

Farewell to prices and incomes policies:
Conservative economic policy-making, 1974-79

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Abstract: From 1960 to 1979, Prices and Incomes Policy (“PIP”) was central to Labour and Tory attempts to manage the economy. Since 1979, no Government has attempted direct controls on wages or prices. The Conservatives moved away from controls in the late 1970s. This paper considers two aspects of that change: the move away from PIP and the debates over joining the EMS. In the 1970s, the Conservatives were playing out in microcosm the central economic debates which had tormented policymakers since the 1960s and which were to preoccupy them throughout the 1980s and beyond. In contrast to the Wilson, Heath and Callaghan governments, they were moving away from PIP but they were doing so uncertainly. By default, they decided that markets should fix wages and prices, but with a little discreet assistance from a ‘forum’. Whether that would turn back into PIP remained to be seen. They embarked upon, but did not resolve, a key question that then arose: should economic management depend upon close linkage with Europe and the Deutschmark? Or was the UK to be a monetarist island, ‘entire of itself’? It is tempting to think that the abandonment of PIP, and British refusal to join the EMS, were inevitable. But this is not so. By 1979, the Conservatives had posed many questions about inflation, but they had arrived at very few answers.

Introduction

Between about 1960 and 1979, Prices and Incomes Policy was a central feature of attempts by successive British Governments, of both parties, to manage the economy. Since 1979, no Government has even considered seeking to control directly the rate of increase of wages and prices. How did this change come about, and, in particular, what was the attitude of the Conservatives to these matters in the mid to late 1970s?

What is meant by Prices and Incomes Policy? Of course, all governments have to have some form of policy for prices and incomes. No modern government could affect indifference to high, or rapidly increasing, rates of inflation. All Western governments are involved in the setting of wages, in that they directly or indirectly employ a good part of the workforce. Equally, prices are a matter for governments in that they themselves provide services for which charges are made, and they (at least) regulate the prices charged by, for example, utilities. However, the ambition of governments, not merely in the UK, but throughout the Western world, went far wider than this in the 1960s and 1970s. By “Prices and Incomes Policy” was meant a policy whereby government sought to impose a limit on the rate of increase in wages and prices throughout the economy. Very often, the limit also applied to other revenues, such as dividends, profits or the remuneration of the self-employed. The controls were exercised either through the force of law (statutory) or persuasion (“voluntary”). Various policy models were attempted. It could be said that every possible method of dealing with inflation had been tried and failed in this period: corporatism (Macmillan to Wilson 1961-1966); emergency measures (Wilson 1966 and Heath 1972); voluntary controls, backed by sanctions (1966-9 and 1975-9); free collective bargaining (Heath 1970-1972); statutory controls (Heath 1972-1974); the Social Contract (1974-5, continuing in a varied form until 1979). This, then, was the background against which the Conservatives were considering their policy options in the 1970s.

Prices and Incomes Policies were promoted, in Britain, the US and elsewhere as having essentially three advantages. First, that workers would be encouraged, or compelled, to accept pay increases which matched their rate of improvement in productivity. Second, that pay would be allocated in a fairer manner than if matters were left to the market alone. Thirdly, that the combined effect of the first two features would lead to a happy coincidence of low inflation, full employment and sustained growth. The problem, of course, was that,

during the 1970s, economies, particularly in Britain, struggled with a miserable combination of high inflation, increasing unemployment and low growth.

In this scenario, those who had never believed in such policies, or had come to doubt their efficacy, were able to express their views with more confidence. Brittan and Lilley were amongst a number of free market orientated economists who fundamentally opposed all governmental controls on wages or prices.¹ Such controls, they said, led to market distortions, unacceptable bureaucracy and the adoption of expensive measures to buy union support.² They did not work, even in their own terms, since the performance of the British economy on inflation was poor by any international standards.³ They concluded with a plea for market wages, and sought to rally opinion in resounding terms 'If sufficient people decide that to empower the state to control each individual's income is intrinsically totalitarian, economically foolish and politically repugnant, then incomes policies will not be attempted.'⁴ Other economists, although expressing their views in somewhat less trenchant terms, agreed that Prices and Incomes Policies were ineffective, or even counter-productive. The impact on wage rates was 'derisory'.⁵ Very often, even if there was a downwards effect, this was immediately eliminated by higher increases as soon as the controls were lifted.⁶ The overall effect on inflation was tiny at best, and controls might actually make inflation worse.⁷ Controls also gave rise to unintended consequences and anomalies; for example a flat rate policy, intended to be fair, might end up squeezing the low paid.⁸

These economic arguments, as Brittan and Lilley pointed out, obviously had a large political component. Many on the Right of the Conservative Party regarded incomes policies in general, and the Heath statutory regime in particular, as a betrayal of Tory principles. These policies, they said, had put collectivism and interventionism permanently at the centre

¹ See also: Paish, F.W., *Rise and fall of incomes policy* (London, 1971); Harris, Ralph, 'A View from the Outside' in *British Economic Policy 1970-74* (London, IEA, 1975).

² See Brittan, and Lilley, *The delusion of incomes policy* (London, 1977) at pp.9-40 and 64-66.

³ See *ibid.* pp.177-179.

⁴ *Ibid.* p.234.

⁵ Parkin, Michael et al, 'The effects of Excess Demand, Generalized Expectations, and Wage-Price Controls on Wage Inflation in the UK: 1956-1971' in Brunner, Karl, and Meltzer, Allan, (ed.), *The Economics of Price and Wage Controls* (Amsterdam, 1976) pp.193-221 at p.213.

⁶ See Henry, S. G. B., and Ormerod, P., 'Incomes Policy and Wage Inflation: Empirical Evidence for the UK 1961-1977.' *National Institute Economic Review*, August 1978, 85, pp. 31-39.

⁷ See Lipsey, Richard, and Parkin, Michael, 'Incomes Policy: a reappraisal' in Parkin, Michael, and Sumner, Michael, *Incomes policy and inflation* (Aldershot, 1972) pp.85-110.

⁸ See Pond, Chris, *The attack on inflation, who pays? : a reply to the White Paper on the pay policy* (London, 1976);
Pond, Chris. *For whom the pips squeak: differentials in the pay policy* (London: Low Pay Unit, 1977).

of government.⁹ Why should a Government decree that A could not pay B £100 per week if both parties so agreed? In reality, in a free society, it was only supply and demand that could make sense of income patterns.¹⁰ And then there was Enoch Powell. Since the 1960s, he had been denouncing all forms of wage and price control. In addition to political and economic arguments that were on similar lines to those put forward by Brittan, Lilley and others, he made a constitutional point. If Government introduced statutory controls, then, however absurd and ineffective, they would have to be obeyed. But what Government could not do was to persuade, or bully, people into complying with supposedly voluntary guidelines.¹¹ Voluntary controls were a contradiction in terms. From 1968 onwards, Powell had drifted away from the Conservative Party, and by 1974 had left it. Nonetheless, many on the Right regarded him as a prophet. In this context, he was thought to have been prescient in denouncing Heath's Counter-Inflation Bill in 1972:

It is only when the Government perform their function, of controlling what they alone have the power to control—the supply of money—that the employer, the manufacturer, the entrepreneur can do their work in society and in the economy, and that the trade unions, in the freedom that they ought to have, can bargain on behalf of their members...¹²

Curiously enough, there were elements of Powell's analysis which found some echo on the Left and within the Trade Unions. By the early 1970s, many Trade Unionists were deeply disillusioned with the pay restraint imposed by the Wilson Government, precisely because it had denied them the opportunity to 'bargain on behalf of their members'.¹³ This disillusion was, if anything, exacerbated by the Social Contract.¹⁴ For the Left, pay policy of any kind was no more than a device to disguise attacks on the living standards of working people.¹⁵ This Trade Union and socialist analysis was of some importance for Conservatives as well. If Trade Unionists regarded pay policy in Labour hands with suspicion, they were hardly likely to welcome it when imposed by a Tory Government. But the point went further.

⁹ See Bruce-Gardyne, Jock, *Whatever happened to the Quiet Revolution?* (London, 1974) at pp.140-147, 166; Cosgrave, Patrick, 'The Failure of the Conservative Party, 1945-1975' in Tyrell, R. Emmett, *The Future that doesn't work* (New York, 1975) at pp.121-122.

¹⁰ Lewis, Russell, *Incomes policy? : against and for* (London, 1972) at p.5.

¹¹ See Powell, Enoch, *Freedom and Reality* (London, 1969) at pp.101-125.

¹² <http://hansard.millbanksystems.com/commons/1972/nov/07/economic-situation>, accessed 05.09.11.

¹³ See for a summary of hostile Trade Union opinion, Blackaby, Frank, (ed.), *An Incomes policy for Britain: policy proposals and research needs* (London, 1972) at p.12.

¹⁴ See Gill, Ken, 'Incomes Policy: The Trade Union View' in Charter, Robin, Dean, Andrew and Elliott, Robert, *Incomes policy*, (Oxford, 1981) pp.180-192.

¹⁵ See Cliff, Tony, *The Employers' Offensive: productivity deals and how to fight them* (London, 1970) at p.4; Glyn, Andrew, and Harrison, John, *The British Economic Disaster* (London, 1980) pp.116-119.

In 1972, the Marxist economist Andrew Glyn had pointed out that between 1950 and 1970, the share of profits in company output had fallen from 25% to 12%, whilst the share of wages had risen from 75% to 87%.¹⁶ This period, as we have seen, coincided with pay policies of various kinds. One could conclude from all this, as did Glyn, that profits were being squeezed as capitalism entered its death throes.¹⁷ However, one could equally conclude that the share taken by profits needed to rise if capitalism was to be revived and that the way to do this was to let markets, rather than governments, fix the level of wages and prices.

