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CABINET

THE ECONOMIC SITUATION

Note by the Secretary of the Cabinet

By direction of the Prime Minister I circulate, for the consideration of the Cabinet, the attached memorandum, prepared by officials, on a prices and incomes standstill.

(Signed) BURKE TREND

Cabinet Office, S. W. 1.

18th July, 1966
A Prices and Incomes Standstill

Note by Officials

It has been suggested that, as one of a series of measures to meet the immediate economic situation the Government might declare a freeze (which might best be officially called a "standstill") on increases in prices and incomes for a specified period.

2. Experience during and since the War suggests that very little reliance could be placed on legal enforcement for this purpose. No satisfactory and acceptable way was found during the War of controlling directly increases in pay. Early attempts at price control in 1939/40 had little success until price control was linked with elaborate controls over quality (the Utility schemes), rationing, state trading, Exchequer subsidies, etc. backed by a very large administrative machine.

3. This suggests that the proposed standstill will have to rely largely on voluntary cooperation. It will have in any case to start on a voluntary basis until any legislative powers are enacted. This emphasizes that the scheme for a freeze must be of a kind which will be generally accepted by the community as necessary in the national interest. From a strictly economic point of view the present need is to combine a freeze on money incomes with measures to reduce demand. But in practice a pay freeze would be regarded as tolerable by trade unions and public opinion only if it was accompanied by a comparable standstill on prices and dividends.

Type and period of Standstill

4. There is no possibility of an absolute freeze on prices. On the incomes side there is a broad choice between an attempt to secure either a complete freeze for a short period or a standstill with some provision for exceptions for a longer period.

5. To be most effective the first course would provide for no exceptions (even for lowest paid workers or for productivity). There would be a prohibition on the implementation of existing commitments, including pay increases due under long term agreements and on the payment of wage and salary increments for the period of the freeze. A complete freeze of this kind would involve pretty rough justice for many groups and, in so far as prices rose, would involve a cut in real incomes. It would probably not therefore be possible to sustain it for more than six months. Negotiations and arbitration and reports by the N.B.P.I. would continue, and agreements reached would be implemented at the end of the six months period.

6. A short but complete freeze could be expected to have an immediate and dramatic impact, both on home costs and on overseas opinion. It would have the appearance of greater equality of treatment even though the treatment would be harsher, but the anomalies and inequities would accumulate over the six months, and there would be a flood of pent-up increases at the end of the period, which could be very damaging. Six
months would be a very short period in which to make effective arrangements for an orderly and moderate pattern of pay increases to follow the freeze. Making the freeze effective so long as it lasts is likely to take up most of the Government's energies during this period.

7. The second course would involve a less crude approach to pay increases and could therefore be sustained for a longer period, say 12 months. But it would have a much less immediate impact, particularly if existing commitments and cases in the pipeline were allowed as exceptions. Once some exceptional cases are admitted, it becomes very difficult to draw the line. The main advantages of the second course are that it would be likely to be more acceptable and therefore more effective and that it would provide a longer period in which to plan for the orderly growth of incomes following the standstill. Although there would be very considerable difficulties in defining the criteria for exceptions and operating the machinery for applying them, these criteria and the machinery could continue to be used with any modification thought desirable after the standstill period.

8. It might be possible to combine elements of both these courses by having a year's standstill which provides for strictly limited exceptions together with a six-month deferment of all increases under existing commitments, including annual increments, due in the course of the year. This would combine some of the advantages (as well as the disadvantages) of both courses.

Legislative provision

9. Since it would be impossible to enforce detailed controls over prices and pay by law, there would be no advantage in introducing detailed legislation. Even if it were possible to take comprehensive statutory powers of control fairly quickly, it would take a considerable period to build up the machinery needed for enforcement, by which time many people would have "jumped the gun".

10. It would, however, be desirable to support the request for a standstill with some statutory powers, if only to deter some or those who deliberately set out to flout the policy. The alternative possibility of fitting selective provisions into the Prices and Incomes Bill is discussed in para. 38 (iii) below.

