CABINET

CONCLUSIONS of a Meeting of the Cabinet
held at 10 Downing Street on
THURSDAY 22 MAY 1975
at 10.30 am

PRESENT

The Rt Hon Harold Wilson MP
Prime Minister

The Rt Hon Edward Short MP
Lord President of the Council

The Rt Hon Lord Elwyn-Jones
Lord Chancellor

The Rt Hon Denis Healey MP
Chancellor of the Exchequer

The Rt Hon Michael Foot MP
Secretary of State for Employment

The Rt Hon Shirley Williams MP
Secretary of State for Prices and Consumer Protection

The Rt Hon Anthony Wedgwood Benn MP
Secretary of State for Industry

The Rt Hon William Ross MP
Secretary of State for Scotland

The Rt Hon Merlyn Rees MP
Secretary of State for Northern Ireland

The Rt Hon James Callaghan MP
Secretary of State for Foreign and Commonwealth Affairs (Items 1-3)

The Rt Hon Roy Jenkins MP
Secretary of State for the Home Department (Items 3 and 4)

The Rt Hon Anthony Crosland MP
Secretary of State for the Environment (Items 1-3)

The Rt Hon Eric Varley MP
Secretary of State for Energy

The Rt Hon Barbara Castle MP
Secretary of State for Social Services

The Rt Hon Reginald Prentice MP
Secretary of State for Education and Science

The Rt Hon John Morris QC MP
Secretary of State for Wales

The Rt Hon Fred Peart MP
Minister of Agriculture, Fisheries and Food
The Rt Hon Harold Lever MP
Chancellor of the Duchy of Lancaster

The Rt Hon Robert Mellish MP
Parliamentary Secretary, Treasury

The Rt Hon Lord Shepherd
Lord Privy Seal

The Rt Hon John Silkin MP
Minister for Planning and Local Government

The Rt Hon Robert Mellish MP
Parliamentary Secretary, Treasury

The Rt Hon Judith Hart MP
Minister of Overseas Development
(Items 2-4)

The Rt Hon Joel Barnett MP
Chief Secretary, Treasury
(Items 2 and 3)

Mr Eric Deakins MP
Parliamentary Under Secretary of State,
Department of Trade (Item 4)

SECRETARIAT

Sir John Hunt
Mr P Benner (Item 1)
Mr J A Hamilton (Items 2-4)
Mr E J G Smith (Item 1)
Mr J A Marshall (Items 2 and 3)
Mr J Peters (Item 4)

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PARLIAMENTARY AFFAIRS

1. The Cabinet were informed of the business to be taken in the House of Commons during the week following the Spring Recess. It was proposed to use Monday, 9 June for the Second Reading of the Statutory Corporations (Financial Provisions) Bill, rather than as a Supply Day. The latter would be preferred by the Opposition, who had indicated that they would welcome business on that day which would not involve divisions; moreover there would be advantage in securing an even spread of the numerous Supply Days which were outstanding. But the Second Reading debate of the Statutory Corporations (Financial Provisions) Bill would provide a suitable opportunity for a debate on steel, for which the Opposition had for some time been pressing and which the Lord President had undertaken that time would be found during the first week after the Recess; and on balance this seemed the preferable course.