Of course, there were many economists who continued to argue for Prices and Incomes Policies, and to devise schemes which sought to learn from errors in the past.¹⁸ However, even some former advocates of such policies began to have their doubts.¹⁹ Those who continued to contend for the regulation of incomes were nonetheless well aware of the inherent difficulties in their path. An 'acceptable incomes policy...is thus something of a balancing act; it would need to incorporate widely-held views about fairness, be compatible with collective bargaining developments and still achieve the economic ends set it for by government.'²⁰ Furthermore, an incomes policy could only work if unions were heavily committed to it.²¹

If one put all these arguments together, one could put forward a convincing case that no intelligent Conservative in the 1970s should have had any truck with anything remotely resembling an incomes policy. Such policies appeared not to have worked in the past, and they had ended in humiliation under Heath. Expert economic opinion had shifted against them on both sides of the Atlantic. They depended on the goodwill of the unions, a quality in short supply even for Labour. They also assumed that there were 'widely-held views about

¹⁶ Glyn, Andrew, and Sutcliffe, Bob, *British capitalism, workers and the profits squeeze* (Harmondsworth, 1972) at pp.58/59. The general trend of the profit share to fall, and wages to rise, was noted by many economic historians: see e.g. Matthews, R, Feinstein, C, and Odling-Smee, J, *British economic growth, 1856-1973* (Oxford, 1982) at pp.163, 177.

¹⁷ Glyn, and Sutcliffe, *British capitalism, workers and the profits squeeze* pp.180-181.

¹⁸ See, for example: Layard, Richard, *Is incomes policy the answer to unemployment? : an inaugural lecture presented at the London School of Economics on 7th October 1981* (London, Centre for Labour Economics, London School of Economics, 1982); Robinson, Derek, and Mayhew, Ken, 'Conclusions' in *Pay policies for the future* (Oxford, 1983) pp.127-139, at pp.138-139; Peston, Maurice, 'Incomes Policy' in Nolan, Peter, and Paine, Suzanne, *Rethinking Socialist Economics* (Cambridge, 1986), pp.315-325; Meade, James, *Full employment without inflation* (London, 1994).

¹⁹ Brown, William, *Incomes policy in Britain: lessons from experience*, (Cambridge, Department of Applied Economics working paper, no. 9309, 1993).

²⁰ Willman, Paul, *Fairness, Collective Bargaining and Incomes Policy* (Oxford, 1982) at p.145.

²¹ *Ibid.* p.156.

fairness', but it was less and less clear what these views might be, certainly if you were a Conservative.

This paper discusses the deliberations of the Conservatives in respect of both incomes policy and price control. Consideration is then given to what, if anything, they proposed to put in place of Prices and Incomes Policies: monetary discipline, increased unemployment or control via the exchange rate?

Discussions on incomes policy

Certainly, there was no shortage of senior Conservatives who had been closely involved in the events and arguments discussed above. Joseph and Maudling, for example, had served in the Cabinets of Macmillan, Home and Heath, as well as observing the travails of the Wilson Governments from close quarters. The difficulty was that they drew from these experiences radically different conclusions.

Joseph had, by 1974, come to the view that, in essence, the whole course of post War British economic policy had been entirely misconceived. In the present context, this meant that attempts to cure inflation through incomes policy were simply wrong, addressing (at best) a symptom of the underlying problem. The cause of inflation was not wages negotiated by the Trade Unions but the excessive supply of money: inflation was caused by Governments.²² It followed that incomes policy was not going to end inflation, since that could only be achieved by government self-discipline in relation to the money supply.²³ Moreover, Joseph expressly rejected the whole basis of the post War approach to wages, and much else, namely that Government action could direct the economy in a positive direction. That had been the spirit of the National Plan, and there were many in positions of influence who continued to adhere to this approach.²⁴ Joseph disagreed, decrying the efforts of NEDO and similar organisations to develop an “industrial strategy”.²⁵ In all this, Joseph was an enthusiastic disciple of Friedman; indeed, he seemed to claim more for monetary policy than did Friedman himself.²⁶ His views on incomes policy were, however, certainly in line with the British economists who were advising the Conservatives. They were strongly opposed to

²²Speech _____ at _____ Preston, _____ 5.9.74, <http://www.margaretthatcher.org/speeches/displaydocument.asp?docid=110607>, accessed 8.6.10; see also Joseph, Keith, ‘Inflation: the Climate of opinion is changing’ in *Stranded on the middle ground? : reflections on circumstances and policies* (London, 1976): there was an emerging consensus that ‘...inflation was not a natural calamity but government-made, that governments should talk less about “fighting inflation” and simply stop causing it’.

²³ See letter to Thatcher 4.5.76, Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/1/1/37.

²⁴ See, for example, McIntosh, Ronald, *Future British Industrial Strategy* (Reading, 1976): ‘Our aim in NEDO is to secure the adoption of an industrial policy for Britain which combines strategic vision with durability and with the absence of dogma’ (p.20). McIntosh was the Director-General of the National Economic Development Council (“NEDC”). As to his discussions with the Conservatives, see further below.

²⁵ Press release of 31.1.77, Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/6/1/153.

²⁶ See: Friedman, ‘The role of monetary policy’, *The American Economic Review*, 18, (1968) pp. 1-17.

incomes policies of all kinds: 'the record of both voluntary and statutory incomes policies as a method of controlling inflation is dismal'.²⁷ All such policies could do was to restrain wages for a short period, after which the dam would burst.²⁸ The Conservatives were urged to wash their hands of any such policy.²⁹

However, amongst the politicians Joseph was, if not a lone voice, certainly in a distinct minority in expressing such trenchant views. The curious thing, if one looked at the position in 1974, was, in fact how quickly opinion was moving against controls, and how resistant many Tories were to this change. On the one hand, many economists began to express support for monetarism in 1972/3 as the 'Barber boom' was accompanied by rapid inflation.³⁰ *The Times*, formerly a stout supporter of incomes policies, began to have its doubts, and was soon an eager monetarist convert.³¹ In 1974, a parliamentary select committee (with a non-Tory) majority condemned incomes policy as 'impracticable and objectionable'.³² On the other hand, apart from Joseph, many senior Conservatives were keen that the Party should not be seen as antagonistic to controls.³³ Indeed, the Party was content to be seen as 'the party of statutory pay and price control'.³⁴

Leading advocates of the status quo included Reginald Maudling. He had seen the problem of inflation from the vantage point of the Treasury from 1962-1964. He had, at that time, wrestled with the issue of achieving expansion without inflation and concluded that there was no alternative to an incomes policy.³⁵ He remained of this view throughout the

²⁷ Note by Brian Griffiths 'The criteria for an Anti-Inflationary Package', 11.7.75 at Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/6/1/93.

²⁸ See Minute of Meeting between Thatcher and others from the Shadow Cabinet with Brittan, Griffiths, Pepper, Walters and others, 8.7.75, at Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/6/1/93.

²⁹ Letter Ralph Harris to Howe, 9/7/75, Oxford, Conservative Party Archive, Bodleian Library, the Papers of Keith Joseph, Conservative Party Archive, Bodleian Library, KJ10/11.

³⁰ For an admittedly partisan account, see: Congdon, Tim, *Monetarism: an essay in definition* (London, CPS, 1978) pp.3-8.

³¹ See e.g. *The Times*, editorial, 22/6/73, *Not By Incomes Policy Alone*. By 1976, the editor (Rees-Mogg) was urging 'a sudden attack on money supply': see Benn, Tony, *The Benn Diaries 1940-1990* (London, 1995), p.370.

³² See Bruce-Gardyne, Jock, *Myths and magic in economic management* (London, 1976), p.x. The Committee's Specialist Adviser was Alan Walters.

³³ At LCC(74) 6th mtg., 4/4/74, Barber was concerned that the Party should not be noted for 'Tory antagonism to price controls': see Oxford, Conservative Party Archive, Bodleian Library, Leader's Consultative Committee Papers, LCC 1/3/1.

³⁴ See Paper LCC/74/8, undated but about April 1974, at *ibid*.

³⁵ Maudling, Reginald, *Memoirs* (London, 1978) at p.104.

Heath Government.³⁶ And he expressed this view forcefully to his colleagues in the Shadow Cabinet in 1976. It was not that he did not understand the monetarist arguments: he simply did not agree with them. Nor did he give any credence to appeals to 'the free market' or 'free collective bargaining' in an environment dominated by strong Trade Unions. The same answer was required as in the 1960s:

The sole and overwhelming reason why an incomes policy is needed is to deal with the monopoly power which the unions now possess...We can endeavour to bring pressure on the unions, though education, persuasion and public opinion, to exercise moderation in their demands; which is what succeeding Conservative administrations have meant by an incomes policy...³⁷

Many others doubted that it was possible to return to free collective bargaining, or to do without an incomes policy. Prior, another veteran of the Heath Government, was consistent in his opposition to 'a "free for all" situation' or a move to 'free collective chaos'.³⁸ This view commanded widespread support.³⁹ Certainly, when the Shadow Cabinet as a whole reviewed 'the Economic Prospect and the Party's Political Position' in 1976, it was noted that 'there were numerous arguments in favour of continuing to support an incomes policy'.⁴⁰ These arguments included the views of the CBI, the state of public opinion and the need to counter the monopoly power of the unions. Some were in fact prepared to support statutory controls on pay, if Labour introduced these and they were essential.⁴¹

³⁶ Taylor, 'The Need for an Incomes Policy' in Charter, Robin, Dean, Andrew and Elliott, Robert, *Incomes policy*, (Oxford, 1981) pp.149-167 at p.149.