11. It should be recognised that even if the standstill were reinforced by some statutory powers, it could not be expected to be completely effective. But given a reasonable measure of public support it could be sufficiently effective to strengthen the economy in the short-term.
Incomes standstill

12. In principle it would be necessary to call for a standstill on all personal incomes, including incomes of self-employed persons, fees, dividends, etc., if it were not to be regarded as discriminating unfairly against wage and salary earners. In practice it would be difficult to make a standstill effective except in respect of those wages, salaries and fees which are negotiated.

13. One of the biggest problems is how to treat existing commitments. These fall into several categories:

(a) Pay increases due under agreements already in force. In the 12 months to 31st July, 1967 increases in wage rates or reductions in hours (or both) averaging 5.5% per annum are due under existing agreements to about 5 million manual workers (about a third of the total number of wage earners) including workers in engineering and shipbuilding, iron and steel, and railways. There is no commitment at present outstanding in respect of the non-industrial Civil Service, although about 60,000 civil servants are due for increases under pay research.

(b) Pay increases recently agreed but not yet in operation. Examples are electrical contracting, local authority manual and non-manual workers. In some cases the settlement and its implementation may have been delayed as a result of Government pressure. Wages Council proposals not yet approved by the Minister of Labour might be regarded as falling in this category.

(c) About two million workers are covered by cost of living sliding scale arrangements, mainly in construction, iron and steel, printing and hosiery.

(d) Some groups are expecting pay increases as a result of action taken or supported by the Government. Examples are the dockers, railwaymen, policemen and Government industrial workers.

(e) Some workers have contractual rights to pay increases at future dates, which employers could not be expected to abrogate on a voluntary basis; others are entitled to pay reviews. Civil Service P.R.U. Surveys covering ever a quarter of a million civil servants are due for completion by the middle of next year.

(f) Many salaried workers (and some wage-earners) receive pay increases in the form of annual increments on a scale.

14. These forward commitments pose a difficult dilemma. If a standstill is introduced on the basis that they are to be honoured (as was done in the 1961/62 pay pause) its effectiveness would be much reduced and it would be regarded as falling unjustly on those workers who by chance or for other reasons (including pressure from the Government in some cases) are not covered by an existing commitment. On the other hand to deprive large numbers of workers of pay increases to which the employers have agreed would be no less unpopular and, so far as the private sector is concerned, might be impracticable.
15. If the standstill made any provision for exceptions it would be necessary in addition to declaring a "norm" of zero -

(a) to lay down much more stringent criteria for deciding exceptions, probably with a relatively low upper limit on exceptional increases;

(b) to channel exceptional cases through the Board, since it would otherwise be very difficult to control them. This would call for a re-thinking of the scope and functions of the Board, since a very large number of cases might need to be handled over a short period of time.

16. The functions of statutory wage-fixing bodies would need to be modified or suspended; arbitration awards would have to conform to the criteria laid down by the Government or would have to be put in abeyance for the standstill period.

17. There would in practice be no effective way of preventing pay increases at work-place, site or factory level, nor would this necessarily be desirable in a case where a pay increase was the only way of getting work done. There would be widespread pressure from workers, if the cost of living increased significantly during the standstill period. There would be no effective way of preventing collusion between employers and individual employees to secure pay increases through upgrading, reclassification of jobs, etc. The attempt to impose a legal standstill on pay increases would be strongly resented by some if not all trade unions. If pressed very far it would result in strike action and a general worsening of industrial relations.

18. The main danger of a complete standstill (which would apply to a lesser extent to the less rigid forms) is that the pressure for pay increases which would build up during the standstill period, exacerbated by the inevitable feelings of unfairness would result in a spate of increases as soon as it was over which would nullify the economic advantage that had been gained. It would be necessary, therefore, to try to phase out the increases at the end of the standstill in accordance with priorities that had been worked out in agreement with the T.U.C. and C.B.I. and with the assistance of the N.B.P.I. Alternatively, by using amended powers under Part II of the Prices and Incomes Bill it might be possible to ensure that the implementation of settlements reached during the standstill period and subsequently was deferred by up to six months from the date of the settlement.