THE LORD PRESIDENT OF THE COUNCIL said that it was proposed that there should on 12 June be a debate on a Motion bringing before the House the Reports from the Select Committee recommending Mr Stonehouse's expulsion unless he returned to this country and resumed his Parliamentary duties within a month. There was one minority school of thought in the House of Commons that, procedurally, it was not for a Select Committee to prescribe a period of grace and that, before their recommendation could be effective, the House would have to adopt a substantive motion providing for Mr Stonehouse's expulsion at the end of a month, beginning from the date of the resolution. The consequence of this would be that, unless a change were made in the Standing Order which prevented by-elections during recesses, Mr Stonehouse's constituency would remain unrepresented for many months. A second minority view was that, since Mr Stonehouse would almost certainly be arrested if he returned to this country and thus prevented from resuming his Parliamentary duties, it would be unjust to expel him for failing to do something which it was not within his power to do. Majority opinion in the House, however, supported the recommendations of the Select Committee and he proposed accordingly to put down a Motion for Mr Stonehouse's expulsion for debate on 12 June. If the Motion were adopted, a by-election could take place during the first week of July. But it could not be ignored that in the Attorney General's view the legal position was not wholly satisfactory, particularly because the Select Committee's Report in effect brought pressure to bear on Mr Stonehouse to leave Australia before his legal rights there had been exhausted. If he nevertheless wished to return voluntarily to this country, he would have to apply to the Australian courts for release from bail; such an application need not, but probably would, be granted. Again, if
the pending application to the Australian courts for his extradition to this country was successful when it was heard later in the month, Mr Stonehouse would under Australian law have to be retained in Australia for 15 days from the date when the extradition order was granted; and it was doubtful whether this requirement could be waived. Moreover, if he returned here voluntarily and was arrested on arrival, his ability to resume his Parliamentary duties would depend on whether or not he was allowed bail.

THE PRIME MINISTER, summing up the discussion, said that the Select Committee had made no assumption either way about Mr Stonehouse's guilt but was concerned solely with the question whether or not he should be regarded as having abandoned his Parliamentary duties. The Cabinet agreed that plans should be announced for a debate on 12 June but that no Motion should be put down until much nearer the time. The position should be reconsidered and the debate if necessary postponed if Mr Stonehouse returned to this country, as he had stated he intended to do in order to attend a meeting of his constituency party on 11 June, or if it were clear that he had made a genuine attempt to return and to resume his Parliamentary duties but had been prevented from doing so by legal processes in this country or in Australia.

The Cabinet -

Took note, with approval, of the Prime Minister's summing up of their discussion.

THE PRIME MINISTER said that he would be readily available for official business through the Recess. No Cabinet meetings had so far been planned but arrangements could be made as necessary for the collective consideration of urgent business. The meeting of the Ministerial Steering Committee on Devolution which had been arranged for 3 June had however been deferred until 13 June. Arrangements would be made, either after the DS meeting on 13 June or more probably on 16 June, for a meeting of the Ministerial Committee on Industrial Development (IDV) to undertake a thorough review of the Industry Bill following completion of its Committee Stage and in preparation for the Report Stage. In the meantime the Official Committee should prepare an analysis of the position reached and clear as much ground as possible in preparation for the IDV meeting. Following the latter there would need to be urgent discussions with the Trades Union Congress and the Confederation of British Industry leading to Cabinet decisions on 19 June.
2. The Cabinet had before them a memorandum by the Prime Minister (C(75) 60) setting out proposals for the future consideration by Cabinet of public expenditure questions.

THE PRIME MINISTER reminded Cabinet that, at the meeting on 10 April, he had undertaken to consider the arrangements which should be made to enable the Cabinet in future to reach a collective view on its public expenditure strategy. Ministers had expressed concern about the economic judgment implied by any particular level of public expenditure, and about how the public expenditure system could be made responsive to the Government's own political strategy. He had considered the problem carefully, and had consulted closely with the Chancellor of the Exchequer. His proposals for improving the arrangements were set out in his paper. What he had tried above all to do was to ensure that, at a sufficiently early stage for its views to influence the content of the public expenditure survey report, Cabinet had adequate opportunity to consider the economic assessment upon which forward spending plans would have to be based, and the political and economic options open. The economic assessment would be presented by the Treasury, together with a commentary by the Central Policy Review Staff (CPRS); it would put before Cabinet the main elements of the Treasury's Medium Term Economic Assessment. This presentation would lead to a separate discussion in Cabinet at which decisions would be taken on the broad allocation of resources between public expenditure and private consumption. At a subsequent Cabinet meeting there would be a discussion of public expenditure priorities on the basis of a paper produced jointly by the CPRS and the Treasury in which the Policy Unit at 10 Downing Street would be involved. This would enable the Cabinet to discuss the political and economic options open to them and consider where their whole public expenditure policy was leading them in terms of the next General Election. In this way the public expenditure survey report, when it was prepared, should reflect the Government's own decisions more clearly than had been possible in the past. Even so, there would remain unresolved problems after the report had been completed, and he proposed that the Official Steering Committee on Economic Policy should consider the report, identify the main issues for Ministers, and set out the options which were open. In this way the final Cabinet discussion in the Autumn would be on material which took full account of the priorities Ministers had expressed earlier; and Ministers would be enabled to concentrate their attention on the major issues without getting involved in the more indigestible material in the report itself. This new procedure was bound to some extent to be experimental, and might need to be adjusted in the light of experience. His proposals related to a normal year, but since the 1975 Survey was unusually late in starting, he had set out in paragraph 12 of his paper a modified arrangement whereby some of the ideas could be
injected into this year's procedure. He hoped that Cabinet would endorse the proposals as meeting their desire to have an opportunity to discuss the economic background and the political implications of major issues of public expenditure at an early stage in the annual cycle so that officials could then be given political guidance before carrying out the Survey.