³⁷ Maudling Paper on Incomes Policy, 24/5/76, Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/6/1/158. It is not clear that the Shadow Cabinet ever discussed this paper. Although it was an agenda item for the meeting of 7/6/76, the minutes do not record any discussion – see agenda for LCC (76) 113th mtg and minutes for same both at Oxford, Conservative Party Archive, Bodleian Library, Leader's Consultative Committee Papers, LCC1/3/11. It was also Maudling's recollection that the matter was never discussed: Maudling, Reginald, *Memoirs* at p.209.

³⁸ See letter Prior to Joseph 24.6.76, KJ 8/16 and letter Prior to Healey 9.8.77, Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/6/1/164.

³⁹ See e.g. ERG Minutes of Meeting 10, 20.11.75, Oxford, Conservative Party Archive, Bodleian Library, Conservative Central Office Papers, CRD 4/4/26 at paras 2 (Prior) and 4(Gilmour).

⁴⁰ Meeting of Shadow Cabinet LCC (76) 98th mtg., Cambridge, Churchill Archives Centre, the Thatcher Papers THCR 2/6/1/158. An earlier draft paper by Howe of the same title [LCC/75/94] advised 'acceptance of the case against a return to free collective bargaining': see para 16(4) (Oxford, Conservative Party Archive, Bodleian Library, Leader's Consultative Committee Papers, LCC 1/3/9). In the paper under discussion at the meeting, Howe suggested that 'the ideal solution' was the German one of 'no formal control over prices or incomes but pervasive acceptance of economic realities': paper by Howe LCC/76/99 11/2/76, LCC 1/3/10.

⁴¹ See minutes of LCC (75) 67th Mtg., 1/7/75, Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/6/1/156.

The truth was that the Conservatives were struggling with the same issue as had troubled politicians (of both parties), and economists, since the 1950s: how was growth to be achieved without inflation? They were doing so in an environment which was very hostile in a number of respects. For one thing, the problem which had faced Maudling and Macmillan in the early 1960s had been the need to curb modest inflation in a time of rapid and sustained growth. The 1970s witnessed massive inflation coupled with prolonged recession. Furthermore, some, at least, of the techniques of incomes policy which had been tried before seemed out of the question. It was difficult to see how the Conservatives could enter into a 'Social Contract' with the unions, a policy which had been tried and failed under Labour.⁴² There was little enthusiasm for statutory restraint, which was very complex and liable to lead to industrial confrontation.

On the other hand, there was a degree of consensus on certain matters, a consensus which extended to the Labour Government, almost everyone in the Conservative Party, and many economists.⁴³ Firstly, control of the money supply was now very important and there could be no repeat of the rapid growth permitted in the Barber years. By 1975, the view inside the Government was that 'monetary policy is...central to strategy'.⁴⁴ In 1976, it was said that the UK had been more successful than any developed country bar West Germany in restraining money supply growth over the last 2 to 3 years.⁴⁵ Secondly, public spending must be rigorously controlled by cash limits, which Labour had also introduced. This necessarily involved that public sector pay bargaining had to fit in with the system of cash limits.⁴⁶ The

⁴²This very point was made in the report of the ERG LCC/76/123 at para 27: 'it is least of all credible that a Conservative government will be able to manage a prolonged or "new" incomes policy better than a Socialist one': Oxford, Conservative Party Archive, Bodleian Library, Leader's Consultative Committee Papers, LCC 1/3/11.

⁴³ The main dissenters were the promoters of the Alternative Economic Strategy on the Left and at Cambridge. For a flavour of the alternative view, see e.g. Coutts, Kenneth, Godley, Wynne, and Nordhaus, William, *Industrial pricing in the United Kingdom*. (Cambridge, 1978). Francis Cripps, a founder member of the Cambridge Economic Policy Group, served from 1974-9 as economic adviser to Tony Benn, the leading proponent of the AES and briefed him on a separate line from official Government economic policy: see e.g. Benn, *The Benn Diaries* pp.364/365.

⁴⁴ Cambridge, Churchill Archives Centre, the Papers of Lord Donoughue, Note from Donoughue to Wilson 23/12/75, DNGH 1/1/7 Part 2.

⁴⁵ Cambridge, Churchill Archives Centre, the Papers of Lord Donoughue, Note from Donoughue to Callaghan 9/11/76, DNGH 1/1/14.

⁴⁶ CRD paper on Public Sector Pay, 4/4/79, Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/6/1/164. Note that there was uncertainty as to how to respond to the Clegg Commission on Pay Comparability: see letter Howe to Thorneycroft 22/3/79, Oxford, Conservative Party Archive, Bodleian Library, Conservative Central Office Papers, CCO 20/1/28.

Conservatives were keen, as far as possible, to distance politicians from the wage negotiation process in the public sector.⁴⁷

What that left for argument was a relatively narrow but important point: should one rely on monetary controls alone, or should they be supplemented by a pay policy of some kind? After the failure of the Social Contract, Labour had staked much of its authority on its pay policy. Within the Conservative Party, there were some who thought likewise that the supposed ‘money supply versus pay policy’ dilemma was a non-existent one: obviously any government would have to use all the tools at its disposal to rein in inflation.⁴⁸ Thatcher herself certainly seemed reluctant absolutely to rule out incomes policy, despite its troubled past.⁴⁹ However, it was recognised that there was a fundamental difference of opinion between the Joseph view (reliance on monetary policy alone) and the Maudling approach, which recognised the importance of ‘cost push’ inflation.⁵⁰ So sensitive was this issue that, when *The Right Approach* was published in October 1976, the Conservative Research Department’s (CRD) Briefing Notes, running to some 117 pages, deliberately did not ‘...deal with the two main questions we shall be asked -(i)do you believe that incomes policies are good or bad?-(ii)how would you get on with the Unions?’⁵¹

The Right Approach represented an early stage in the process by which the Conservatives responsible for economic policy (in particular Howe, Prior and, later on, Lawson) sought to develop an approach to inflation which neither explicitly embraced free collective bargaining nor returned to a statutory incomes policy. For example, in May 1976 Howe outlined six principles for dealing with inflation.⁵² Some of these were, in reality, if not in rhetoric, common ground with Labour, such as the need for strict control of the money supply and of public spending. The distinctive Conservative contribution was to suggest that

⁴⁷ See memo: A Ridley to Thatcher 12/3/79, Oxford, Conservative Party Archive, Bodleian Library, Conservative Central Office Papers, CRD 4/4/31.

⁴⁸ See CRD Note LCC (75)36, 30/6/75, Oxford, Conservative Party Archive, Bodleian Library, Steering Committee Papers, SC 14.

⁴⁹ See Letter Lawson to Thatcher 1.3.76, arguing that incomes policy always led to more trouble than it was worth, and her cautious response of 2.3.76, both at Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/1/1/42A.

⁵⁰ See Paper ‘Inflation and Investment’, PG/10/75/15, 30/10/75, Cambridge, Churchill Archives Centre, the Papers of Lord Howell HWLL 2/4/1/1, 1975, Part 2/2. See also memo Thorneycroft to Thatcher, 25.5.76, Oxford, Conservative Party Archive, Bodleian Library, Conservative Central Office Papers, CCO 20/8/19.

⁵¹ CRD’s Briefing Notes on *The Right Approach*, undated but about October 1976, Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/6/1/215.

⁵² Speech by Howe at the Carlton Club, 12.5.76, Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/1/3/9 (Press Release); 2/1/30(full text).

Government needed to secure better understanding for its policies and a more open approach to economic management.⁵³ The model in this respect was said to be the ‘Concerted Action’ approach operated in West Germany, whereby ‘all those who are concerned with economic decision-taking...meet together regularly in order to exchange, and as far as possible agree, information about the future progress of the economy’.⁵⁴

From this point onwards, and subject to dissent in certain quarters, the search was on for means of achieving ‘responsible wage bargaining’ through institutional means, probably based on the NEDC.⁵⁵ This aimed to avoid making the choice between incomes policy and free collective bargaining.⁵⁶ Howe and Prior were clearly much taken with the role of the NEDC and what could be done to enhance it through emulating the German model.⁵⁷ To this end, the Economic Reconstruction Group (ERG) considered, and approved, a report on Concerted Action.⁵⁸ At their meeting on 28th April 1977 it was noted that ‘(Concerted Action)...had proved useful in gaining acceptance and understanding of the social market approach. We needed something similar, probably based...on NEDC, and possibly linked to a small council of wise men, as in Germany...’⁵⁹

There were those who had doubts about this strategy. In particular, some, like Thatcher and Thorneycroft, saw this as a recipe for bureaucracy and corporatism.⁶⁰

⁵³ Ibid.

⁵⁴ Cambridge, Churchill Archives Centre, the Thatcher Papers, 2/1/30 (full text, page 16).

⁵⁵ Paper by Howe: “Our attitude towards pay policy”, LSC (77) 59, 4.3.77, Thatcher Archive 2/6/1/245, para 25.

⁵⁶ Ibid. para 1.

