

THE PRESENT CRISIS - SOME SCENARIOS AND QUESTIONSNote by the Research DepartmentThe Crisis

1. Since the Budget sterling has depreciated by 3 per cent bringing the fall since the Smithsonian agreement to 25 per cent against other major currencies. Although the Budget was moderately tough and although several Ministers have been making "belt-tightening" speeches, all that the Government's recent actions seem to have done is to underline the gravity of our economic situation and the inadequacy of the weapons with which they are tackling it. Inflation is mounting in Britain while it abates elsewhere. Unions are demanding (and receiving) wage settlements which probably ensure an even higher rate of inflation in the future, and these demands are pressed home even at the risk of bankrupting the enterprises involved or creating greater unemployment. Production and investment are falling. The collapse of British Leyland typifies much that has been wrong with British management, industrial relations and Government policy for the last few years, and the latest chapter in the sad story shows that few, if any, lessons have been learned. While the economic situation deteriorates, Mr. Benn pushes through a major programme of nationalisation which further depresses confidence. There is widespread bitterness and unrest. Events seem beyond the capacity of government to cope, and when foreigners say we are ungovernable they are repeating what they hear us say about ourselves.

The time-scale*and our position

2. We have assumed in the past that, though the situation was deteriorating fast, we probably had until after the Referendum or even into the autumn or the beginning of next year before reaching the brick wall at the bottom of the hill. It now seems possible that the crunch may be reached sooner rather than later - and that the Government may even have to act before the Referendum. In these circumstances, we may possibly find ourselves confined even more firmly to the margins of events than is customary for Oppositions. It is doubtful whether it is in our interests or the nation's for us to seem so peripheral, especially at a time when the possibility of some temporary or permanent redrawing of the political boundaries looks attractive to a growing number of people and seems less unlikely than it usually has in the past.

The Lever scenario

3. The Shadow Cabinet may recall that the last Research Department note on the political situation set out a number of scenarios including the rosy-spectacled view that might be taken by Harold Lever. It now seems considerably less likely that this scenario will work out. The reactions to Mr. Wilson's Panglossian performance on Sunday show that expounding the Lever philosophy is not enough to restore confidence. Of course, things may not be as bad as they seem. It was always expected that sterling would depreciate before the Referendum and it may be that the market will adjust in the next few days* We may
 (* The fact that we have a floating rather than a fixed exchange rate possibly stretches the time-scale as against previous crises of confidence).

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even get through the summer with a mini "July package", and then, with a trade union movement made more compliant by mounting unemployment, hatch a more successful successor to the Social Contract. After a difficult few months, everything will then come right as the oil arrives in greater quantities next year. This does not seem very credible; in addition to the economic realities, one has to consider the political difficulties inside the Labour Party. Mr. Wilson's position may be less secure, and the degree of political bitterness inside his Party makes it unlikely that there will be any "rallying round" after the Referendum or that the Cabinet, and the Labour Party in general, will be able to agree on economic policy.

The "Benn take-over" scenario

4. Less likely still than the Lever scenario is a complete shift to the siege economy measures favoured by Mr. Benn (import controls, price freeze, direction of investment etc.). We are only likely to be faced with this if there is a "No" vote in the Referendum; it may then be possible that under a stooge Prime Minister (e.g. Mr. Wilson) Mr. Benn's Socialist visions would be turned into some sort of reality. However, a "No" vote and the on-set of Bennery on an even larger scale might split the Labour Party and drive the right-wing into the wilderness. A Government committed to Bennery might not be able to survive the withdrawal of Jenkins, Williams, Lever, Prentice and others. We cannot however depend on their much advertised political courage and integrity.

The Summer Package

5. We can probably now expect one of the following:
- (a) Measures in the next few days (e.g. a big increase in interest rates) which steady the position until after the Referendum, when a full-scale package of measures is produced;
 - (b) a full-scale package before the Referendum-- and may be another one later;
 - (c) a major package after the Referendum - and perhaps another later in the summer or in the autumn.

The Government may not be able to delay action (as they would like to do) until after the Referendum.

6. The contents of any package or packages could be tipped towards Lever or Benn; in the first case they are likely to be inadequate, in the second economically disastrous and difficult for the Right-wing of the Labour Party to accept. No-one outside (e.g. the I.M.F.) will tell us precisely what we must do, but it will be made pretty clear what is needed to restore confidence. Likely measures include:

(a) Some public expenditure cuts now with more promised later. The Government will be in difficulty here as they have already made some cuts and are now entangled in the early stages of the PESC exercise. However, they could act on subsidies (to rents, food and nationalised industry prices), increase some charges, cut actual programmes and issue/toughen guide lines to local authorities and nationalised industries.