In discussion there was a general welcome for the Prime Minister's proposals, which were regarded as a major step forward. Two specific suggestions were made:

a. In the discussion of the Medium Term Assessment envisaged in paragraph 9 ii. of the paper, it should be possible, without putting the Budget into Commission, to include options on tax policy as one of the aspects to be covered.

b. Given the complexity of the subject, it would be helpful if, whenever public expenditure was to be discussed, the papers could be circulated 7 days, rather than 48 hours, in advance of the meeting.

THE PRIME MINISTER, summing up the discussion said that the Cabinet clearly welcomed the proposals he had put forward. It would now be for the Chancellor of the Exchequer and the CPRS to provide Cabinet with the material needed to implement those proposals. The Chancellor of the Exchequer would consider what could be done to meet the specific points raised in discussion.

The Cabinet -

1. Took note with approval of the Prime Minister's summing up.

2. Invited the Chancellor of the Exchequer and the Central Policy Review Staff to arrange for the proposals in C(75) 60 to be implemented.

3. The Cabinet's discussion and the conclusions reached are recorded separately.
4. The Cabinet had before them a memorandum by the Chancellor of the Duchy of Lancaster (C(75) 64) recording the conclusions of the groups of Ministers under his chairmanship which had considered a proposal by the Secretary of State for Industry to impose temporary restrictions on imports of textiles and clothing.

THE CHANCELLOR OF THE DUCHY OF LANCASTER said that his paper set out the arguments which had convinced the group of Ministers, in spite of their natural concern, to decide against the imposition of import restrictions. The root of the problem did not lie in an increase in textile imports - the degree of import penetration in 1975 was tending to fall compared to 1974 - but in a marked decrease in demand at home and abroad. It was essential not to add to the difficulties of developing countries; it was also most important not to undermine the Multi Fibre Arrangement which helped our industry by making it possible to spread the increasing imports from developing countries more fairly among the developed countries, including those in the European Economic Community. The developed countries too were suffering severely from the recession, and would certainly retaliate if we imposed discriminatory restrictions against them, as had been shown in the case of Turkey recently. The rest of the world expected the British Government to abide by international agreements and obligations, and its credit must not be damaged, or there was a risk of turning a temporary problem into one which was much bigger and lasted longer. However, the group of Ministers fully realised the difficulties of the British textile and clothing industry, and for this reason had tended to favour his suggestion that some other method should urgently be sought to provide selective help to those parts of the textile industry that were hardest hit.

In discussion there was general agreement that the difficulties of the textile and clothing industry demanded urgent attention, both on general grounds and from a political point of view: the industry faced the worst recession since the 1930's. The trade unions concerned were generally moderate and responsible, the industry had modernised and improved productivity, and it deserved special help to enable it to weather the current recession. A letter just received from the General Secretary of the Trades Union Congress argued strongly in support of this, and also requested the Government to give immediate consideration to the request from the British Textile Confederation for temporary restrictions to be imposed on imports across the board. So strong was the feeling among the Members of Parliament concerned that it was imperative for reference to be made to the problems of the industry during the economic debate later the same day. There were strong arguments against imposing restrictions on imports, but it was certainly worth seeing if more help might not be provided under the Industry Act, on the lines of the existing scheme under Section 8 to help the wool textile part of
the industry. However, it was important to remember that the object of such assistance was to regenerate British industry; this meant giving help in ways which would enable useful production to expand when the recession ended and not subsidising goods which no-one wished to buy.