⁵⁷ In February 1976, Howe and Ronald McIntosh, the Director-General of the NEDC went to Hamburg for the conference of the Anglo-German Industrial Federation: McIntosh, Ronald, *Challenge to Democracy: Politics, Trade Union Power, and Economic Failure in the 1970s* (London, 2006) diary entry for 27.2.76 to 29.2.76 (pp.254-256). There they discussed and compared the roles of the NEDC and Concerted Action. According to McIntosh, Prior told him on 2.3.76 that ‘...Howe had come back from (Hamburg) expressing very different views from those he had held before it...’: diary entry for 2.3.76, *ibid.* p.257.

⁵⁸ It consisted of a thirty-page survey of the history of “Die Konzertierte Aktion” by Konrad Zweig: PG 10/77/28, Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/6/1/37. The ERG was the principal policy group within the Party considering economic policy, chaired by Howe.

⁵⁹ ERG Minutes of Meeting 21, 28.4.77 Oxford, Conservative Party Archive, Bodleian Library, Conservative Central Office Papers, CRD 4/4/27.

⁶⁰ See: Notes by Thatcher on her copy of a letter from Howe about Concerted Action ‘This paper frightens me to death even more – we really must avoid some of this terrible jargon. Also we should recognise that this German talking shop works because it consists of Germans.’: Letter from Howe to Thatcher of 26.5.77, Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/1/3/9; as to Thorneycroft, see: Thorneycroft manuscript notes on pages 8-11 of draft 2 of the economic document circulated on 28.7.77, Oxford, Conservative Party Archive, Bodleian Library, Conservative Central Office Papers, CCO 20/9/8; Thorneycroft memorandum of 1.8.77, *ibid.*; Note Thatcher to Thorneycroft of 4.8.77, at *ibid.*; Letter Howe to Thorneycroft of 5.8.77, at *ibid.*

Nonetheless, by the summer of 1977, a consensus had been agreed between Howe, Prior and (somewhat curiously, given his public statements), Joseph.⁶¹ Even more curiously, the consensus in fact represented an apparent victory for the Maudling version of incomes policy, namely an 'endeavour to bring pressure on the unions, through education, persuasion and public opinion, to exercise moderation in their demands'. There were two aspects to this consensus. The first was a rejection of 'free collective bargaining': 'John Biffen is wrong to say we should favour this: it implies disregard for limits on resources. We should argue for realistic bargaining'.⁶² The second point was that monetary discipline was not enough by itself to control inflation, without institutional change. Government could not disappear from pay negotiations, since 'The central purposes of our proposals for developing machinery somewhat on the lines of the German 'Concerted Action' model are to meet the need for economic explanation and to provide a forum for discussion and mutual education.'⁶³

This approach found expression in the somewhat tortuous language of *The Right Approach to the Economy*, published in October 1977 following much internal debate:

some kind of forum is desirable, where the major participants in the economy can sit down calmly together to consider the implications – for prosperity as well as for unemployment and pay-bargaining – of the Government's fiscal and monetary policies. NEDC may well be the most appropriate for this purpose...⁶⁴

As Howe pointed out to Thatcher at the time, this document went considerably further down the corporatist route than had *The Right Approach*.⁶⁵ There was clearly some internal unease about the document.⁶⁶ However, the most penetrating critique largely came from outside the Party. Enoch Powell had welcomed the Tory defeat in February 1974 on the basis

⁶¹ Note from Ridley to Howell of 30.6.77 referring to '...the consensus which has been agreed...' between Howe, Joseph and Prior: Cambridge, Churchill Archives Centre, the Papers of Lord Howell, HWLL 2/4/1/1 1977.

⁶² Note of discussion on Incomes Policy 2.5.77, between Howe, Joseph, Prior and Adam Ridley, Oxford, Conservative Party Archive, Bodleian Library, Conservative Central Office Papers, CRD 4/4/28.

⁶³ Note from Ridley to Howell of 30.6.77: Cambridge, Churchill Archives Centre, the Papers of Lord Howell, HWLL 2/4/1/1 1977.

⁶⁴ Conservative Party, *The Right Approach to the Economy* (London, 1977).

⁶⁵ Letter Howe to Thatcher of 16th September 1977, attaching a note of differences between *The Right Approach* and *The Right Approach to the Economy*, Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/6/1/161.

⁶⁶ 'It was agreed that we would make clear to the press that the document consisted of proposals from four members of the Shadow Cabinet; it had not been discussed by the full Shadow Cabinet, and the proposals could not be presented as Shadow Cabinet commitments. There could be no guarantee that all the proposals in the document would be included in our Manifesto.' LCC/77/175th Mtg., 6.10.77, Thatcher Archive 2/6/1/161.

that this would compel the Party to disavow compulsory wage controls.⁶⁷ He was quick, however, to criticise the slowness of his former colleagues to move in the right direction. On the one hand, he pointed out, Labour was now embracing the monetary explanation of inflation.⁶⁸ But ‘somebody always seemed to be coughing at the wrong moment’ when Howe had the chance to join in this new consensus.⁶⁹ On the other hand, calls for ‘responsible’ bargaining begged some critical questions. Who was to determine which bargains were and were not ‘responsible’? And if they were not ‘responsible’, what would the Government do about it?⁷⁰ The Powell solution, of course, was that all controls on wages (and prices, the exchange rate and so on) should be abandoned at once.⁷¹

This was not a solution that the Conservatives seemed willing to adopt. But as a rare internal dissenting voice pointed out to Thatcher, this left some awkward questions.⁷² If the Conservatives were now pledged to ‘Concerted Action’, with economic explanation in a forum, how did this differ from the Social Contract or an incomes policy?⁷³ And why should it work any better?⁷⁴ And why, might one add, were the Conservatives likely to have any more luck with this approach – which seemed to assume an attitude of sweet reasonableness from the great economic interests, especially the Trade Unions – than they had had with free collective bargaining in the early 1970s? After all, the Conservatives had previously, and probably rightly, analysed the Social Contract as a Bennite concept.⁷⁵

There was no answer forthcoming to these questions, because most Conservatives seemed determined to stick doggedly to the compromise that had been agreed: responsible collective bargaining, reinforced by a ‘forum’ modelled on the principles of Concerted

⁶⁷ See Press Release dated 2/3/74, Cambridge, Churchill Archives Centre, the Papers of Enoch Powell, POLL 4/3/3 file 2 of 4.

⁶⁸ See speech at Cafe Royal, 9/3/77, Cambridge, Churchill Archives Centre, the Papers of Enoch Powell, POLL 4/1/12 file 5 of 5.

⁶⁹ See Speech to Westminster Chamber of Commerce, 5/9/78, Cambridge, Churchill Archives Centre, the Papers of Enoch Powell, POLL 4/1/12 file 2 of 5.

⁷⁰ See speech in London, 25/10/78, Cambridge, Churchill Archives Centre, the Papers of Enoch Powell, POLL 4/1/12 file 1 of 5.

⁷¹ Speech at Hounslow 22/6/77, Cambridge, Churchill Archives Centre, the Papers of Enoch Powell, POLL 4/1/12 file 5 of 5.

⁷² See Memo Adam Butler (Thatcher’s PPS) to Thatcher, 14/6/77, Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/1/1/46.

⁷³ Ibid.

⁷⁴ Ibid.

⁷⁵ See CRD memo on the history of the Social Contract 17/1/75, Oxford, Conservative Party Archive, Bodleian Library, Conservative Central Office Papers, CRD 4/4/83.

Action.⁷⁶ Detailed preparations were made for the implementation of this policy. In October 1978, CRD officers met with the senior staff of NEDO to discuss how Concerted Action was to be implemented.⁷⁷ On the day before the election, the CRD distributed a ‘Dossier for Government: General Economic Management and Public Expenditure’.⁷⁸ This set out detailed plans for Concerted Action and for the involvement of NEDO. Internally and externally, spokesmen continued to walk a tightrope between a return to free collective bargaining and the adoption of incomes policy. As Howe put it ‘Our objective must be a return to responsible collective bargaining without direct government interference. We must avoid, on the one hand, the imputation that we are going back to free collective bargaining and on the other any suggestion of a return to an incomes policy...we must have guidelines...’⁷⁹

Indeed, Howe and Prior, in particular, declined to be drawn into making a choice between belief in an incomes policy and free collective bargaining. This choice, posed ‘in almost theological form...is too stark’.⁸⁰ The ‘forum’ approach ‘...is, in a very real sense, a policy for pay, an “incomes policy” if you like’.⁸¹ In December 1978, Thatcher herself made a major speech setting out ‘...a definitive statement (of pay policy) which was carefully drafted after extensive consultations with Geoffrey Howe and Jim Prior, in particular...’:⁸²

1. Strict control by the Government of the rate of growth of the money supply...6.
Open discussion—and explanation—between Government, employers, unions and all interested parties, so that people know what is happening and why. It must be made

⁷⁶ See e.g.: Note on Pay of 16.1.78, Christ Church, Oxford, the Nigel Lawson Papers, Lawson/1/1978; exchange of notes with Howell on pay 22.6.78 and 10.7.78 at *ibid*; Minute of Meeting to discuss pay bargaining, attended by Howe, Joseph, Prior and Lawson on 6/2/78, Oxford, Conservative Party Archive, Bodleian Library, Conservative Central Office Papers, CRD 4/4/103.

⁷⁷ Record of meeting at NEDO, 17/10/78, Christ Church, Oxford, the Nigel Lawson Papers, Lawson/1/1979.

⁷⁸ Dossier dated 2/5/79, Christ Church, Oxford, the Nigel Lawson Papers, Lawson/1/1979.

