Sir G Howe

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Summary of a speech by The Rt. Hon. Sir Geoffrey Howe, Opposition Spokesman on Treasury and Economic Affairs, speaking to a meeting of the Bow Group Economic Standing Committee at the Carlton Club, St. James's, London S.W.1, on Wednesday 12th May 1976.

In a major speech, Sir Geoffrey Howe, the Shadow Chancellor of the Exchequer, sets out the long-term Conservative approach to the vexed question of prices and incomes policy.

"The present pattern", Sir Geoffrey suggests, "has only the slenderest chance of survival for more than a short period."

He acknowledges "that the sum of £6 ... may be playing a legitimate role in fortifying a basically monetary exit from the almost hyper-inflationary tunnel of the social contract. For it can be said to have helped

- in reducing inflationary expectations.
- in curbing the size of the pay and salary element in public spending.
- in tempering the growth in unemployment". (p17)

But Sir Geoffrey foresees increasing difficulty from the flattening of differentials and other constraints upon the labour market.

After tracing "the U-turns and double U-turns of politicians and parties on this issue" and those of journalists, academics and public opinion, Sir Geoffrey stresses the need to find "a way through the middle ... I do not believe that this will most easily be solved by those of us who may be tempted to see the answer in theological absolutes - by asserting that incomes policy is 'vital' on the one hand or 'disastrous' on the other. The test of British statemanship in the years immediately ahead is to find the best way of securing acceptance of the economic imperatives.. (p12)

/Sir Geoffrey spells

Sir Geoffrey spells out (P. 6) six arguments against incomes policy and stresses (P. 9) the central importance of monetary policy. But goes on (P. 10) to show why "Strict Monetary Policy is not Enough". There is need to take account of the way in which "trade unions, not themselves the cause of inflation, all too often are the motive force that leads government to take fatal steps that cause inflation". (P. 12) .

After analysing the success of West Germany's approach to this problem, Sir Geoffrey spells out six basic principles (P. 15)

1. Financial prudence, strict control of the money supply should be an essential foundation of economic policy.

2. Government must be determined to secure the widest possible understanding of this policy. The self-destructive folly of excessive wage demands needs to be demonstrated by every argument that can be brought forward.

3. Public spending and borrowing must be reduced. For the £12 billion public sector deficit is the most explosive part of the present economic scene.

4. As the only secure basis for future jobs, the profits of industry must be allowed to rise. Price controls must be substantially relaxed.

5. We must develop a more open approach to economic management. The undue influence of one interest group (the TUC) needs to be challenged. An extended NEDC would provide the best basis for this.

6. We need to develop a better method of handling wage claims in the public sector, "the soft under-belly of the British economy".

It will not be easy, concludes Sir Geoffrey, "to leap over-night to this ideal solution. That is why the present policy, following the disastrous year of the social contract, has a part to play. But one should be very plainly aware of the way in which it is likely to enthrone the trade union leaders in a position of undue influence and to open the road to Socialism.

"That is why there must be no doubt about the absolute necessity of pursuing policies that should make unnecessary any further resort to such a possibility.

/"The present existence

"The present existence of an incomes policy must in no circumstances be regarded as an excuse for avoiding the correct monetary policy. In formulating its monetary policy, the assumption of government should be that its policy for incomes will not succeed. Monetary restraint (and reduced public spending) remains the key to the future.

"The worst mistake of all would be to regard the existence of a policy for incomes (of whatever kind) as an alibi for monetary or fiscal incontinence."

END OF PRESS SUMMARY. Full text follows

Full text of the speech by Rt. Hon. Sir Geoffrey Howe, QC MP (East Surrey).

IS THERE A LONG-TERM ROLE FOR A PRICES AND INCOMES POLICY?

For the first time in our history a Chancellor has made his Budget conditional upon the acceptance by the TUC of a formal incomes policy. The bosses of the TUC have become the centrepiece of our economy. Their decisions will supposedly determine the future not only of wages but prices, the pound, the economic recovery and unemployment. The mainstay of the Chancellor's strategy is his incomes policy.

But this is the fifth major post-war incomes policy. The others have ended with bitterness and disillusion.

