference of Trade Union Executives on 30th April.

5. If, as I confidently expect, the memorandum is approved by the five governing bodies, I propose to announce the fact in a statement in the House of Commons on 8th April and to publish the text in a White Paper.

6. It can fairly be said that the memorandum in its final form begs some questions and ignores others. I think however that the important thing is to have reached agreement in a relatively short space of time on a document which:-
(a) sets out the main considerations which we believe to be relevant;

(b) sets a strict limit on arguments which can be advanced in support of claims for exceptional treatment for either prices or incomes;

(c) enunciates an agreed incomes "norm" at a level (3-3 1/2 per cent) which reflects current economic realities.

It is intended that the considerations set out in the document should help all concerned with determining prices and incomes to act in a manner consistent with the national interest and I hope that both sides of industry will give the widest publicity to the document when it is published. I am sure it will also provide a useful starting point for the work of the National Board for Prices and Incomes and will serve as a foundation on which a body of case-law can be built up.

G. B.

Department of Economic Affairs, S.W.1.

23rd March, 1965
INTRODUCTION

In the Joint Statement of Intent on Productivity, Prices and Incomes, representatives of the T.U.C. and the employers' organisations have accepted that major objectives of national policy must be:

- to ensure that British industry is dynamic and that its prices are competitive;
- to raise productivity and efficiency so that real national output can increase, and to keep increases in wages, salaries and other forms of incomes in line with this increase;
- to keep the general level of prices stable.

2. They have also agreed with the Government's proposals, set out in the White Paper on Machinery of Prices and Incomes Policy (Cmnd. 2577) that:

   (i) the National Economic Development Council should keep under review the general movement of prices and of money incomes of all kinds; and
   (ii) a National Board for Prices and Incomes should be set up to examine particular cases in order to advise whether or not the behaviour of prices or of wages, salaries or other money incomes is in the national interest as defined by the Government after consultation with Management and Unions.

Trends in national productivity

3. The figure for the growth of the economy between 1964 and 1970 which is being assumed in the preparation of the Government's plan for economic development is 25%. This gives an average annual rate of growth of rather less than 4%. In calculating the long-term annual rate of growth of national production per head of the working population allowance has to be made for the growth of the total national output due to increases in the numbers of the working population and for short-term variations in the rate of growth which result from fluctuations in the level of demand and the level of employment. The most recent forecasts indicate that between 1964 and 1970 the labour force may grow, as the result of the natural increase in the population of working age...
and the continuance of rising trends in the proportions working or seeking work, by no more than $1\%$ over the whole period. Some further increase in the numbers employed should result from the more vigorous regional policies to which the Government is committed.

4. These assumptions imply an average annual rate of growth in output per head of something approaching $3\%$. During the early years of the Plan period the underlying rate of growth will inevitably be below the average for the period as a whole; in addition the rate of increase may be slowed down by reductions in working hours and extension of holidays. By comparison the underlying rate of growth per head in the nineteen-fifties averaged about $2\%$ a year. It is now probably about $3\%$.

Considerations of the national interest

5. Against this background the Government have now drawn up, after consultation with Management and Unions, a statement of considerations which should be taken into account if the pricing policy of individual enterprises and increases in money incomes are to conform to the national interest and in particular to achieve the objectives set out in paragraph 1 above. These considerations are outlined below. They will help all those concerned with determining prices and incomes to act in a manner consistent with the national interest. They are also intended to guide the National Board for Prices and Incomes in its examination of particular cases.

Considerations affecting prices

6. The development of an effective policy for keeping the general level of prices stable will call for considerable efforts on the part of management generally to increase efficiency, avoid cost increases and wherever possible to stabilise or reduce prices. The rate of change of the average level of prices over any period of time is determined by differing movements of a very large number of individual prices. Even when the average level of prices is rising, there are many prices which fall. It would be impossible to lay down detailed rules which would cover all the circumstances which individual enterprises face when deciding the prices to ask for their products. On the other hand, unless some general guidance is given on the circumstances in which it might be appropriate to raise or reduce prices, there will be no basis for deciding whether individual price decisions are consistent with the national objectives. The considerations set out in paragraphs 9-10 are for the guidance of all concerned with the determination of prices.
7. It is not intended that the considerations set out in paragraphs 9-10 should inhibit the structural changes that will be necessary in the interests of faster economic growth. These take account of the fact that competition has an important part to play in stimulating economic expansion, and are consistent with the smooth working of a competitive system. It should be a normal part of enterprising business behaviour to increase efficiency, keep down costs and hold prices at a level compatible with its long-term growth. This would speed up the replacement of old techniques and out-of-date equipment by new techniques and modern equipment. Moreover, the considerations recognise not only that an enterprise must make sufficient profit to secure the capital necessary to meet home and overseas demand, but also that the vigorous and efficient enterprise can reasonably expect a higher level of profit than one that is not.

8. These considerations apply equally to the prices of goods and services whether provided by private or public enterprise. The Government regard the nationalised industries as being under the same obligations as private enterprises to contribute to the general objective of price stability, while taking account of their financial and social obligations.

Criteria for price behaviour

9. To keep the general level of prices stable, it is vital that price increases should be avoided where possible and that prices should be reduced wherever circumstances permit. Enterprises will not be expected to raise their prices except in the following circumstances:

(i) if output per employee cannot be increased sufficiently to allow wages and salaries to increase at a rate consistent with the criteria for incomes stated in paragraph 15 below without some increase in prices, and no offsetting reductions can be made in non-labour costs per unit of output or in the return sought on investment;

(ii) if there are unavoidable increases in non-labour costs such as materials, fuel services or marketing costs per unit of output which cannot be offset by reductions in labour or capital costs per unit of output or in the return sought on investment;

(iii) if there are unavoidable increases in capital costs per unit of output which cannot be offset by reductions in non-capital costs per unit of output or in the return sought on investment;
(iv) if, after every effort has been made to reduce costs, the enterprise is unable to secure the capital required to meet home and overseas demand.