19. The standstill would have to be imposed rigorously in respect of the pay of public servants and employees of nationalised industries. It would probably be desirable for statutory directions to be issued to the Boards of nationalised industries forbidding them to increase rates of pay without Ministerial consent. It would be necessary to secure similar restraint on the part of local authorities. It would probably be difficult to avoid a widening discrepancy between the treatment of employees in the public and private sectors. This would be strongly resented by employees in the public sector.
prices standstill

20. It would be impossible to secure a complete standstill over the whole field of goods and services. There are important differences between movements of incomes and of prices because of the direct influence on prices of e.g. increases in Purchase Tax and of world market prices of food and raw materials. Nevertheless the trade unions would expect every effort to be made to have a standstill on all types of prices and charges. Management also would tend to feel that it would be unfair if the standstill on prices covered only a part of the field.

21. An attempt to secure by statutory control that no prices were increased would tend to be ineffective unless extensive machinery, involving very large staffs, was devised to control prices and police them. Moreover in much of the consumer goods field it is almost impossible to define price except in relation to quality, style, etc., e.g. clothing and furniture. Given wartime experience, it is clear that the controls would have to extend to defining quality.

22. Initially there would have to be a voluntary approach with an appeal to all concerned not to increase prices and the response would depend on the reception of the proposed Government measures as a whole. This should apply to all prices and charges.

23. But for the statutory phase it would seem unavoidable that the main emphasis should be placed on a selective approach resting on the list of goods and services covered by the current voluntary early warning and standstill arrangements. It should be possible to extend this list somewhat, though groups such as clothing and imported foods and foods subject to seasonal fluctuations could not readily be covered. It might be possible, however, to develop the technique in use by the Ministry of Agriculture, Fisheries and Food of keeping certain food prices under constant watch to apply over a wider field.

24. For all the items listed, there would be a statutory early warning covering an initial period of up to three months (or possibly even six months) and a total period of up to one year if the proposed price change was referred to the N.B.P.I.

25. The criteria for judging whether a case existed for a price increase would need to be narrowed, compared with those set out in the White Paper on Prices and Incomes Policy (Cmd.2639). But the following would have to be accepted from the outset as reasonable grounds for seeking an increase:

(a) Increases in the cost of imported materials;
(b) Marked seasonal factors;
(c) Increases in costs imposed by the Government such as Selective Employment Tax and increases in indirect taxation.
26. Provision might also be made in the Prices and Incomes Bill to the effect that where a price not covered by the early warning requirement had been increased and had been referred to the N.B.P.I., the Government should have power, if the Board so recommended, to require the enterprise to lower its price to the original level. As in the case of incomes references, the Board would have to be organised to be able to deal with large numbers of cases on the basis of more stringent and precise criteria.

27. It would be important to try to enlist the immediate support of larger firms, both in manufacturing and in distribution. If a number of the largest firms were willing to give specific pledges this would be a valuable example to the business community as a whole.

28. Inevitably, the public would tend to expect most prices to remain unchanged and there would no doubt be a large flow of complaints about price changes. These would at least provide some help in watching the behaviour of firms and might make it possible to take some exemplary action against unjustifiable increases.

29. Given a measure of deflation in the economy and some check to incomes increases, the climate might in time become more favourable to holding prices. But it must be remembered that prices have shown greater stability than incomes over the past year and that some recent
large increases in labour costs have not yet been reflected in prices. The initial phase of the standstill might therefore prove difficult, particularly if there was any real lag between announcement and legislation.

Charges by Nationalised Industries and Government Departments.

30. The price standstill would need to apply with particular rigour to the prices and charges of the nationalised industries. This would mean in practice that no price or charge could be increased without reference to and a favourable report from H.B.P.I. In so far as charges are fixed by independent statutory bodies (e.g. London passenger fares) special legislative provisions might be necessary.

31. As far as other public sector prices and charges are concerned, the position is less straightforward because some of them e.g. charges for school meals reflect public expenditure and taxation considerations. An increase in charges of this type could best be presented as part of the measures to reduce public expenditure.