⁷⁹ See ACP Discussion on Prices and Incomes Policy Paper, 7/6/78, Oxford, Conservative Party Archive, Bodleian Library, Advisory Committee on Policy (and Political Education) Papers, ACP 3/21.

⁸⁰ Speech by Howe at Newcastle, 27/10/78, Oxford, Conservative Party Archive, Bodleian Library, Conservative Central Office Papers, CRD 4/4/12, page 1. See also to similar effect speech by Prior at Harrogate 26/10/78, CRD 4/4/102.

⁸¹ *Ibid.* p.6.

⁸² Letter Thatcher to Thorneycroft of 5.1.79, Oxford, Conservative Party Archive, Bodleian Library, Conservative Central Office Papers, CCO 20/8/21. The consultees also included Thorneycroft (see letter Thorneycroft to Thatcher of 15.12.78 at *ibid.*) and Joseph (see note of 5.12.78 at *ibid.*). The speech was extensively reported. In its editorial the next day, the Daily Telegraph said that it ‘...had something of the quality of an encyclical...’: press cuttings at *ibid.*

clear that a solvent nation like a solvent business can operate only within certain inescapable financial constraints.⁸³

The reality was that this formulation was ‘papering over not a crack but a chasm’.⁸⁴ It is also clear that, in private, Thatcher herself had little patience with the attempt to finesse the Party’s divisions.⁸⁵ There were a number of fundamental and irreconcilable unresolved issues. The first was that if there were to be ‘guidance’ on the right level of pay increases, discussed in a ‘forum’, how did this differ from a pay ‘norm’ of the kind which had caused such problems for the Conservatives in the past and was now destroying what was left of the Social Contract?⁸⁶ Secondly, official policy seemed to envisage ‘cosy tripartite chats’, involving the Unions.⁸⁷ But did anyone in the Conservative Party really believe that these could succeed?⁸⁸ Thirdly, in February 1979, the Government and the TUC had entered into a ‘concordat’, which called for an annual ‘national assessment by Government and both sides of industry of our economic prospects’.⁸⁹ Was this not essentially the same as the ‘forum’, but, in this case, being put forward by the Party that had had historically close relations with the Unions? Finally, and most fundamentally, did the Conservatives believe in fixing wages through the market, or through the sort of pay policy which, in reality, *The Right Approach* and *The Right Approach to the Economy* appeared to envisage?⁹⁰

Despite all this, the 1979 Manifesto stuck faithfully to the approach which had been cobbled together:

⁸³ Speech to Paddington Conservatives (pay policy and unions), 18/12/78, <http://www.margareththatcher.org/document/103804>, accessed 13/9/11.

⁸⁴ See speech in London, 25/10/78, Cambridge, Churchill Archives Centre, the Papers of Enoch Powell, POLL 4/1/12 file 1 of 5.

⁸⁵ See her annotations on the draft 1979 manifesto e.g. ‘This paragraph is pathetic’ in relation to a somewhat tepid commitment to ‘re-establishing conditions in which pay awards can and do vary’: undated notes on draft, p.12, at Oxford, Conservative Party Archive, Bodleian Library, Leader’s Consultative Committee Papers, LCC 1/3/16.

⁸⁶ For internal discussion of these issues, see: Minute of Meeting to Discuss Pay Bargaining held in the Leader’s Office, 15/2/78, Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/6/1/96; Note Howell to Lawson about the problems of a ‘norm’, 10/7/78, Christ Church, Oxford, the Nigel Lawson Papers, Lawson/1/1978; Note by Adam Ridley, ‘Inflation – a Telegraphic Exposition of our Policy’, 24/10/78, Oxford, Conservative Party Archive, Bodleian Library, Conservative Central Office Papers, CRD 4/4/70.

⁸⁷ *TV Interview for London Weekend Television Weekend World: Brian Walden question to Thatcher, 7/1/79*, <http://www.margareththatcher.org/document/103807>, accessed 13.9.11.

⁸⁸ Thatcher herself was very evasive on this when interviewed by Walden, at *ibid*.

⁸⁹ Quoted in CRD Briefing Notes on the manifesto 5/4/79, p.26, Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 1/11/5; see also CRD Note re ‘Concordat and the Social Contract’, 14/2/79, Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/6/1/257.

⁹⁰ *The Financial Times* posed essentially this question in an editorial commenting on the Paddington speech: ‘Words, not action’: *The Financial Times* 19/12/78.

There should also be more open and informed discussion of the Government's economic objectives (as happens, for example, in Germany and other countries) so that there is wider understanding of the consequences of unrealistic bargaining and industrial action. Pay bargaining in the private sector should be left to the companies and workers concerned...⁹¹

However, this formula was perhaps more significant for what it left out than what it retained. There would be no statutory wages controls. There was no mention of a 'norm'. There was to be no Pay Board or, indeed, any mechanism for penalising 'unrealistic bargaining'. A body of some kind would have discussions, but, otherwise, it was a matter for the buyers and sellers of labour to negotiate. In deference to Party opinion, a Maudlingesque fig leaf, with an apparently new German name, was placed over the policy, but the real victory was for the Josephite view that controls should go. Understandably the Party elders emphasised continuity in their public statements.⁹² But the change was real; the departure was not so much the policy adopted to regulate incomes, as the absence of such a policy.

⁹¹ Conservative Party, *1979 Conservative Party General Election Manifesto*, (London, 1979).

⁹² For example, when Powell launched an attack in the wake of the Paddington speech ['...I doubt if anyone has read the recent speeches of the Leader of the Opposition on the subject of inflation without remarking to himself: "If the Conservatives were to get in again, they would be off once more on a policy of price and income control before you could say Jack Robinson...': Speech to Incorporated Society of Valuers and Auctioneers on 2.1.79, The Papers of Enoch Powell, Churchill Archives Centre, POLL 4/2/4, file 3.], Thorneycroft pointed out in response that, in fact, Powell had joined with him in the establishment of the "three wise men" in 1956/7, '...a system not dissimilar to that used in Germany today and that set out in *The Right Approach to the Economy...*': *Daily Telegraph*, 3.1.79, The Papers of Enoch Powell, Churchill Archives Centre, POLL 12/1/30.

Price and dividend control

In 1979, the Conservatives inherited an elaborate system of statutory control over prices and dividends. This system had essentially been in place since 1972, when it had been introduced by the Heath Government.⁹³ Prices were subject to complex regulation as to both gross and net profit, in each case subject to investigation by the Price Commission.⁹⁴ This body had been very active, producing thirty three reports between 1974 and 1978.⁹⁵ As to dividends, companies were not allowed to declare dividends more than 10% higher than the previous year, save with the consent of the Treasury.⁹⁶ This approach closely followed that of the 1973 legislation.⁹⁷

One might have thought that any even tentatively pro-capitalist party would find a system of controlling prices and dividends repugnant, emphasising instead the beneficial effects of the market in regulating such matters. However, the position was more complex than this. Of course, every Conservative attested to the virtues of competition. For some influential economic liberals, like Hayek, competition was at the heart of any non-Socialist system. However, there were very few Conservatives who believed that the relationship between buyers and sellers could be left to the market and the common law alone. By 1979 there was a substantial body of legislation to protect consumers. This recognised that, even in a competitive economy, the individual was often in an inferior bargaining position. Much of this legislation had been introduced by Conservative Governments.⁹⁸ No one in the Party was proposing to repeal this regulatory legal framework.

It followed that prices, at least, would continue to be controlled not merely by competition but also through consumer legislation and investigation of anti-competitive

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Conran, C. C., *Guide to the 1977 counter-inflation legislation* (London, 1978) p.4.

⁹⁴ *Ibid.* p.5.

⁹⁵ See e.g. *Price Commission Report 19, Television Rental Charges* (1976). London: HMSO, October 1976; *Price Commission Report 22, Funeral Charges* (1977). London: HMSO, March 1977.

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Conran, *Guide to the 1977 counter-inflation legislation* p.22.

⁹⁷ The Counter-Inflation (Dividends) Order 1973, as to which see Bracewell-Milnes, *The Counter-Inflation Act 1973*.

⁹⁸ E.g. the Consumer Protection Act 1961 and the Consumer Credit Act 1974: see Mickleburgh, John, *Consumer Protection* (Abingdon, 1979) at pp.3, 8, and 239-243.

practices. The real question for the Conservatives was whether they would abolish, or curtail, the detailed system to control prices and dividends which they had themselves introduced in 1972. Despite the historic aversion of Conservatives to such systems, this was indeed a real question. By 1974, many Conservatives had become convinced that, in a time of unprecedented inflationary pressure, it was necessary 'to retain the principle of statutory price control at large and preferably the Prices Ministry'.⁹⁹ In the election of October 1974, the Party's platform included a 'price stabilisation programme' incorporating subsidies and the threat of statutory controls. There was also a pledge to limit mortgage rates to 9.5%.¹⁰⁰ Such views obviously reflected considerable public nervousness about levels of inflation not seen in living memory. The popular press strongly favoured controls, *The Daily Mail*, for example, asserting that 'we need statutory restraint on prices. We need statutory restraint on profits. We need statutory restraint on incomes'.¹⁰¹

In relation to price control, therefore, the Party proceeded with some caution. In 1975, the Shadow Spokesman (Sally Oppenheim) set up the Price Code Alternative Policy Group.¹⁰² When the Shadow Cabinet reviewed the position in early 1976, there was agreement that price controls should be reduced rather than eliminated.¹⁰³ Considerations militating against a commitment to abolition outright included the attitude of the C.B.I and of public opinion.¹⁰⁴ Oppenheim's Group recommended that, in the long term, the Party should seek to remove controls on both prices and profits, but that 'a positive policy commitment to abolish the Code at this precise moment would be inappropriate and politically disadvantageous'.¹⁰⁵ It also suggested that the Price Commission should be replaced with a Prices Review Board, with powers to investigate prices, and that there should be voluntary restraint agreements on

⁹⁹ Paper 'Counter-Inflation', 24/6/74, Cambridge, Churchill Archives Centre, the Papers of Lord Howell, HWLL 2/4/1/6.