THE PRIME MINISTER, summing up the discussion, said the Cabinet agreed that the condition of the textile and clothing industry was serious, and deserved special consideration. They accepted the strong arguments against imposing restrictions on imports on textiles and clothing, particularly those from the developing countries; but they wished urgent consideration to be given to the possibility of providing more help under the Industry Act, to assist the industry to ride out the recession and to be well-placed to take advantage of the coming up-turn in world trade. He proposed in his speech in the economic debate that afternoon to refer to the very thorough examination which Ministers had given to the problem, and to promise a statement on the following day. That statement should be now drafted by the Chancellor of the Duchy of Lancaster in consultation with the Chancellor of the Exchequer and the Secretary of State for Industry; it should explain the arguments for rejecting import controls, and promise an urgent investigation into other means of helping the industry under the provisions of the Industry Act. The Secretary of State for Industry, in consultation with the Chancellor of the Exchequer, should then examine urgently what selective schemes might be appropriate, with the object of making an announcement during the recess or shortly after.

The Cabinet -

1. Took note, with approval, of the Prime Minister's summing up of their discussion.

2. Agreed that restrictions should not be imposed on textile and clothing imports, either across the board or on a selective basis, but that urgent examination should be given to the possibility of extending further selective help to the textile and clothing industry under the provisions of the Industry Act.

3. Invited the Chancellor of the Duchy of Lancaster, in consultation with the Chancellor of the Exchequer and the Secretary of State for Industry, to prepare a statement to be made by the Prime Minister the following day, on the lines indicated in the summing up.

4. Invited the Secretary of State for Industry, in consultation with the Chancellor of the Exchequer, urgently to examine the scope for further selective schemes to help the textile and clothing industry under the provisions of the Industry Act with the object of making an early announcement.

Cabinet Office
22 May 1975
PUBLIC EXPENDITURE SURVEY 1975

The Cabinet had before them memoranda by the Chancellor of the Exchequer on public expenditure and economic strategy (C(75) 62), on the significance of the borrowing requirement (C(75) 61), and on the public expenditure survey 1975 (C(75) 63).

THE PRIME MINISTER emphasised that on this occasion there was no question of the Cabinet committing themselves to any particular magnitude or distribution of public expenditure cuts, nor was it desirable that at this stage they should seek to close any options. The purpose of the exercise was to consider a procedure designed to present Ministers at a later stage with a series of options on the basis of which it would then be possible to make political choices.

THE CHANCELLOR OF THE EXCHEQUER said that the new arrangements which had been agreed under the preceding item could not be fully adopted in the current year because of the constraints of the calendar. He agreed that the only decisions required at the present meeting were procedural ones. For this purpose the Cabinet would need to look at the total proportion of the national income which might be allocated to public expenditure; but the time for a decision on this, and for a discussion of public expenditure priorities, would be in July when more work had been done. Final decisions would not be appropriate until September when the Survey report would be available.

His proposal was that the Public Expenditure Survey should proceed on the basis that expenditure in 1978-79 might need to be reduced by at least £2,000 million at 1974 Survey prices below the projections in the Public Expenditure White Paper (Cmnd. 5879). However, in order to assemble sufficient options to enable the Cabinet to make shifts in the present pattern of priorities if they so wished, he proposed that officials should identify cuts totalling £3,000 million. In reaching his view that cuts totalling £2,000 million might be necessary he could not ignore the fact that between 1955 and 1975 the proportion of the gross domestic
product (GDP) taken by public expenditure had increased from 42 per cent to 58 per cent, most of the increase having taken place in the last 10 years. This had been reflected in the tax burden on ordinary people. In 1965 the income tax on the average earnings of a married man with two children took 5.6 per cent of his income, whereas today it took 18.9 per cent. In 1955 69 per cent of the working population paid income tax, whereas today 82 per cent paid it. Furthermore, it should be remembered that when the low paid entered the tax system, they did so at the rate of 35 per cent. If present public expenditure plans were left unchanged, it would mean that by 1980 income tax would have to be raised to 45p in the pound. Nor could this be avoided by imposing heavier taxes on the richest part of the population. Indeed even if all taxable income above £6,000 a year (just over twice average earnings) were confiscated, it would raise only £450 million on a once-for-all basis as compared with the current public sector deficit of £7,600 million. The public sector's present spending plans (including onlending) involved spending 119 pence for every 100 pence of revenue raised; and it was this fact which was reflected in the balance of payments deficit which last year amounted to 5 per cent of the national income.

