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CABINET

THE REAL CHOICES FACING THE CABINET

Memorandum by the Secretary of State for Energy

INTRODUCTION

1. In his paper to the Cabinet of 22 November (CP(76) 111) the Chancellor advised us of the grave economic dangers facing the country due to the run down of our reserves and the need to fund them by an International Monetary Fund (IMF) loan, later to be supplemented by a more general funding of the sterling balances which we were told cannot be achieved without accepting the loan.
2. The Chancellor also advised us that the conditions the IMF would be likely to impose would involve a cut in the public sector borrowing requirement (PSBR) of at least £1½ billion, including £1 billion in straight cuts in public expenditure in 1977-78 with differing arrangements to be phased in for 1978-79 so as to provide a two year cover for our external position.
3. During the Cabinet discussion an alternative proposal was discussed comprising a £1 billion reduction in the PSBR of which nearly a half would derive from the sale of public holdings in British Petroleum (BP), leaving the other £½ billion to be covered by a mixture of tax increases and cuts.
4. It was agreed that further discussions should be held with the IMF at the highest level to sound them out on this approach and on a general relaxation of their original terms.

THE DANGERS DERIVING FROM IMF CONDITIONS

5. It became clear at the Cabinet that certain dangers to the Government's economic, industrial and political strategy might flow from the Chancellor's proposals.

6. These can be summarised as follows:

- i. They would be very deflationary when unemployment is high and rising, investment is slow and sluggish, interest rates are high already, and living standards are falling and due to fall more sharply.
- ii. They would involve cuts into public services so deep as to endanger their basic function and cuts in social benefits that would put at risk the Social Contract.
- iii. They would put at risk our Parliamentary majority by creating circumstances that might make it difficult for Labour Members to carry through the necessary legislation.

7. There are other dangers that we did not discuss, but which the Cabinet must consider while awaiting the outcome of the further discussions with the Fund.

a. Any agreement with the Fund which controls the Domestic Credit Expansion (DCE) if accepted might carry policy implications not immediately apparent.

The Letters of Intent already sent to the IMF in association with our earlier drawings and borrowing under the oil facility did commit us to DCE targets which, since they have not been met, have precipitated much of the lack of confidence which has led to the present sterling crisis and driven us back to the Fund with the expiry of the standby credit.

b. DCE targets at or below our present expectation might not immediately impact upon the PSBR, but if exceeded could commit us now to future cuts in the PSBR of an unpredictable magnitude at an unspecified date which could be quite soon.

c. Further cuts or tax increases designed to bring the DCE back into line with targets we had agreed would then follow on a scale and in a form that might commit us to further deflation, higher unemployment and lower benefits or public expenditure from which the Cabinet cannot escape within the terms of a new Letter of Intent.

d. The Chancellor has told us repeatedly in the past that a loan from the IMF would not be available to us unless we were prepared to give a categorical assurance that we would forgo completely our right to impose import controls or exchange controls during the two year period which the IMF loan will cover.

e. Some references were made by colleagues to the possibility of a wage/price freeze as an alternative or addition to our present policies which it seemed to be suggested we might offer in return for easier conditions. The Cabinet has not discussed this, but with inflation now forecast to rise to 16 per cent in the coming year, a wage freeze - whether sought voluntarily or imposed statutorily, would terminate the Social Contract and should therefore not be mentioned in any talks with the Fund.

THE REAL CHOICE

8. i. The IMF Road

The Cabinet is therefore faced with a real choice. We might accept that a loan is inescapable and unavoidable in which case we are bound in the end to accept the very best conditions that we can negotiate, even if they fall far short of what we think right and involve us in all the dangers set out above, including a commitment to abandon an option to introduce the alternative strategy during the duration of the loan.

Indeed if we allow ourselves to be persuaded that there is no alternative to the loan we surrender from that moment to any demands that may be made upon us whatever their consequences for the British people and whether or not we were able to carry them through as a Government.

ii. The Alternative Strategy

The case for the alternative strategy has been argued in the Cabinet before. It is based on a plain recognition that the strategy we have followed since March 1974 has failed, and in recommending that we accept the IMF conditions the Chancellor too has now recognised that the existing policy has failed.

The alternative strategy is based upon the belief that the price we must pay for borrowing to finance a free trade policy is too high because it involves unacceptable levels of unemployment, unacceptably low levels of investment and a progressive deterioration of our manufacturing capacity. All these tendencies can be observed to be at work now and our forecasts imply that they will be accelerated by the conditions the IMF might require us to accept.

9. Since we are starting afresh the Cabinet should now look at a five point plan for national recovery, which if adopted will be the basis for a vigorous public campaign for support and would extend up to, during and beyond the next General Election.