That is why I want today to address my remarks to the problem that has defied politicians and pundits alike:
What, if any, should be the long term role of a prices and incomes policy?

MY RIGHT TO SPEAK

Anyone bold enough to thrust himself forward into this controversy would be well advised to do so with humility. All too often the question is posed in almost theological form: "Do you believe in incomes policy?"

That caution is not intended simply for politicians.

The U-turns and double U-turns of politicians and parties on this issue are well catalogued. So is the diversity of opinion that exists within both the major parties. All this is not the result of any unique incompetence or wickedness on the part of British politicians. It has to do with the intractability of the problem and the elusiveness of a solution.

/Look, for example...

Look, for example, at Canada, where Mr. Trudeau has performed a somersault all too familiar in Britain.

And look too within every editorial conference in Fleet Street, or in every university or public bar. You will not often find consistency - still less unanimity.

Let me confess my own erratic record.

I did not find it difficult to be sceptical about Sir Stafford Cripps' first White Paper ("Personal Incomes, Costs and Prices", 2½ pages, one penny) which threatened to use price controls as a buttress for a volunatry policy. This scepticism was powerfully revived in the years of Opposition that preceded my entry into Mr. Heath's Government in 1970.

But when I was invited by Mr. Heath to join his Cabinet on Guy Fawkes' Day 1972 (the day before the announcement of the Stage 1 Freeze) I had already refreshed my memory of the articles that had appeared during my editorship of "Crossbow" (1960-62), in anticipation of the Maudling search for a voluntary policy.

That approach - more precisely indeed the 1973 approach - had been closely foreshadowed in James Driscoll's Bow Group pamphlet "National Wages Policy", published in 1955 when I was Chairman of the Group.

So I have been sitting on the intellectual roundabout for as long as most of today's seekers after truth. And from 1972 to 1974 I was in the stifling engine-room of prices and incomes policy, as the Minister responsible for price control and a participant in the almost continuous round of meetings with the TUC and CBI.

/The Case Against...

THE CASE AGAINST INCOMES POLICY

That experience gave me a highly practical insight into the very real arguments against an incomes policy.

The first objection to the setting of wage targets or norms (whether they be flat rate or percentage, or on a more subtle basis) is that they substantially destroy the functioning of the labour market. Changes in relative wage rates are the lights that wink at each other over the market-place. In an economy where over half-a-million people change their job each month, no national plan can replace the signalling of market prices.

To interfere for a year or two with changing differentials may not be disastrous. But try to maintain such control for a longer period and the necessary movements of labour between the changing demands in individual industries will cease to occur. If that does not happen, the policy itself will begin to crumble.

The second major objection is a political one, and one which has particular importance for Conservatives. If the State itself should attempt to simulate the market-place and to plan relativities throughout the economy, then freedom itself will be endangered. The road to comprehensive job evaluation is a not-so-primrose path, with a cage and a locked door at the end. How could a society where everyone's remuneration was to be assessed by some Board, be compatible with freedom as we know it? Surely a free society could be defined as one where the value and worth of each individual is not something to be determined by the Government or its agencies? If all incomes were determined by the State, the verdict could be much more fiercely resented than the anonymous judgment of the market-place.

The third objection is a very practical one. It has not proved easy to evolve a practical method of making those non-market judgments. The George Brown policy involved direct parliamentary application of a pay code. The Heath policy sought to transfer enforcement of the code to a quasi-judicial agency, with an unobtrusive ministerial discretion in reserve.
The Foot policy (not yet involved in the complexities that must follow a flat-rate policy) has left everything to the Secretary of State or the TUC.

But each approach has led, or surely will lead, to its own problems: from the frequent anguish of parliamentary debates in the Brown era to the mediaeval intellectualism of miners' "washing time" or "London weighting" in a later period.

The fourth objection

The fourth objection that is often put forward is less compelling than some of the others. It is often said that an incomes policy increases the risk of avoidable conflict between Government and the trade unions.

In the public sector at least this risk is always present so long as government accepts -- as it should -- its clear responsibility for limiting the size of the wage-bill that is financed by the Exchequer.

Even so, a formal incomes policy certainly increases the risk of conflict, the more so if it embraces the private sector.