¹⁰⁰ See Conservative Party, *October 1974 Conservative Party General Election Manifesto* (London, 1974).

¹⁰¹ *The Daily Mail* 27/2/74, p.6.

¹⁰² See Note Oppenheim to Joseph 5/9/75, Oxford, Conservative Party Archive, Bodleian Library, the Papers of Keith Joseph, KJ17/7.

¹⁰³ Meeting of Shadow Cabinet LCC (76) 98th mtg., Cambridge, Churchill Archives Centre, the Thatcher Papers THCR 2/6/1/158.

¹⁰⁴ Public opinion remained strongly in favour of controls: see, for example, CRD Note 'Public opinion on incomes policy' 22/11/78, see Oxford, Conservative Party Archive, Bodleian Library, Conservative Central Office Papers, CCO 20/9/5, and Britto memo 7/12/79, CRD 4/4/103.

¹⁰⁵ Oppenheim report on the operation of the Price Code, LCC/76/115, 9/5/76, Cambridge, Churchill Archives Centre, the Thatcher Papers THCR 2/6/1/159; see also Report of the Price Code Alternatives Policy Group, 9/6/76 at *ibid*.

prices between Governments and particular industries.¹⁰⁶ In keeping with this cautious attitude, the commitment in *The Right Approach* hesitantly called for ‘substantial relaxations of the Price Code’.¹⁰⁷

This did not seem to make much sense as a policy; if the Price Code did not prevent inflation (as many Conservatives seemed to think) what was the point of keeping it at all? Recognising this, they then embarked on a search for an acceptable means of dismantling the system of price controls. One view was that the trade-off for the abolition of the Price Commission should be stronger enforcement of competition and an enhanced Monopolies Commission.¹⁰⁸ A Competition Policy Group was set up.¹⁰⁹ However, there was no real agreement on the way forward. A number of discordant views was apparent. Some, like Prior, thought that ‘the price...enforcement system operated by the present government is a subtle and effective one which we should be unwise to discard immediately’.¹¹⁰ Joseph unsurprisingly believed that the emphasis should be on ‘competition as the best form of price control’.¹¹¹ Others again, whilst impatient of the Price Commission’s interference in the marketplace, wanted to see a body remaining which could investigate commercial pricing.¹¹²

In 1977, Oppenheim brought forward the conclusions of the relevant policy groups.¹¹³ Their proposals were wide-ranging and would have left much of the current price control system still in place, in substance if not in form. The Price Code would remain until the end of 1977; the OFT should be expanded by setting up within it a Competition and Prices Board. The former would be an early warning system for monopoly situations and the like. The latter was to ‘investigate, monitor and report on price increases in areas of widespread public concern’. These proposals were greeted within the Party with little enthusiasm or, in some

¹⁰⁶ See Report of the Price Code Alternative Policy Group, 15/7/76, at Oxford, Conservative Party Archive, Bodleian Library, Leader’s Consultative Committee Papers, LCC 1/3/3.

¹⁰⁷ Conservative Party, *The Right Approach* p.31.

¹⁰⁸ See memo from Joseph to Howe 29/10/76, Cambridge, Churchill Archives Centre, the Thatcher Papers THCR 2/1/1/38.

¹⁰⁹ See Minutes of Meetings in February/March 1977, Cambridge, Churchill Archives Centre, the Thatcher Papers THCR 2/6/1/31. For more extensive documentation of this Group, see Oxford, Conservative Party Archive, Bodleian Library, Conservative Central Office Papers, CRD4/4/17.

¹¹⁰ Howe Paper ‘Our attitude towards pay policy’, LSC (77) 59, 4/3/77, Oxford, Conservative Party Archive, Bodleian Library, Steering Committee Papers, SC 15. Howe was ‘not so sure of this’.

¹¹¹ Note to Oppenheim and Nott, 15/4/77, Oxford, Conservative Party Archive, Bodleian Library, the Papers of Keith Joseph, KJ 10/12.

¹¹² See letter Nott to Oppenheim 20/6/77, Oxford, Conservative Party Archive, Bodleian Library, Conservative Central Office Papers, CRD4/4/17.

¹¹³ See: Memo Oppenheim to Joseph 28/4/77, at ditto; undated memo Oppenheim to Thatcher at Cambridge, Churchill Archives Centre, the Thatcher Papers THCR 2/1/1/46; paper ‘A Policy for Prices’ LCC(77) 163, undated but about June 1977 at THCR 2/6/1/37.

cases, outright hostility.¹¹⁴ *The Right Approach to the Economy*, published later that year, edged hesitantly towards an end to controls.¹¹⁵

There was good reason for this hesitancy. Public opinion was felt to favour price control, so that stealth was required in abolishing the current system.¹¹⁶ It would therefore be ‘electorally disastrous to offer the immediate outright abolition of...price controls, and yet offer nothing in return’.¹¹⁷ The problem was: what to offer? Everyone in the Party agreed that competition was a good way to control prices, but there was less agreement as to how, if at all, the regulatory regime could be enhanced to promote competition. Oppenheim continued to press for a higher profile to be given to proposals to strengthen the OFT’s role in restraining price abuse.¹¹⁸ However, there were many in the Party who regarded all this as a recipe for pointless additional bureaucracy.¹¹⁹ The Leader was closer to much Party opinion when she told *The Sun*:

She is scathing about some of the Government's myriad state "watchdogs"—particularly the Price Commission. “People like Freddie Laker with Skytrain, and Marks and Spencer, and British Home Stores, and the supermarkets, have been responsible for better value in keeping prices down than the Price Commission,” she said. “Our policy is really effective competition...”¹²⁰

¹¹⁴ See: Joseph’s notes on Memo Oppenheim to Joseph 28/4/77, and his note of 11/5/77, both at Oxford, Conservative Party Archive, Bodleian Library, the Papers of Keith Joseph, KJ 10/12; Thatcher’s manuscript note on undated memo Oppenheim to Thatcher at Cambridge, Churchill Archives Centre, the Thatcher Papers THCR 2/1/1/46; Nott’s memo on a Policy for Prices dated 13/5/77 at ditto; Minutes of meeting of ERG (26), 30/6/77, Oxford, Conservative Party Archive, Bodleian Library, Conservative Central Office Papers, CRD4/4/28.

¹¹⁵ Conservative Party, *The Right Approach to the Economy*.

¹¹⁶ See Minutes of Meeting of Policy Sub-Committee 21/11/77, Oxford, Conservative Party Archive, Bodleian Library, the Papers of Keith Joseph, KJ 26/7.

¹¹⁷ See ‘A Policy for Prices’, 25/11/77, Cambridge, Churchill Archives Centre, the Papers of Sir Adam Ridley, RDLY2/2/1/13.

¹¹⁸ See letter Oppenheim to Thatcher, 22/2/78, Cambridge, Churchill Archives Centre, the Thatcher Papers THCR 2/7/1/17.

¹¹⁹ See notes on draft Manifesto for meeting on 4.9.78 by David Wolfson ‘Page 14 To create wealth, and reduce Inflation, we are going to promote competition by [Help, Haven’t we learned anything?] “Strengthening the Monopolies Commission” and (OH, NO) “ENLARGING” the Office of Fair Trading. MORE UNPRODUCTIVE CIVIL SERVANTS’: Oxford, Conservative Party Archive, Bodleian Library, Leader’s Consultative Committee Papers, LCC 1/3/16. Wolfson worked in Thatcher’s office: see letter at Cambridge, Churchill Archives Centre, the Papers of Lord Howell, HWLL 2/4/2/1.

¹²⁰ Interview for *The Sun*, 18/7/78, <http://www.margaretthatcher.org/document/103493>, accessed 14.9.11. Thatcher had been briefed by CRD for this interview that it was important to avoid mentioning the abolition of the Price Commission! : Briefing Note 11/7/78, Cambridge, Churchill Archives Centre, the Thatcher Papers THCR 2/11/9/8.

But how was this competition to be ensured? Oppenheim circulated an “Introductory paper” on the matter in January 1979.¹²¹ This contained wide-ranging proposals, including statutory definitions of oligopoly and uncompetitive practices, powers for the OFT and the MMC to investigate the latter, and facilities for the OFT to examine price increases. The Steering Committee considered the paper in February 1979, and agreed that Howe, Thorneycroft and Nott would “re-examine” the matter.¹²² Howe and Thorneycroft duly killed off the Paper during the course of March 1979, despite Oppenheim’s protests.¹²³ Howe indeed advocated a policy of legislative inaction ‘until a Conservative Secretary of State has been in charge of competition policy for some years’.¹²⁴ The upshot of these deliberations was a magnificently vague passage in the 1979 Manifesto:

Profits are the foundation of a free enterprise economy. In Britain profits are still dangerously low. Price controls can prevent them from reaching a level adequate for the investment we need. In order to ensure effective competition and fair pricing policies, we will review the working of the Monopolies Commission, the Office of Fair Trading and the Price Commission...¹²⁵

There was, therefore, no commitment to abolish the Price Commission or price controls.¹²⁶ Nor was there any explanation as to what the ‘review’ of the workings of the regulatory bodies might entail. The former omission was, no doubt, a reflection of continuing nervousness within the Party as to public reaction to such ideas.¹²⁷ The latter was a function of the fact that the Conservatives had developed no detailed proposals in these areas, and many of them had no wish to do so. However, it was nonetheless clear that a line had been crossed. Internal briefing documents for the 1979 election assumed that, if elected, the Party would abolish both the Price Commission and price controls. To some this might have appeared counter-intuitive in a time of high inflation, but the Conservatives had two answers ready, if challenged. First, inflation was caused not by a lack of controls but by deeper causes,

¹²¹ ‘Competition Policy’, 2.1.79, Cambridge, Churchill Archives Centre, the Thatcher Papers THCR 2/6/1/64.