10. Enterprises will be expected to reduce their prices in the following circumstances:

(i) if output per employee is increasing faster than the rate of increase in wages and salaries which is consistent with the criteria for incomes stated in paragraph 15 below, and there are no offsetting and unavoidable increases in non-labour costs per unit of output;

(ii) if the costs of materials, fuel or services per unit of output are falling and there are no offsetting and unavoidable increases in labour or capital costs per unit of output;

(iii) if capital costs per unit of output are falling and there are no offsetting and unavoidable increases in non-capital costs per unit of output;

(iv) if profits are based on excessive market power.

Considerations affecting incomes policy

11. The development of an effective policy for keeping increases in money incomes in line with increases in real national output will call for considerable efforts on the part of unions and management and all others concerned with the determination of incomes. The object must be to increase productivity and efficiency as rapidly as possible in order to raise real incomes and to avoid, wherever possible, increases in money incomes that push up costs and prices. An important step will be to lay down a "norm" indicating the average rate of annual increase of money incomes per head which is consistent with stability in the general level of prices. In present circumstances the appropriate figure for this purpose is 3-3½ per cent. This would be subject to re-examination by the Government in the light of reviews to be conducted from time to time by N.E.D.C.

Employment incomes

12. Wages and salaries are determined by many factors, including changes in the supply and demand for different kinds of labour, trends in productivity and profits, comparisons with levels or trends of incomes in other employments and changes in the cost of living. The weight given to these different factors varies with circumstances. They are also influenced by the policies which
the Government pursue in relation to the distribution of incomes. The Government in the Joint Statement of Intent on Productivity, Prices and Incomes have affirmed that their social objective is to ensure that the benefits of faster growth are distributed in a way that satisfies the claims of social need and justice. It is in that context that the following considerations are set out for the guidance of all those concerned with the determination of wages and salaries.

13. If wages and salaries per head are to keep in step with the long-term rate of increase in national productivity, less weight than hitherto will have to be given to the factors mentioned in paragraph 12 and more weight will have to be given to the incomes norm. Moreover, in applying the norm to wages and salaries, it will be necessary to take into account not only increases in wage and salary rates, but also increases in costs resulting from reductions in working hours without loss of pay, from higher rates of pay for overtime or shift work and from improvements in fringe benefits.

14. It would be impracticable and undesirable to lay down detailed rules so as to provide an indication of what changes in wages and salaries were warranted case by case. Nor would it be desirable to inhibit the structural changes necessary in the interests of faster growth. However, experience has shown that in conditions of full employment the normal processes of collective bargaining both at national and local level can result in pay increases which are inflationary in effect. It is accordingly important to ensure that increases in wages and salaries above the norm should be confined to cases in which exceptional treatment can be shown to be required in the national interest. These exceptional increases should be kept to a minimum, bearing in mind that they will need to be balanced by lower than average increases to other groups if the increase in wages and salaries over the economy as a whole is to be kept within the norm.

15. Exceptional pay increases should be confined to the following circumstances:-

   (i) where the employees concerned, for example by accepting more exacting work or a major change in working practices, make a direct contribution towards increasing productivity in the particular firm or industry. Even in such cases some of the benefit should accrue to the community as a whole in the form of lower prices;
where it is essential in the national interest to secure a change in the distribution of manpower (or to prevent a change which would otherwise take place) and a pay increase would be both necessary and effective for this purpose;

(iii) where there is general recognition that existing wage and salary levels are too low to maintain a reasonable standard of living;

(iv) where there is widespread recognition that the pay of a certain group of workers has fallen seriously out of line with the level of remuneration for similar work and needs in the national interest to be improved.

Non-employment incomes

16. Some types of non-employment incomes, for example those of farmers and landlords, are to a considerable extent determined by Government policy. The Government will, in accordance with its general objective of price stability, have regard to the fact that increases in incomes of this type have a direct effect on the prices of goods and services. The income of nationalised industries, local authorities, etc. accrues directly to the community, but this does not mean that the prices charged by such undertakings should not be susceptible to the general considerations outlined above. The incomes of self-employed persons are an important category of personal incomes. They differ from those of employees in some respects, and allowance must be made for these differences. Nevertheless, those who are responsible for determining or are capable of influencing the incomes of self-employed persons should be guided by the considerations relating to the settlement of incomes and, where appropriate, to the criteria for price behaviour. Increases in these incomes may therefore be referred to the National Board. The other main category of non-employment income is profits, a part of which is distributed in the form of personal income to shareholders. An effective policy for avoiding price increases and securing price reductions wherever possible should ensure that increases in profits arise from increased efficiency. Where the growth of profits or dividends is based on excessive market power this could indicate scope for price reductions and such cases would be referred to the National Board for Prices and Incomes for examination.

General considerations

17. The requirement that total money incomes should rise in line with the growth of real national output does not mean that all
forms of income should increase at the same rate. It is necessary not only to create the conditions in which essential structural readjustments can be carried out smoothly but also to promote social justice. The general review of money incomes of all kinds to be carried out by the National Economic Development Council will involve not only the assembly of the facts about the movement of the main categories of income - wages, salaries, income from self-employment, profits (distributed and undistributed) and rent - but also an appraisal of the way the distribution of the national income is developing under the impact of the prices and incomes policy. The Government have pledged themselves to use their fiscal powers or other appropriate means to correct any excessive growth in aggregate profits as compared with the growth of total wages and salaries, after allowing for short-term fluctuations.

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