The fifth objection to the establishment of an institutionalised incomes policy is more formidable. I refer to the greatly increased leverage that trade unions (or their leaders) acquire, through an incomes policy, over many matters that are properly the responsibility of the elected Government.

In recent years, under both Conservative and Labour administrations, policies for taxation, prices, industry and other matters have all been changed, often in a harmful way, to persuade trade unions to accept an incomes policy.

Governments have all too often given promises that ought not to have been given in exchange for promises that could not be fulfilled. For the sake of a fragile promise of wage restraint, fundamental policy changes have been introduced. For a mess of pottage, birthrights have been bargained away.

The price of the social contract, for example, included:

1. An entrenchment of the mistaken belief that real living standards could be protected, in face of a sharply adverse movement in the terms of trade.
2. A disastrous diet of Socialist legislation.
3. Sharply increased hostility to profits, incentives and ownership.
4. An explosive growth in public spending.
5. A rise in taxes, which itself provoked larger pay claims.

The whole exercise (undertaken against the background of a theoretical commitment to "full employment") actually blunted the counter-inflationary effect of tighter money policies, except in the form of higher unemployment.

The distortion of taxation policy is a particularly serious hazard of incomes policy bargaining. Professor Galbraith -- so often an enthusiastic advocate of policies that can do great damage — has declared:

"Restraint on incomes

"Restraint on incomes and consumption in the lower levels of the income pyramid is only possible if there is positive curtailment higher up.... ...Heavy taxation of the affluent was once justified on the grounds of social equity. It is now a matter of social necessity".

Penal levies and surcharges on higher income groups may do little harm if they are adopted as temporary cosmetic expedients. But as a permanent feature of economic life, particularly in a country whose existing high rates of taxation are driving more and more entrepreneurs, engineers and entertainers abroad, such policies are as harmful as they are unacceptable.

The sixth, and perhaps the strongest objection to an incomes policy is the control of prices which is, said Lord Carr of Hadley in a characteristically thoughtful recent article, "an inevitable quid pro quo for the acceptance of an incomes policy".

The Price Code was started by the last Conservative Government upon the basis of experience in the United States. But it was always envisaged, perhaps too naively, that, as happened in the United States, the controls would be progressively dismantled. I explained to a Financial Times Conference on 31st January 1974 that the then Conservative Government was already planning the removal of "the counterproductive constraints of the present cost-plus system of price control".

It is by now very clear that the maintenance of price control of our present type, which makes British industry the most tightly regulated outside Eastern Europe, is immensely damaging. And damaging to workers as well. For the control reduces present profit margins and present employment. And it destroys the hope of future profits, so as to inhibit investment. This prevents the creation of future employment.

MONETARY POLICY IS CRITICAL

There is then a powerful case to be made against an incomes policy, particularly of a "permanent" kind. I shall consider in a moment whether it may have a more transient role.

But first let me consider some more fundamental questions about inflation.

Any discussion of this question must rest upon one foundation. Inflation is essentially a monetary phenomenon. If government does not strictly control the supply of money (and public expenditure) then no policy for dealing with inflation has any hope of success.

James Driscoll's....

James Driscoll's Bow Group pamphlet put this very plainly, as long ago as 1955: "It is monetary policy which is central and primary, and wages policy which is peripheral and secondary". It is a pity that his advice has not been more consistently remembered.

This is the way in which the monetarists are basically right. Rising wages are not in themselves <u>the</u> cause of inflation. If Government rigidly refuses to expand the money supply, then as unions bid up their members' wages, more and more people are priced out of their jobs. Union pressures will, of course, have an impact on money wages as well as on the level of employment. All too often this short-term rise in living standards is at the expense of profits, and so of investment. In the end this <u>reduces</u> the likelihood of an improvement in <u>real</u> wages.

This is why it must be a critical long-term objective to hold the growth of money supply in line with the underlying growth of the economy. Hand in hand with this must go tight control of public expenditure. If we do not have the latter, a Government can quickly find itself in a situation where it has no choice but either to bankrupt industry or to reverse its monetary policy and print more money.

A restrained monetary policy can only be sustained against a background of controlled public spending. Hence my anxiety about the present Government's failure, even in the future let alone in the past, to control Government expenditure.