The medium term economic forecasts were worse than previously for two reasons. The rate of growth of GDP, formerly put at 3 per cent per annum, was now expected to be rather less - perhaps only 2.5 per cent. Furthermore, the oil producers were spending their surpluses quicker than had been expected, which meant that the developed countries would have to pay in goods for their oil sooner than anticipated. The United Kingdom had therefore to close its balance of payments gap at a faster rate than had been planned. These two factors alone meant there were fewer resources available for public expenditure. In addition, it was now likely that North Sea oil would become available more slowly than had previously been hoped; and the fact that inflation in the United Kingdom was running at twice - and by later in the year might be running at three times - the rate elsewhere in the world, meant that Britain's ability to borrow overseas would be greatly reduced. This was the background to the draconian target for cuts which he now proposed. Of the £3,000 million to be identified, one half should be sought by considering the implications of stated percentage reductions in current and capital expenditure on goods and services, while the balance would need to be found from a range of other expenditures, including transfer payments.
In discussion it was argued that, while the decisions now sought were said to be only procedural in character, it was not unknown for such decisions later to acquire a more substantive nature. As regards the proportion of GDP taken by public expenditure it was relevant that 20 years ago the public sector in the United Kingdom took a lower proportion of GDP than in any other advanced country. The significance of the percentage increase could not therefore be judged without comparisons with the position in other countries today. Doubt was also cast on the suggestion that the country was living 5 per cent above its means - a reference to the scale of the balance of payments deficit - since a recent newspaper article had put the figure at nearer 2 per cent. Furthermore the cuts proposed were unsatisfactory in that they treated virtually all public expenditure as if it were uniform in its nature, drawing no distinction between expenditure involving the use of resources and expenditure on the acquisition of assets. If the need for a cut of £2-3,000 million were based on the argument that the level of tax would become too high, then the Cabinet should discuss the merits of high taxation and high public sector spending against a lower level of both. If on the other hand the argument were founded on the balance of payments position, the brief reference in the paper was not an adequate basis for forming a firm view. It was by no means proven that it was necessary to push up the level of spare capacity - which would be the consequence of the cuts proposed - to such an extent. The political implications were enormous since for the first time the Cabinet was discussing cuts in absolute terms, and not merely cuts in rates of expenditure growth. Indeed there must be serious doubt whether it would be possible to impose cuts of this kind on local authorities without new machinery for the purpose. One of the by-products of the cuts would be likely to be a disastrous effect on the prospects for the construction industry.

In further discussion it was argued that the whole diagnosis and strategy were wrong. The situation was much worse than had been suggested. Unemployment was rising sharply, and would probably be over one million by the end of the year. The country was on the edge of a deep slump, as was evidenced by falling investment intentions. It was by no means certain that the upturn in world trade would take place at the end of the year, and even if it did other countries - notably Germany, Japan and the United States - were better placed than Britain to take full advantage of it. Cuts of the magnitude proposed would lead to increased unemployment which would produce a loss of £1,200 million in tax revenue, and an additional cost of £1,000 million in social security payments, so that the net effect would be to produce savings of only £800 million. If public expenditure priorities had to be replanned, this should be done in a full employment context. The reductions
proposed would simply cut back the real resources available. Moreover by embracing a macro-economic strategy of the kind proposed, micro-economic strategy would be put in a straitjacket. The strategy implied high unemployment, but jobs were productive capacity, and this would represent one further step in the ratcheting down of productive capacity in the United Kingdom. There was a wholly feasible alternative policy based on import controls - which the Government would be compelled to bring in within a year in any case - combined with increased investment in the context of fuller employment.