(b) Tax increases.

(c) An import deposits scheme or selective action aimed against particular products (e.g. textiles, clothing, cars). Across-the-board import controls have been ruled out by many Ministers, though this does not make their introduction impossible. Any direct action on imports would presumably have to await the Referendum in view of the trouble caused with our EEC partners.

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(d) Action on wages. This could take a number of forms. The Government may seek a voluntary pause while pursuing the idea of a "national dividend" with Government and both sides of industry involved in deciding the size and allocation of the shares in any increase in the national product. This might appeal to Mr. Wilson but probably not - for long - to many others. Alternatively the Government might go for a tightening of the Social Contract guide lines with, say, some element of indexation (possibly linked to food, fuel and rents). They may finally be driven the whole way into a freeze or statutory incomes policy; this might be called something else (e.g. job protection) and involve new machinery (e.g. use of the tax system as the Liberals suggest), but in practice it would involve the same interference in the free collective bargaining machinery that has provoked union hostility before. Failure to apply a price freeze as well as wage controls or a wage standstill would greatly increase Left-wing opposition, but surely even this Government could not now be so witless as to try to hold down prices, again.

(e) In addition to direct action on wages, the Government might abandon Benn in favour of Finniston and Marsh - insisting in other words on linkage between nationalised industry wage settlements and price and employment levels, and also on greater commercial discipline in these industries.

(f) There are other more technical things that might be done such as increasing interest rates or asking for special deposits from the clearing banks.

Conservative Reactions

7. We would presumably support (a) and (b), though we would want to look at the detail and to urge much heavier reliance on expenditure cuts and increases in charges than on tax increases. We would almost certainly incline towards opposing any direct action on imports but obviously our attitudes would depend on what exactly the Government proposed to do. On wages, Mr. Prior is circulating a paper which the Shadow Cabinet is discussing tomorrow. It might, however, be worth noting the following points:-

(a) No-one sensible is now suggesting an incomes policy as the alternative to public expenditure cuts and a tight grip on the money supply.

(b) Price controls in addition to action on wages would not be tolerable.

(c) We will have "confrontations" with or without incomes policy (e.g. over unemployment levels or the closing down of a firm).

(d) We will have to say something on wages soon, partly since whatever the rival schools of economists say the public see a rather obvious connection between 30 per cent wage demands and big price increases. We would be heavily criticised if we said nothing about wages, if only that wage restraint is the best way of preventing unemployment going even higher than would otherwise be the case.

Political effects of a package

8. (a) Any package that is likely to work will cause an explosion of hostility from the Tribune Group and some unions. They may prove to be paper tigers, but this is less likely now that there is such a fundamental division between the Left and the Social Democrats.

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(b) If the Government cannot carry their measures through the House of Commons on their own they have a number of options:*

(i) to challenge us to support them - on their terms - on the grounds that it would be unpatriotic for us not to do so;

(ii) to attempt to reach a formal agreement with us without actually going the whole way to a coalition government - this might involve dropping Mr. Wilson and replacing him with, say, Mr. Callaghan;

(iii) to seek a national government;

(vi) to call an election.

(c) The choices for us might be as follows:-

(i) to abstain - this would probably not be politically possible or desirable;

(ii) to support the Government on their terms - unless we take an initiative ourselves we may be driven into this position;

(iii) to bargain our support in return for dropping the nationalisation programme and doing what we believe to be the right things on public expenditure etc;

(vi) to insist on a General Election - but could we govern if we won? and do we really want to do all the dirty work on our own?

(v) to seek to bring about a coalition or national government.

Questions to be resolved

9. Against this background, some obvious questions arise involving our view of the national interest and of our own party interest:-

(a) Should we continue to adopt a relatively low profile, leaving the Labour Government to do all the dirty work and responding to events according to our week-by-week view of our party interest?

(b) If this is not our view, what initiative should we take? Should we confine ourselves to spelling out in general terms what we think should be done (abandoning Bennery, cutting public expenditure, action on wages)? Or should we actually set out our terms for a bargain? Would this be wise at this stage? It could trap us with little room for subsequent manoeuvre. If we are going to act, we may have to move soon.

(c) Do we actually need to take any action now which might help push events towards or away from a coalition? If we think a coalition may be necessary do we actually know what we should do to bring it about on our terms? Is it necessary or desirable to embark on this potentially dangerous road in such a fast-changing situation? Anyway, are national governments in practice created by parties or borne by events?

(d) Is any package of conventional deflationary measures going to solve our problems in the medium and long term, even if it saves sterling this summer? Can this Government or a Conservative Government reduce the nation's standard of living and survive? Are these questions at best over-dramatic and at worst hysterical?

C.P.