STRICT MONETARY POLICY...

STRICT MONETARY POLICY IS NOT ENOUGH

But there are no simple solutions, and no easy tableaux to be unveiled to mass applause. Just because there are no easy answers, we should also pay attention to another warning - from one of the most distinguished monetarists, Professor Hayek - that we should not place too much reliance in our analysis on monetary policy.

The main snag is that, even in Britain today, the maintenance of full employment at any given wage level is still too widely regarded as the exclusive responsibility of Government and the monetary authorities.

When unemployment rises, that has been regarded as the fault of the authorities. Insufficient responsibility has been attached to the actions of the trade unions. Even the authorities themselves have failed to understand the normal working of the economic cycle - and have too often hastened to give it a shove.

If the monetary authorities refuse to accommodate high wage settlements by increasing the money supply, then the resultant rise in unemployment is inevitably exacerbated. Yet it is the prime responsibility of the authorities to preserve a stable currency. If there is any accommodating to be done, then that should surely be done by the trade unions on behalf of their members? If they price themselves out of the market, is that not their responsibility?

The political pressures that operate on government are, of course, more complex even than this.

For the unemployment caused by a continuing high level of wage settlements often shows itself in sectors well removed from those with the highest wage claims. A miner's wage increase in Durham may cost a computer programmer in Billericay his job. But the public will see little connection between the two events.

/If the unemployment

If the unemployment caused by excessive wage claims were confined to those making the claims, then the solution would be easier to understand. It is the random nature of the unemployment, and its "unjust" distribution, that causes public opinion to question the assertion that there should never be any Government intervention in the wages arena.

Fortunately there is now some reason to believe that the complexities of this argument are being more widely understood. Increasing moderation in wage claims is undoubtedly due to more widespread rank-and-file awareness of the way in which employees can price themselves out of jobs. This change of atmosphere is of huge importance to the success of restrained monetary policy. The message cannot be spelt out too often.

The worst, and most familiar, problem arises through the public sector. As Frances Cairncross put it, in a perceptive piece about trade union power (The Guardian/17 May 1975) "When an employer can print his own wages he can hardly tell his employees that he cannot afford to pay them more".

When the Government stands behind the public sector both as guarantor and as the ultimate source of finance, it is no easy task to persuade the trade unions either that wage claims will not be met or that if they are met, a loss of jobs will follow.

The Conservative policy of applying cash limits, now being developed by the Government, is an attempt to fill this credibility gap and so to impose some discipline on the public sector. But the political difficulties on this road are not to be under-estimated.

If a firm manufacturing pencils is brought to a halt by its workers, there will be no public pressure to settle. But if hospital wards or sewage works are closed, the Government comes under intense pressure to make a special case.

/This is the.....

This is the way in which trade unions, not themselves the cause of inflation, all too often are the motive force that leads Government to take the fatal steps that cause inflation.

Sadly, the appetite of the trade unions has fed upon itself and led to increasing awareness of this power. Add to this the acceptance of the "full empoyment" objective that appeared to relieve the unions of any responsibility for the loss of jobs and it is hardly surprising that trade union activity has been a powerful driving force towards inflation since the war.

One theoretical solution of this problem might be to set about reforming the labour market so as to reduce the monopoly power of the trade unions. That would mean reconsidering the closed shop, the legal privileges of trade unions and the law relating to picketing.

Some of these questions, were, of course, touched on by the Industrial Relations Act. But it was not the purpose of that legislation to pave the way towards a wages policy. On the contrary. Nor even to have a substantial impact upon the balance of industrial power - but mainly to promote the cause of order and fair play, in place of strife.

No-one understands better than I the political difficulties of going down that road again in the near future. Mrs. Thatcher has, of course, staked out the main issues of individual freedom to which we attach importance in that field. But even Professor Hayek has concluded (A Tiger by the Tail, IEA, 1972, p.117) that "there seems little immediate prospect that we shall be able directly to eliminate that determination of wages by collective bargaining which is the ultimate cause of the inflationary trend".