¹²² LSC/79/63rd meeting, 5.2.79, Oxford, Conservative Party Archive, Bodleian Library, Steering Committee Papers, SC 17.

¹²³ See note of meeting of 6.3.79 attended by Howe, Thorneycroft, Oppenheim and Nott, and Oppenheim’s note of 22.3.79, both at Oxford, Conservative Party Archive, Bodleian Library, Conservative Central Office Papers CCO 20/9/9.

¹²⁴ Letter of 22.3.79 at *ibid.*

¹²⁵ Conservative Party, *1979 Conservative Party General Election Manifesto*.

¹²⁶ However, it seems clear that Party opinion had moved strongly in favour of abolishing the Price Commission : see memo ‘An approach to competition policy dated February 1979 at Oxford, Conservative Party Archive, Bodleian Library, Conservative Central Office Papers CCO 20/9/9.

¹²⁷ See Dossier for Incoming Minister 2/2/79, para 1, Cambridge, Churchill Archives Centre, the Papers of Sir Adam Ridley, RDLY 2/2/1/13.

such as excessive public spending and monetary indiscipline.¹²⁸ Second, prices were kept down by competition, not by controls.¹²⁹

By 1979 the Party, despite its timid public pronouncements, had moved a very long way from its earlier adoption of extensive price controls with their attendant bureaucracy. Although there were political risks involved, it would do away with the Price Code, any remaining subsidies and the Price Commission, and allow prices to be regulated by the market. In future, trust would be placed in 'people like Freddie Laker', rather than in public bodies, even bodies responsible for ensuring competition.

¹²⁸ See 'Question of Policy 85', 16/4/79, Cambridge, Churchill Archives Centre, the Papers of Sir Adam Ridley, RDLY 2/2/1/13.

¹²⁹ See 'Speaking module –prices', 29/3/79, Cambridge, Churchill Archives Centre, the Papers of Lord Howell, HWLL 2/4/2/1.

If not Prices and Incomes Policy, then what?

Inflation had proved to be the overriding issue for British policymakers throughout the 1970s. In substance, the Conservatives had decided to abandon the key weapon which Governments had deployed to counter inflation since the early 1960s, namely controls over prices and incomes. With what, if anything, were they going to replace it?

Undoubtedly, at a rhetorical level, there was a commitment to monetary discipline. It is tempting to conclude from this that the Conservatives were monetarists, that is to say committed to the belief that strict control of the money supply on its own would ensure the conquest of inflation. However, this is a considerable over-simplification. For one thing, it was not clear that even Friedman was a ‘monetarist’ in this sense. Certainly, he had put forward the concept that ‘inflation is always and everywhere a monetary phenomenon’.¹³⁰ However, his claims for the role of monetary policy were, on analysis, quite modest.¹³¹ Furthermore, it was only at the very edges of the economic discourse that it was argued that monetary policy alone could turn back the inflationary tide.¹³² On the other hand, by the mid-1970s, everyone was a ‘monetarist’, in the sense of believing that strict control of the money supply was necessary to restrain inflation.¹³³ That had been the policy of the Conservatives for the October 1974 election.¹³⁴ The Labour Government, as soon as it had decided that the Social Contract was not working, had pledged ‘to use the full range of instruments available...to keep the growth of the money supply under firm control’.¹³⁵

¹³⁰ Friedman, Milton, *The counter-revolution in monetary theory: first Wincott Memorial Lecture, delivered at Senate House, University of London, 16th September 1970* (London, 1970) at p.24.

¹³¹ Friedman, ‘The role of monetary policy’.

¹³² Certainly, this was Powell’s view: ‘serious and continuing inflation is attributable solely to the financial operations of governments’: Speech to Westminster Chamber of Commerce, 5/9/78, Cambridge, Churchill Archives Centre, the Papers of Enoch Powell, POLL 4/1/12 file 2 of 5.

¹³³ Rather as Nixon had announced that he was ‘now a Keynesian in economics’ in 1971: *New York Times* 7/1/71: <http://select.nytimes.com/gst/abstract.html?res=FA0F15FB3959107B93C5A9178AD85F458785F9&scp=4&sq=nixon&st=p>, accessed 15.9.11. ‘Everyone’ did not include the Left or other advocates of the AES.

¹³⁴ ‘We will rigorously control public spending and the money supply’: Conservative Party, *October 1974 Conservative Party General Election Manifesto* (London, 1974).

¹³⁵ *The Attack on Inflation* (1975), London: HMSO, Cmnd. 6151, para 46.

In this context, the Conservatives enthusiastically embraced the new orthodoxy that control of the money supply was necessary, but not sufficient, to control inflation.¹³⁶ They recognised that monetary policy was part of the ‘battery of weapons’ to control inflation.¹³⁷ However, they were not so naive as to think that monetary policy alone would do the trick. After all, they would have available no different instruments to control the money supply than did the Labour Government which had, indeed, had considerable success in reducing monetary growth, as the Conservatives themselves recognised.¹³⁸ Furthermore, at a detailed level, the Conservatives did not, perhaps could not, put much flesh on the bones of the commitment to ‘strict control by the Government of the rate of growth of the money supply’.¹³⁹ They consulted with sympathetic outside experts like Brian Griffiths.¹⁴⁰ This gave rise to a number of technical questions as to how, as opposed to whether, one could control the money supply.¹⁴¹ A monetary policy sub-group was set up to consider these and other questions.¹⁴² However, there remained uncertainty about the mechanics, of ‘the implications of monetary targets. How far should they “bear down” on the rate of inflation.’¹⁴³ It may be that it was impossible to take these issues much further in Opposition. Ultimately, the Party was left with a somewhat vague aspiration in the monetary field:

...it was impossible to prove conclusively whether the relation between money supply expansion and inflation was one of cause and effect. But there was no doubt that the monetary side of economic policy had been neglected in the past, and that this was a mistake against the repetition of which we should have to guard.¹⁴⁴

¹³⁶ This was how the point was put internally: see Note from Ridley to Howell of 30/6/77 referring to ‘...the consensus which has been agreed...’ between Howe, Joseph and Prior: Cambridge, Churchill Archives Centre, the Papers of Lord Howell, HWLL 2/4/1/1 1977.

¹³⁷ Note Howe to Nott, 4/6/76, Cambridge, Churchill Archives Centre, the Thatcher Papers THCR 2/1/3/9.

¹³⁸ See e.g. Report ACP (74) 14, 10/1/75, which noted at p.5 that ‘the money supply is probably growing sufficiently slowly and there may even be a case for a slight relaxation-’ Oxford, Conservative Party Archive, Bodleian Library, Advisory Committee on Policy (and Political Education) Papers, ACP 3/21.

¹³⁹ Thatcher Speech to Paddington Conservatives (pay policy and unions), 18/12/78, <http://www.margaretthatcher.org/document/103804>, accessed 13/9/11.

¹⁴⁰ See e.g. Minutes of 7th Meeting of ERG, para 2(iv), 30.10.75, Oxford, Conservative Party Archive, Bodleian Library, Conservative Central Office Papers, CRD4/4/26.

¹⁴¹ See Minutes of 12th Meeting of ERG, 11/12/75, para 7, at *ibid*.

¹⁴² See Report PG/10/76/22, 17/5/76, Cambridge, Churchill Archives Centre, the Thatcher Papers THCR 2/6/1/159.

¹⁴³ See e.g. Minutes of 19th Meeting of ERG, 16.12.76, p.2, Oxford, Conservative Party Archive, Bodleian Library, Conservative Central Office Papers, CRD4/4/27.

¹⁴⁴ See Minutes of 12th Meeting of ERG, 11.12.75, para 6, Oxford, Conservative Party Archive, Bodleian Library, Conservative Central Office Papers, CRD4/4/26.

Furthermore, whilst there was some tangential discussion of interest rate policy, there was no indication that this would move to centre stage in the battle against inflation. There was also some mention in passing of the high interest rates that might accompany a ‘sound money’ approach.¹⁴⁵ However, one does not have the impression that this had all been thought through in great detail: ‘...we must learn to live with the fact that if we control the quantity of money more carefully, then its price...will be set in the market place, sometimes at uncomfortable levels. This is easier said than done...’¹⁴⁶ What, certainly, was lacking was any systematic plan for the rationing of money through the interest rate mechanism.

What, then, of unemployment? Once the Conservatives gained power in 1979, unemployment rose rapidly to levels not seen since before the War. Many commentators regarded this as an act of deliberate policy, an abandonment of the Keynesian commitment to full employment.¹⁴⁷ In the present context, this meant that inflation would be eliminated by allowing ‘ “the market” [to] invent its own incomes policy in the form of the dole queue’.¹⁴⁸ Did the Conservatives, in Opposition, set out to construct a set of policies whereby increasing unemployment would be used as a weapon to fight inflation?

