ECONOMIC RECONSTRUCTION GROUP

Minutes of the Meeting held in Interview Room D at 10.00 am

on Thursday 20th November

Present: Sir Geoffrey Howe MP (in the chair)
Mr Biffen MP
Mr Gilmour MP
Mr Howell MP
Sir Keith Joseph MP
Mr Nott MP
Mr Prior MP
Mr Ridley (Secretary)
Miss Bulloch
Mr Gilbert

Apologies Sir Leonard Neal

1. Introduction

The Chairman drew the Committee's attention to the note 'On Cause and Inflation' (PG10/75/18). Mr Ridley explained that the note had been done to clarify terminology and with particular reference to the paper produced by Mr Edwards in response to the report to the Shadow Cabinet. The Chairman indicated that the Group were agreed on multiple causation: differences arose on the emphasis to be given to different elements. Mr Edwards' conclusion indicated that he was in agreement on this point.

2. Wage Controls

Mr Prior stated that a return to freedom from Government interference immediately following the formation of the next Conservative Government was unlikely to be entirely realistic. The economy was likely to be running down; 60% of our GNP would be coming from nationalised industries; the unions would still be strong. He was not certain whether a Conservative Government could abandon incomes policy if one had existed forthe previous 2 or 3 years. More sophistication and less restriction would be required: perhaps the entire Price Code and Price Commission mechanism should be replaced by amore general requirement relating to return on capital.

Sir Keith Joseph felt that the prime influence of money supply could not be ignored. Action in other areas might help, but it was perhaps mistaken to believe that wage controls would make things easier. The current Government was likely to find itself in difficulties when the £6 year ran out. Mr Howell believed that if we found wage controls which had appeared to have been useful on our return to office, we should notsweep them away. Equally, if they had been seen to fail they should not be revived.

It was noted that the monetary policy ofthe Conservative Government had been largely correct during 1970/72 prior to the miners strike. Mr Prior took the view that the possibility of effectively repeating this would be much reduced when we faced a more antagonistic union movement, when we would be obliged to take off food and rent subsidies and undertake further expenditure cuts. The Chairman noted that this could lead to a series of Wilberforces, which could be less preferable than a continuous body. Sir Keith, however, felt that the Conservat - ives would return with a doctor's mandate, Labour's policies having been seen to fail, and Mr Howell noted that in these circumstances it might be better understood that high public expenditure was more of a threat than a reduction of it. A spirit of greater co-operation would exist.

Mr Howell felt that a major pre-election task was to gradually overthrow the popular view that the Conservatives could never work effectively in the face of union opposition. As inflation got worse, some unions would see better the argument on public expenditure; increased internal democracy would allow more potential influence through rank and file members; more could be made of the importance of the 14 million non-unionised employers who would work with the

Conservatives.

The Chairman noted that the Group were undecided on whether statutory controls or substantial intervention in the labour market should be excluded, and in particular on whether the £6 policy and its continuation was necessary, given that it meant the exclusion of other policy options.

Sir Keith noted that pay controls had to be seen as being accompanied by price and dividend controls. It was suggested that a position should be adopted which was against continuation of dividend controls and of price controls. Some felt that this was politically unrealistic, but others took the view that it would be possible if it was clearly shown that the present position was leading to the removal of jobs.

Mr Biffen noted that it was argued persuasively - if wrongly - that the £6 policy had kept public sector pay lower than it would otherwise have been. He believed that in fact the Government was moving towards the same difficulties that the Conservatives had experienced with their incomes policy: they would have to become more discriminating, and here it would be open to widespread evasion and avoidance. Stopping inflation was directly dependent on controlling public sector expenditure.

Reducing the powers of Unions.

The Chairman indicated that the problem was political and industrial pressure by trade unions could persuade Governments to abandon monetary continence and he referred members to an article by Frances Cairncross on the subject. Hayek argued that the power of the unions must be diminished or extinguished. This view held that there should be no state monopolies in public services. Mr Prior recalled that it had been hoped that the Industrial Relations Act might restrict the powers of unions. If a reduction in public expenditure was enforced without co-operation from the unions on pay, the use of their monopoly power could rapidly negate the achievement. So fragile was the state of the economy that some form of pay controls was likely. The British union movement was different from its German equivalent, e.g. there were many more British unions, and this meant that the establishment of a similarly regulated economy would be difficult. It was not realistic to assume that there could be any return to a legislative approach to union power in the next few years. In the short term, policy should be directed tangentially: more moderation should be encouraged via greater democracy; management should be clearly told that they should inform and educate their their workforces; consideration should be given to methods of removing certain props from the unions - such as social security benefits for strikers families and tax rebates - and to ways of supporting industry during strikes.

4. The potential post-election scenario

In response to a query from Mr Nott, the Chairman indicated that the Group was agreed that there should be cash control in the public sector. The disagreement arose over the extent to which it was possible to rely on this as the only distinct regulator of pay when the private sector faced bankruptcy and unemployment.

Mr Gilmour felt that it should be borne in mind that the avoidance of a socialist state entailed that the Conservatives win the next election. This might mean a willingness to accept pay controls in the interim.

5. The purpose of the Group

As discussions frequently centred on the public sector and taxation, and since those were covered by other specific policy Groups, Mr Nott questioned the need for the Economic Reconstruction Group. If its major function was to be deciding the form of an incomes policy, then it should not continue.

The Chairman indicated that the differences in opinion within the group on the possible use of incomes policy should be seen as a reflection of the views of the intellectual community. The group's major function was to act as a 'holding company' for other groups and to co-ordinate their work.

There was no disagreement about the desire to secure a situation in which there would be no Government intervention, and to move closer to the German system.

Members noted that it was difficult to make public utterances about pay policy at this time as these would be read as a statement of our views on its successor. Mr Gilbert pointed out that the present policy was essentially voluntary and that the Government would not necessarily be forced to adopt a stronger statutory policy in July. Other parts of their economic management might make it possible to reach a further voluntary agreement. It was agreed that the subject was one on which a fixed view was not immediately needed. It could be returned to from time to time.

6. Money Supply and Unemployment

The Chairman reminded members that Mr Ridley and Mr Griffith were working on money supply. Sir Keith questioned whether the fact that the UK was borrowing more than it was financing did not indicate excess demand, but Mr Ridley noted that a deficit - covered or uncovered - was not same after the pressure of demand in the labour market. In fact, high unemployment could lead to an excessive deficit and concern must be expressed about the possibility of the preconditions for excess demand being brought about during 1975 in ways which would be irrevocable in future years.

Mr Howell drew the groups attention to recent American papers which indicated that there was a distinct relationship between money supply reduction and unemployment, but that it had been ignored recently because the timescale of its operation had not been understood.

Robbie Gilbert

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