I should prefer, with Aristotelian precision, to replace Professor Hayek's use of the phrase "the ultimate cause" with my own "a most significant proximate cause". But we are not involved in philosophy but in the practical business of government. And, either way, it is an important insight into reality.

NO CASE FOR DESPAIR

So where then are we to go? Having looked at the problems of living both with a permanent incomes policy, and then without such a policy, are we to conclude: "Well, this doesn't work, neither does the alternative," and so to throw up our hands in despair?

Certainly not. I recall, vividly, the occasions, during Mr. Heath's prolonged discussions with the TUC, when Sir Sidney Greene exclaimed: "But, Prime Minister, you know that at the end of all this we shall all have to get 'back to normal', back to free collective bargaining!" More than once I responded by pointing out that we had been "back to normal" four times since the end of the War, and as often had to revert to some new brand of the abnormal.

The task, I insisted, was to find a way through the middle. That problem still remains at the top of the nation's agenda.

I do not believe that it will most easily be solved by those of us who may be tempted to see the answer in theological absolutes - by asserting that incomes policy is "vital" on the one hand or "disastrous" on the other.

The test of British statesmanship in the years immediately ahead is to find the best way of securing acceptance of the economic imperatives, and of a strict monetary policy. And, in face of the other factors to which I have referred, this must involve consideration of the way in which incomes are determined. If not an "incomes policy", at least a "policy for incomes".

/Is there a....

IS THERE A CREDIBLE ALTERNATIVE?

In some countries such restraint exists entirely on an informal basis. There are many reasons for this. Probably the most important is the recognition that Government neither will nor should accommodate excessive wage increases through the creation of more money.

Professor Galbraith referred recently to Western Germany as a country that operates a prices and incomes policy. If an incomes policy could be defined in those terms, then it would be difficult to find any sensible person who would oppose such a thing.

I am more than content to regard the West German solution, although not entirely inflation-proof, as the one which approaches the ideal. In that country, according to a Federal Government publication, "wage freezes or the fixing or limiting of wage increases are not included amongst the instruments employed in evolving the State's incomes policy".

Probably the most important instrument in West Germany is what is known as the policy for "concerted action". This is the system whereby all those who are concerned with economic decision-taking, Government, trade unions and employers' organisations, meet together regularly in order to exchange, and so far as possible agree, information about the future progress of the economy. The Federal Government aims to secure the co-operation of all concerned upon the basis of harmonisation of the economic decisions taken individually by the groups participating in the talks. Account is taken of the opportunities and needs of the economy as a whole with a view to achieving price stability, a high degree of employment, equilibrium in foreign trade and reasonably well-maintained economic growth. Although there is no formal machinery to ensure that these decisions are implemented, the participants, having striven to produce a common analysis, have good reason to adjust their own actions accordingly.

There can be no doubt that the most effective policy is to be found along these lines: a policy that operates informally and with recognition by the trade unions of the harsh realities of the economic world. Ideally, in Britain as elsewhere, responsibility for full employment should be seen to rest with the trade unions.

It is, in a very real sense, a "voluntary policy".

SIX BASIC PRINCIPLES...

SIX BASIC PRINCIPLES

Against that background, let me now seek to enunciate some of the main principles that should guide us along the way ahead.

FIRST, we must accept that financial prudence, strict control of the money supply, should be an essential foundation of economic policy. Since expectations adjust only gradually to reductions in inflation, this restoration of monetary discipline must happen gradually but inexorably. This approach will minimise the dislocations involved. It will also reduce the pressure for reflationary measures and is more likely to be a sustainable policy.

SECOND, as an essential part of this exercise, Government must be determined to secure the widest possible understanding of its monetary policy. It must spell out very clearly to trade unions the unemployment consequences of any attempt to overthrow the monetary discipline which any responsible Chancellor will have to maintain. The self-destructive folly of excessive wage demands needs to be demonstrated by every argument that can be brought forward.

THIRD, public spending and borrowing must be reduced. For the £12 billion public sector deficit is the most explosive part of the present economic scene. Either it will oblige the Government to resort to "printing money" — and thus lead to the next round of rising prices. Or it will lead to higher interest rates — and a dramatic "stop" in the economy.

