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ANR/VA

Monday's Sh Cab?

24th May, 1976.

MRS THATCHER

Shadow Cabinet - paper on incomes policy
by Mr Maudling

I am enclosing a copy of a paper on incomes policy which Mr Maudling has submitted. It is being circulated to all colleagues. I spent some time on Friday trying to persuade him to accept a substantial number of drafting changes, in particular putting to him the point that monetary policy and the level of demand did have some influence on the rate of inflation. I am afraid I did not succeed in inducing him to change his text in the time available.

A.W.R.

Adam Ridley

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TO ALL MEMBERS OF THE LEADER'S CONSULTATIVE COMMITTEE

Mr. Maudling has asked for the enclosed paper on incomes policy to be circulated before the Shadow Cabinet meeting on Wednesday, 26th May, for discussion under Item 4 of the Agenda.

ADAM RIDLEY

Conservative Research Department,
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INCOMES POLICY

(Paper by Mr. Maudling)

1. During our discussion of economic policy I have not taken the scarce time of the Shadow Cabinet to expand my views on the need for an incomes policy. After all, I have been saying the same things consistently since I was Chancellor of the Exchequer and my views may well therefore appear to be either repetitive or out of date, or indeed both. But I thought I might set them down in this necessarily sketchy paper.

2. All economic problems are basically political problems, and politics are about power. The sole and overwhelming reason why an incomes policy is needed is to deal with the monopoly power which the unions now possess and, even more important, are now fully conscious that they do possess. So long as they continue to wield power to destroy individual businesses or indeed, complete industries, and the threat of bringing the entire economy to a halt, any talk of a return to "free collective bargaining" or the operation of a "free market" is meaningless. The simple fact is that for years now the unions have increasingly demanded, with effective menaces, excessive wage increases which have inevitably led to excessive cost and price increases. That is what has happened. That, and the other side of the union coin, their total unwillingness to co-operate in raising productivity, constitute the "English disease" which has become the despair of our friends and the bane of sterling.

3. There are apparently only three ways in which this problem can be tackled.

i) It would help if we could reduce by law the power of the unions, but we have tried this and it has hardly been a great success.

ii) We can endeavour to bring pressure on the unions, through education, persuasion and public opinion, to exercise moderation in their demands; which is what succeeding Conservative administrations have meant by an incomes policy. (Strengthening the influence of our own supporters within the unions is becoming an increasingly important part of this policy).

iii) It is argued that the power of the unions to put up costs and therefore prices can be restrained by monetary measures, which I take to mean the restraint of effective demand, or in old fashioned terms, deflation or a credit squeeze. It has always seemed to me that this fails because (a) the big battalions still get their demands while it is the rest of us who suffer; (b) it condemns the economy to stagnation because no businessman is going to invest in increased capacity while he still cannot find employment for the capacity he already has; (c) such a restrictive policy must be permanent for, with respect to Enoch Powell, whose logic on this point is more formal than real, experience shows that once you relax restriction income growth rapidly starts again, as indeed common-sense seems to indicate that it always would.

4. I have remained very sceptical of the effects of monetary policy on inflation. There are after all two types of inflation: cost push and demand pull. If I am a manufacturer of kettles and

...../ my wage

my wage bill goes up I have to increase my prices or lose my profit. If on the other hand demand for my product rises, my prices will rise too, initially because my profit rises, but later because of the effect on the demands of labour. No doubt these forms of inflation can co-exist and indeed interact but it is a fundamental mistake to try and deal with one form by measures appropriate to the other.

5. I do not see how reducing the money supply can help combat a cost inflation. Of course, there are many other reasons for reducing public expenditure, above all the need to restrict the public sector's share of the economy and to provide incentives by reducing taxation. What I am thinking of here is solely "effective demand management". (What a pity we cannot use Erhard's favourite single word 'conjuncturpolitik').

6. The first questions to which I have not yet seen satisfactory answers are:

i) What actual measures do we intend to take in practice to maintain a tighter monetary policy?

ii) How does the money supply, whether it be M1 or M3, effec[t] the economy, save through its influence on demand? What people spend is limited by the amount they can earn, borrow or dissave and is determined by the extent they wish, at any given time, to approach this limit. In the past, flexibility of demand management has always rested on the credit base and I doubt if this has really changed.

7. How can a credit squeeze and the consequent reduction of demand effect prices? Take the two components of prices:

i) Profit. Low demand can certainly reduce profits. As we all know the present trouble is that profits are too low already.

ii) Cost. Taking very crudely the main components of costs, the results seem to me very much as follows: (a) it can have little effect on basic raw material prices; (b) its effect on overheads is to spread them over a lower output and therefore increase rather than reduce unit cost of production. This seems to me to leave only the largest component of cost incomes, wages, salaries and to a small extent dividends, and the argument therefore boils down to whether a general deflation of demand is a better way of holding down union pressure for higher incomes than an incomes policy.

8. For the reasons I have given above I do not think it is an effective way of restricting the monopoly of power of the unions.

9. Of course, effective demand can be expanded too rapidly and lead to demand inflation which will then interact with cost inflation. But I find it hard to believe that effective demand is too high so long as the economy is running as far below capacity as it certainly is now (remember the three-day week), and a permanent policy of keeping affective demand well below potential capacity is a policy designed permanently to confine this country to industrial stagnation, inadequate growth and continuing economic decline.

R.M.

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