On the other hand it was strongly argued that a policy based on import controls totally failed to deal with inflation which was the central and crucial element in the current economic situation. Inflation was the problem which above all needed to be tackled, and it was vital that Ministers should turn to consideration of it after the recess. The current rate of inflation was bankrupting a wide range of institutions and unless checked could threaten civilised government itself. If the Cabinet were unwilling to face up to the swingeing public expenditure cuts proposed, they must be prepared to consider a much tougher pay policy than they had followed hitherto, even if this meant considering voluntary guidelines with some kind of statutory back-up machinery. The Trades Union Congress (TUC) were already considering possible adjustments in pay policy, as were the Confederation of British Industry, and it was high time that the Government defined its own policy. Against this, it was argued that whatever was done about wage inflation had to be done by winning the consent of the unions. To impose a statutory policy would be a breach of faith. The truth was that the adjustments to pay policy which were feasible were not going to produce any spectacular reduction in the rate of inflation. Moreover it would be wrong to put the burden of failure in the past 12 months on the trades unions when Cabinet had itself repeatedly agreed to pay settlements in excess of the TUC guidelines. A statutory policy, which, while it was in operation, would build up intolerable pressures, could only lead to gross injustice. What was needed was to get trade union agreement to a broad policy package, which must include measures to avoid any further increase in unemployment.

THE CHANCELLOR OF THE EXCHEQUER said that, as regards the balance of payments, there was no question but that the country had lived 5 per cent beyond its means in 1974. The deficit was expected to be over £1 billion lower in 1975. Nevertheless, the position towards the end of this year was likely to be worse than it had been in the first 4 months of the year, because those four months had seen the benefit of orders placed earlier which were now drying up. The monthly figures were therefore likely to get worse. It was however wrong to suggest that cutting public expenditure
would lead to increased unemployment. The question was whether people should be employed in the private or in the public sectors. Much public sector employment was, in the literal sense, non-productive; and what the economy needed was an increase in production. The upswing in world trade, when it came, should suck more people into productive activity. He agreed that Ministers must discuss wages policy immediately after the recess. The TUC guidelines had not, for the most part, been complied with, and it was fair to ask whether the Government could rely upon a further voluntary bargain working better next time. In any case, whatever was done on wages, the problem of the balance of resources in the economy remained and the need for the public expenditure cuts would still be there. He repeated his own view that a reduction of £2,000 million would be needed but if Ministers really wished to review their public expenditure priorities, it was clear that some programmes would have to go down more than the average in order to benefit others. For this reason it was essential to identify larger savings in all programmes totalling £3,000 million.

THE PRIME MINISTER, summing up the discussion, said that while the Cabinet were not at one on the need for cuts in public expenditure of the magnitude proposed by the Chancellor of the Exchequer, they accepted that only by asking officials to proceed with the expenditure survey on the basis put forward in the Chancellor's paper C(75) 63 could they ensure that they would have available sufficient options later in the year should major cuts have to be made. The Chancellor of the Exchequer should therefore arrange for officials to proceed as proposed in his paper C(75) 63. This did not however imply any assumption about the eventual decision; all that was being done was to prepare the information on the basis of which Cabinet would be able to arrive at firm conclusions later in the year. Before this he would arrange for a full days discussion at Chequers of public expenditure priorities. It was also clear that Cabinet would need to resume their discussion of the broad economic strategy shortly after the recess. He noted the wish to consider economic options other than public expenditure cuts. It would be necessary to consider the question of inflation and pay policy, but it was essential to avoid any speculation that a statutory policy was being contemplated since this could lead to a damaging rush of pay claims.

The Cabinet -

1. Took note, with approval, of the Prime Minister's summing up of their discussion.
2. Invited the Chancellor of the Exchequer to arrange for officials to proceed with the 1975 public expenditure survey on the lines indicated in the appendix to his paper C(75) 63 but on the clear understanding that the Cabinet had reached no decision on the eventual quantum.

Cabinet Office

27 May 1975