FOURTH, as the only secure basis for future jobs, the profits of industry must be allowed to rise. They are doing so already — but from a uniquely low level. To destroy the profitability of British industry is the surest way to create a long-term problem of structural unemployment. This is why price controls must be substantially relaxed.

FIFTH, we must develop a more open approach to economic management. This means much more open budgeting, with the expenditure as well as the revenue sides of the account being considered together — in a much more open framework of public consultation. This would be a far cry from the latest pattern of private bilateral talks with the TUC. The undue influence of one interest group needs to be challenged in much wider, more open, consultation. In the British context it is is at least possible that an extended NEDC would provide the best basis for this.

This is not just a matter....

This is not just a matter of striking an old-style deal, designed only to appease the prejudices of the often old-fashioned, highly political, leaders of the TUC. The many other interests that make up the nation are entitled to be taken into account. The real interests of working people -- in a profitable economy, in the spread of ownership and wealth, in the reform of a tax system that is hostile to prosperity -- will have to prevail.

SIXTH, there is certainly a need to develop a better method of handling wage claims in the public sector where the consequences of surrender are too often magnified by the tendency of wages in that sector to move very closely together.

The public sector is the soft under-belly of the British economy.

In the nationalised industries the main discipline should come from the imposition of strict cash limits on any funds available from the Exchequer, and from the enforcement of strict commercial targets.

But in the directly-employed public sector (and perhaps more widely than that) we also stand in need of some more coherent bargaining arrangements than the series of ad hoc solutions, from Wilberforce to Houghton. Here particularly we should do well to study the example of economies like Sweden and Japan where some, at least, of the problems of leap-frogging are avoided by the negotiation of all wage claims at one season of the year.

THE PRESENT POLICY......

THE PRESENT POLICY

Against that background, is there any case, even on a temporary basis, for the crude kind of codified incomes policy that has just been announced as the "son of £6"?

There are certainly some people in all parties who believe that we do need such an approach - and that it can and should be sustained, with increasing sophistication, over a long period. This was the thinking which I confess had some appeal to me as I helped to plan the old Pay Board's progress through a series of reports on relativities and anomalies.

But, for the reasons given in the opening section of this speech, I no longer regard that as workable for more than a limited period. And many of those who appear in the public debate as incomes policy enthusiasts have implicitly conceded the same point. For almost all of us a much less institutionalised approach should be the more attractive.

But we must not deceive ourselves that it will now be easy to leap overnight into an ideal West German situation. Experience should caution us against such dramatic expectations. We do not start from a position in which that could come immediately to hand. We have to deal with attitudes as they are now.

This is the way in which the Government's crude (but complicated) Stages I and II may be playing a legitimate role in fortifying a basically monetary exit form the almost hyper-inflationary tunnel of the Social Contract. For they can be said to have helped

- in reducing inflationary expectations.
- in curbing the size of the pay and salary element in public spending.
- in tempering the growth in unemployment.

But they are also, predictably, inflicting growing damage upon the necessary flexibility of the labour market, upon the economy and upon society as a whole.

The flattening/

The flattening of differentials that is involved is in fact likely to move quite quickly towards the point of breakdown. The £4 maximum will increasingly impair the will to work. And British management, seriously depressed by policies of this kind (as also by an increasingly confiscatory tax system) will not long endure any further tightening of the straitjacket.

All of which brings us back to the main point: like almost every other incomes policy, the present pattern has only the slenderest chance of survival for more than a short period.

One should not, as I have said, reject without qualification the proposition that such a policy has in certain circumstances (such as those which followed the disastrous year of the Social Contract) a part to play.

But one should be very plainly aware of the way in which it is likely to enthrone the trade union leaders in a position of undue influence and to open the road to Socialism.

That is why there must be no doubt about the absolute necessity of pursuing policies that should make unnecessary any further resort to such a possibility.

The present existence of an incomes policy must in no circumstances be regarded as an excuse for avoiding the correct monetary policy. In formulating its monetary policy, the assumption of government should be that its policy for incomes will not succeed. Monetary restraint (and reduced public spending) remains the key to the future.

The worst mistake of all would be to regard the existence of a policy for incomes (of whatever kind) as an alibi for monetary or fiscal incontinence.

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