Rents and Rates

32. Rents give rise to difficulty. In the public sector there is already a wide measure of subsidisation and if rent increases were held up there would be pressure on local authority finance. This could be eased only by increased Exchequer assistance or by increases in rates. But a considerable number of wage earners would expect local authority rents to be frozen if their pay was being frozen, particularly if taxation had been increased.

33. Private sector rents are now subject to the machinery of the Rent Act 1965, which allows for reduction as well as increases. But here again, the public generally would expect rents to be covered by a prices and incomes standstill.

34. Although rates are a form of taxation, they are also a significant element in the cost of living index. Substantial further increases in rates seem inevitable on present policies, but it hardly seems realistic to envisage a real standstill on increases in rates.

/Mortgage
Mortgage Rates

35. These could only be subjected to a standstill if interest rates generally were kept stable.

Dividends

36. A standstill on dividends paid by individual companies during the twelve months would seem to be essential for presentational and political reasons. Provision might possibly be made for special treatment in cases approved by the Government or approved by the N.B.P.I., but it is in fact probable that dividends this year and next will on average be lower than last year especially with a more marked deflationary trend, so that a standstill might not give rise to undue difficulty.

Other Money Incomes

37. It is open to the Government themselves to have a considerable influence on the incomes of Farmers. The incomes of self-employed persons are more of a problem in the circumstances of a general standstill. It might be necessary to try to devise some arrangements for re-assuring public opinion that such incomes, particularly all forms of professional fees, were being kept under constant watch so that any increases could be referred promptly to the N.B.P.I.
Summary and Conclusions

38. (i) There is no possibility of bringing into existence rapidly the elaborate administrative machine that would be needed to enforce statutory controls over prices and incomes. In any case a standstill would need to become effective as soon as it was announced in order to avoid anticipatory increases in prices and pay. For both these reasons it would be necessary to rely largely on voluntary cooperation.

(ii) This means that a standstill would need to apply to prices, incomes and dividends and to treat them on a basis which was regarded by everyone affected as reasonably fair.

(iii) There would be no advantage in introducing detailed legislation for wage and price control, since this could not effectively be enforced. But it might be desirable to strengthen Part II of the Prices and Incomes Bill by:­

(a) extending the powers of compulsory standstill from one month to three (or six) months in the first instance, and from four months to twelve months in all;

(b) taking power to require prices to be lowered on the recommendation of the N.B.P.I.;

(c) to require notification of all existing commitments for increases in pay;

(d) to indemnify employers for breach of contract resulting from the standstill;

(e) to amend the requirements of legislation relating to Wages Councils, etc;

(f) to impose a standstill on dividends.

Standstill on Incomes

(iv) There are two possible approaches:­

(a) To impose a rigid standstill with virtually no exceptions for a period of six months.

(b) To reduce the norm from 3½% to zero and to introduce more stringent criteria government treatment of exceptional cases. A less rigid standstill of this type might be maintained for twelve months.

The main advantage of course (a) lies in its shock treatment and the impression which this might make on foreign opinion. The advantage of course (b) would lie in the fact that it gave greater scope for dealing with anomalies and obvious inequalities and would make it easier to control pay increases in an orderly fashion at the end of the standstill period.
(v) A possible combination of these approaches would be to require all increases due under existing commitments to be deferred six months from the due date and to permit other increases on the recommendation of the N.B.P.I.

(vi) It would be necessary to lay down more stringent criteria governing increases in incomes and prices. In particular it would be necessary to make it clear that any price increases resulting from increases in indirect taxation or import prices were not to be regarded as justifying increases in pay.

Price standstill

(vii) It would be necessary to accept that increases in prices could still be justified by movements in import prices or seasonal factors or by governmental action (for example, Selective Employment Tax or indirect taxation).

(viii) In addition to an appeal for voluntary co-operation, use might be made of the statutory early warning requirements (as extended in (iii) above).

Dividends

(ix) Companies would need to be required not to increase their dividends for 12 months.

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