17th July, 1957

CABINET

INFLATION

Memorandum by the Chancellor of the Exchequer

My colleagues will wish to know how I view the problem of inflation and what policies I recommend. Many factors enter into the health of the economy and I will comment on the most important of them one by one.

GOVERNMENT EXPENDITURE

2. This is economically and politically among the most important factors. Unlike many of the others, it is within our direct control. We made a collective effort to reduce the level of Government expenditure this year; and I am not dissatisfied with the results. There is thus no need, and I certainly have no intention of, embarking on emergency mid-year cuts, still less to impose an all-round increase in charges for welfare services, etc. Cuts in expenditure may become necessary to keep the growth of expenditure in check, but such measures now would have little practical value and would divert attention from the real economic issues.

3. Nevertheless the future prospects for Government expenditure look serious. There is every sign that, unless we redouble our economy effort, expenditure will rise sharply again in the next few years and will far outstrip the rise in revenue. We must stop this from happening: not only because to keep Government expenditure at the lowest practicable levels is one of the biggest contributions we can make towards restraining inflation; but also because our hopes of further reducing taxation depend almost wholly on our doing so.

4. Our policy, therefore, must be to keep both civil and defence expenditure within the level of the current year’s Estimates, offsetting both the rise in wages and prices and the probable disappearance of any substantial foreign aid on defence next year by economies in other directions.

5. This means that £1,420 millions is the maximum that we should spend next year on defence. The corresponding civil target is £2,650 millions. On the civil side there are some automatic and inescapable increases and we must find positive reductions to offset these.

6. I count on my colleagues most rigorously to scrutinise all their Estimates in this endeavour.
INVESTMENT

7. In the private sector I intend to maintain the credit squeeze through restriction of bank and consumer credit and the control of borrowing exercised by the Capital Issues Committee. The squeeze is already severe. Nevertheless, I am examining some indications that it may be becoming less effective; and, if that proves to be so, I shall be ready to intensify these measures of control and to consider others.

8. In the public sector (investment by the central Government, local authorities and nationalised bodies), I do not think that the level of investment is undesirably high at present. I certainly think we should avoid chopping and changing investment programmes on a short-term basis. What matters is to take decisions which will secure the right long-term pattern of public investment. But existing commitments and policies look like producing a growth of about 30 per cent (£300 millions) in this sector over the next five years. In addition, proposals for substantial new commitments on roads, hospitals, schools and the like are continually arising. We are in danger of entering into excessive long-term commitments, which will cramp other claims upon the economy (including private investment) and will frustrate our other objectives, including a sound balance of payments and a sound currency.

9. I am reviewing the whole question of the size of our commitments in this field and the problem of how to control their growth, and will make proposals to my colleagues in the autumn. Until I have done this I ask that no further proposals involving significant increases in public sector investment should be accepted.

CAPITAL FROM OVERSEAS

10. There is a world shortage of capital. Nothing could be more helpful to this country than to attract capital from overseas to sustain some part of our investment in the public sector - since this is the area in which without this the purely financial problem may force damaging cuts on us. One possibility of such help presents itself at the moment. Although no details have been discussed, it is possible that the International Bank for Reconstruction and Development may be willing to provide capital, on acceptable terms, for some items in the nuclear power programme. Subject to further discussion of details with my colleagues immediately concerned, I would like to pursue this possibility further.

CONSUMPTION

11. While we must do everything we can to encourage savings, I do not think that it would help in our present troubles to restrict consumption by increasing indirect taxation.

PRICES

12. We are in the midst of a round of price increases in the basic industries. Increased charges for postal and telephone services, steel and transport are still to be announced, and there will have to be consequential increases elsewhere. There can be, to my mind, no question of seeking to prevent these price increases, which are the inevitable consequence of cost increases. Indeed to attempt to do so
would only make the situation worse by increasing the pressure of demand and by enabling consumption in real terms to rise. This increased demand would have to be offset by increased taxation.

13. But we should lose no opportunity of making it clear in public that the source of our inflationary disease is wages increasing out of all proportion to increases in production; and that we should do only further harm by trying to suppress increases in prices which are merely symptoms of the disease, not its source, as many appear to think.

WAGES AND PROFITS

14. Through the Budget and through credit policy I have taken steps which should help the economy to continue in balance, but the problem of rising costs, and in particular wages, dwarfs everything else. Wage and salary increases added about £900 millions to costs in 1956, and since then there has been a further big batch of increases. Part of the increase in money incomes may be offset by additional productivity in due course; but the effect of so big an injection of purchasing power into the economy is far more powerful than anything which it is practicable to do to offset it by budgetary and credit measures. It was in recognition and in anticipation of this that I made the proposals which I did in C. (57) 103.

15. What course should we now pursue?

16. First, we are pressing on with the Council on price stability, productivity and incomes. At least that body may make some contribution towards the education of the public, including wage tribunals. These problems will, however, be facing us long before it makes its first report.

17. We must use all our influence to prevent further increases in wages and salaries based on the current price rise which is a direct consequence of the last wage round. The Chairmen of nationalised industries should be told that until further notice they should not concede any increase in wages direct, or indirect, e.g. through shorter hours. The Government, while not abandoning the "fair wages" and "fair comparisons" principles (which relate Civil Service pay to that in comparable outside occupations) should adopt a similar attitude towards the pay of its own servants. Private employers also should be encouraged to look very closely at any proposals which will involve increased costs. If this is done employees may either resort to strike action or to arbitration. If they do the former we must encourage employers to resist; if they do the latter, some increases may become inevitable. But experience shows that arbitrators are showing more awareness of the needs of the community than is likely to be observed in bi-lateral agreements between employers and workers.

18. If by this policy and through the work of the proposed Council we can secure stability in costs over a reasonable time, then there would be a real hope that we could secure general stability in prices; and there would be an opportunity for the recent unjustified increases in costs to be absorbed by greater productivity.

19. In the weeks and months ahead we shall be having a number of meetings with the various sides of industry. Suggestions may be made for the controlling of prices or profits. We shall have to examine these but we need to approach such suggestions with caution. Profits are necessary for the investment without which the rising production so
essential to our needs will not take place. The main difficulty about any bargain at the national level on wages is, however, that it is hard to see how it could be kept. The Trades Union Congress do not control wage claims. Nevertheless we must be prepared to consider measures which may be economically undesirable or politically difficult, if they show any reasonable chance of securing stability in costs and prices.

20. Inflation has been with us for twelve years. Probably our best chance of checking it is not to be found in an attempt to hold any part of the economy completely rigid. Our purpose must be to see that incomes and production move up together. To this end we must stick to our fiscal and monetary policies and hold down the level of Government expenditure. We must make it plain that in the field directly within the area of Government control we are playing our part to the full. Outside that area we must have the courage both to state the truth about wages and costs and to stand firm - and so far as our influence permits encourage others to stand firm - against wage demands which go beyond what new production justifies. A solution is not impossible upon these terms.

CONCLUSIONS

21. I ask for the assent of my colleagues to the following propositions:

(a) That we should aim to keep Government expenditure next year within the total provided in this year's Estimates, meeting all inescapable increases by offsetting economies.

(b) That we should maintain and, if necessary, intensify the credit squeeze.

(c) That pending a general review on which I shall report to my colleagues in the autumn, no further proposals involving significant increases in public investment should be accepted.

(d) That we should not seek to interfere with price changes which flow from recent increases in costs.

(e) That public employers and the nationalised industries should concede no further increases in wages and salaries (direct or indirect) until further notice.

P.T.

Treasury Chambers, S.W.1.

16th July, 1957.