10. A national recovery plan of this kind should be based on the following:

- a. A decision now to introduce overall import quotas for manufactured goods to be set at levels that permitted us to survive without the loan if we had to do so.
- b. The immediate introduction of import deposits to cover the interim period between the enforcement of the import quotas and their full implementation.
- c. The immediate enforcement of exchange controls to check speculative outflows, to be buttressed by special arrangements negotiated for the official holders of sterling to guarantee them against loss.
- d. The reintroduction of a Capital Issues Committee together with arrangements for the control of bank advances to guarantee that investment did not take place in areas that did not rate as a national priority, thus helping to channel funds into projects that would have become attractive because import controls would provide a secure home market.
- e. A lower interest rate for all but the official holders of sterling, to give a secondary incentive to investment and employment which would cut the PSBR by lowering debt interest payments, reduce unemployment and underpin our industrial strategy.
- f. Strengthen our industrial legislation by taking reserve powers to introduce planning agreements and by providing more funds for the National Enterprise Board and the Scottish and Welsh Development Agencies.

THE PROBLEMS OF IMPLEMENTATION

11. Given the abandonment of our existing economic strategy the change to a new one would be difficult whichever of the two roads above we adopted. To that extent the alternative strategy could be presented as having been adopted only after all other policies had been tried.

12. Given the degree of international interdependence that exists our clear objective should be to persuade the IMF, the General Agreement on Tariffs and Trade (GATT) and the European Economic Community (EEC) that this is the right course for Britain and one that they should support for the four or five year period necessary to allow us to re-industrialise so that we can emerge strong again at the end.

13. We should therefore boldly tell them that this is the policy we intend to adopt and seek a loan to assist its success and reduce the severity of the measures which would otherwise be necessary which would reflect themselves in internal sacrifice and an even tougher import restriction. We could explain that our level of import penetration would depend upon their readiness to give such assistance, and that such assistance would benefit them to the extent that it allows us higher levels of imports from their countries than would otherwise be possible.
14. Similarly at home we should present the strategy boldly as a strategy for national recovery upon the basis of which we would feel entitled to seek co-operation and to invite the acceptance of the consequences that would flow from it.
15. I would not suggest that we hammered the term "sacrifice" nor urge people to "face the harsh truth", because there are many of our people for whom the sacrifices are already real and the "harsh truths" have become commonplace in the leading articles of Conservative newspapers.
16. Our approach should be based upon the belief that the interests of this country, short term, mid term and long term, require us to find through economic, industrial and political reforms, a way of using our enormous skill and ability more constructively and productively than our present inadequate political industrial and economic structures allow. It is a reform programme too and unless that element is introduced into it it would appear that it involves another hackneyed appeal for people to buckle down in order to prop up an unfair and undemocratic economic system from which they did not benefit fully when it worked, which has caused suffering for them when it failed, and which even if it could be made to work again would involve further sacrifices without any guarantee at the end that these sacrifices would pay off in a fairly shared distribution of benefit or power.
17. Such an appeal to the British people would have certain clear merits. First it would be based upon an industrial strategy that we left to ourselves believe is right, and would only be abandoning under pressure from the international financial community. Secondly it is a strategy for which there is already great support in the Labour and trade union movement which we ourselves created before, during and after the 1974 General Election. Thirdly it would be built upon values and ideas that the Labour movement has developed and cherished over a much longer period than that. Fourthly it would appeal to all those who are not of our political persuasion, but who already sense that Britain's basic interests are being sacrificed under international pressure which also is being used to humiliate us by lending money in return for the surrender of basic rights of national self-determination.

18. It is a programme that does not require us to adopt a posture or stance of confrontation against anybody, since it invites all to work together - managers as well as unions, industrialists as well as professional people. It is an invitation for a new consensus without which no modern industrial society can work.

CONCLUSION

19. I do not wish to underestimate the difficulties of making the choice set out in paragraphs 8-10 above, but colleagues who dissent from this view should not underestimate either the difficulties of adopting a line enforced upon us by the Fund.

20. Either way we shall have to confront obstacles and face some erosion of support until it is seen that the policy choice we have made is working, and as a Government so finely balanced in Parliamentary terms we cannot be certain how we will fare.

21. At least the alternative strategy can be seen to be firmly based on a belief in our own people's capacity to use their skill if the structures permit them to do so. At least the long road might be seen to be ending. At least we would be counting those who create the wealth as assets, not as human units to be dispensed with as a by-product of imposed cuts on social services or necessary sacrifices as a flood of imports engulf us.

22. The alternative strategy is already accepted by many in our movement and can touch and stir those who have never thought of us before as defenders of the British people.

23. But if we are not seen to be defending our interests we cannot aspire to the national leadership which two General Elections have placed in our hands to exercise for the benefit of all.

24. Since the choice we are being asked to make is of such magnitude I recommend to my colleagues that no decision be made until we have had the opportunity of discussing the alternatives, in conditions of confidentiality, including the ones set out in this paper, with the responsible leaders of the Trades Union Congress and the Labour Party.

A W B

Department of Energy

29 November 1976