The policy background was that, since the War British (and other Western), Governments had aimed to secure broadly full employment. In 1958, Phillips had shown that, over the very long term, ‘the rate of change of money wage rates can be explained by the level of unemployment and the rate of change of unemployment’.¹⁴⁹ The policy conclusion from this discovery was that wage inflation and unemployment could be traded off against one another: a light touch on the tiller from Government, and unemployment might be allowed to rise slightly to reduce inflation, or vice versa.¹⁵⁰ The key point, of course, was that the changes were slight. Politicians, including most Conservatives, ‘totally rejected[ed] a

¹⁴⁵ See ERG Report LCC/76/23, undated but about July 1976, Oxford, Conservative Party Archive, Bodleian Library, Leader's Consultative Committee Papers, LCC 1/3/11.

¹⁴⁶ Howe Paper ACP (76) 3 ‘Economic Policy’, 4/6/76, Oxford, Conservative Party Archive, Bodleian Library, Advisory Committee on Policy (and Political Education) Papers ACP 3/21.

¹⁴⁷ See e.g.: Artis, M.J., and Lewis, M.K., ‘Inflation in the United Kingdom’ in Argy, V.E., and Nevile, J.W., (eds.), *Inflation and unemployment: theory, experience and policy-making* (London, 1985) pp.200-220, at p.213.

¹⁴⁸ *Ibid.* pp. 217/218.

¹⁴⁹ Phillips, A.W., ‘The Relation Between Unemployment and the Rate of Change of Money Wage Rates in the United Kingdom, 1861-1857’, *Economica* Vol.25, (1958) pp.283-299, at p.299.

¹⁵⁰ See e.g.: Artis, and Lewis, ‘Inflation in the United Kingdom’ at pp.213, 217/218.

policy of seeking to cure inflation by the deliberate creation of unemployment'.¹⁵¹ However, confidence in the 'Phillips curve', at least as a tool of economic management, had drastically diminished as inflation rose steadily during the 1970s. According to some economic commentators, Governments, acting with the best of intentions, had managed to deliver high inflation and high unemployment.¹⁵² The apparent policy option of a trade-off between inflation and unemployment was an illusion: 'only an unanticipated accelerating inflation can maintain an unemployment rate below its equilibrium level'.¹⁵³ In parallel with this, the politically possible landscape changed as the electorate came to regard inflation as a greater priority than unemployment.¹⁵⁴

This view – that the 'Phillips curve' was dead as a policy tool – took hold across the political classes with great speed and vigour. Just as 'everyone' was a monetarist by the mid-1970s (the proponents of the AES always excepted), so everyone had lost faith in the idea that Governments could choose, from month to month, between a little more inflation or a slight increase in unemployment. Keith Joseph had led the charge in this respect, but Labour was not far behind.¹⁵⁵ For Joseph, at least, this had certain important consequences. The key point for him was that 'First, it is governments that cause inflation – by creating excess monetary demand. Secondly, it is trade unions that cause unemployment – by insisting on

¹⁵¹ See Paper 'Inflation and Unemployment', LCC/74/33, 10/7/74, submitted to Shadow Cabinet in 1974 by Howell and Higgins, Oxford, Conservative Party Archive, Bodleian Library, Leader's Consultative Committee Papers, LCC 1/3/3.

¹⁵² Friedman, Milton, *Inflation and Unemployment: the New Dimension of Politics* (London: Institute of Economic Affairs, 1977.), at pp.23, 30/31. Of course, many economists did not accept this argument, but they tended to be economists closely associated with the Keynesian / Labour ancien regime: see e.g. Beckerman, W, 'How the Battle Against Inflation Was Really Won,' *Lloyds Bank Review*, January 1985 (155), pp. 1-12.

¹⁵³ Miller, Roger, and Williams, Raburn, *Unemployment and inflation: the new economics of the wage-price spiral* (St. Paul, 1974) at p.58.

¹⁵⁴ Private polling for the Conservatives showed that in January 1972 61% of voters regarded unemployment as the top priority for governments and 34% prices: see ORC Survey 'Attitudes to Economic Affairs, table 1 at Oxford, Conservative Party Archive, Bodleian Library, Conservative Central Office Papers, CCO 180/9/1/7. By September 1975, ORC were reporting that 57% of voters put prices first, compared with 32% for unemployment: 'The British economy: public attitudes and expectations ', Table 2, CCO 180/9/1/8.

¹⁵⁵ See: Joseph, Keith, Speech at Preston, 5.9.74, 'Inflation is Caused by Governments' at <http://www.margarethatcher.org/speeches/displaydocument.asp?docid=110607>, accessed 8.6.10; Callaghan speech 28th September 1976, at the Party Conference, quoted in Dell, Edmund, *A Hard Pounding: Politics and Economic Crisis, 1974-1976*, (Oxford, 1991) at p.236.

wage costs that render us uncompetitive. Thus it is for governments to reduce inflation and trade unions to reduce unemployment.’¹⁵⁶

It followed, therefore, that attempting to curb unemployment through allowing inflation to rise was simply misconceived, as, indeed, was any demand management. The causal connection identified by Phillips did not, therefore, exist. However, it also followed that a higher rate of unemployment could not reduce inflation. Since workers’ demands for wages did not cause inflation, making those demands less vigorous through increased unemployment could not reduce inflation. Whilst one could argue that the Joseph prescription would lead to Governmental indifference to unemployment – because this was a matter for employers and unions to resolve – it is difficult to see that he was contending for the use of unemployment as a disciplinary weapon to reduce inflation.

In any event, Joseph was often at the margins of detailed policymaking. For those at the centre of this process, there were essentially two views, neither of them compatible with the proposition that inflation should be reduced through increased unemployment. Those, like Prior, who had not renounced the post War consensus at all, explicitly contemplated and rejected such a prospect: “No government in a free society...(could) withstand parliamentary and other pressures if unemployment rises to the level that would be required to make monetary policy alone control inflation.’¹⁵⁷ Others, like Howe and Howell, did anticipate that their counter-inflationary policies might involve ‘unprecedented deflation’.¹⁵⁸ However, although rising unemployment, and ‘militant opposition to it’, were contemplated, there seems to have been optimism that this could be resolved through ‘spontaneous job creation’.¹⁵⁹ Overall, the thinking was that if the Government took a firm line on the money supply and public spending, and explained this to the key parties, this would change their behaviour: ‘...Firm control of the money supply would have a critical effect in reducing

¹⁵⁶ Open Letter from Joseph to Callaghan, 1.10.76, Cambridge, Churchill Archives Centre, the Thatcher Papers THCR 2/1/1/37.

¹⁵⁷ ‘Rough Note of Discussion in (sic) Incomes Policy -28th April’,p.2, note prepared by Ridley on 2nd May 1977, Oxford, Conservative Party Archive, Bodleian Library, Conservative Central Office Papers, CRD 4/4/28. See also, Prior’s paper ‘Counter Inflation Policy’, discussed at meeting of Shadow Cabinet LCC (75) 62nd mtg.,14/5/75, Oxford, Conservative Party Archive, Bodleian Library, Leader's Consultative Committee Papers, LCC 1/3/7.

¹⁵⁸ Note by Howe for the ERG, 24/7/75, Cambridge, Churchill Archives Centre, the Thatcher Papers THCR 2/6/1/157.

¹⁵⁹ Minutes of 21st Meeting of ERG, p.1, Oxford, Conservative Party Archive, Bodleian Library, Conservative Central Office Papers, CRD4/4/27.

inflationary expectations, since excessive pay settlements would result in higher unemployment...’¹⁶⁰

Thus, the Conservatives had, by 1979, effectively lost faith in Prices and Incomes Policy. They had found a new creed of strict control of the money supply but they recognised its limitations. What, intriguingly, they had also come to realise was that they might need a little external help to conquer inflation. Howe and Lawson had certainly recognised this by 1990, by which time both had resigned from Thatcher’s last Government. As Howe said in his resignation statement:

Like [Lawson, who had resigned as Chancellor in 1989] I concluded at least five years ago that the conduct of our policy against inflation could no longer rest solely on attempts to measure and control the domestic money supply. We had no doubt that we should be helped in that battle, and, indeed, in other respects, by joining the exchange rate mechanism of the European monetary system.¹⁶¹

The EMS had first emerged as an issue in 1978. In March 1972, the Member States had created the ‘snake in the tunnel’ as a mechanism for managing fluctuations of their currencies (the snake) against the dollar (the tunnel).¹⁶² At Copenhagen in April 1978, they launched a proposal for a new monetary system for Europe which all Member States would join.¹⁶³ In July 1978, at Bremen, the European Council instructed the Finance Ministers to draw up a detailed ‘...scheme for the creation of a closer monetary co-operation (European Monetary System) leading to a zone of monetary stability in Europe...’¹⁶⁴ In December 1978, at Brussels, the Council agreed to establish the EMS.¹⁶⁵ The UK alone did not join. Each currency was allocated a central rate, expressed in terms of the ECU, the European Currency Unit. The ECU was a weighted average of the various currencies.¹⁶⁶ Fluctuation margins of

¹⁶⁰ Meeting to discuss pay bargaining, 15.2.78, Cambridge, Churchill Archives Centre, the Thatcher Papers THCR 2/6/1/96. See also memo by Anne Bulloch, 23/5/77 ‘Unemployment and Concerted Action’, Oxford, Conservative Party Archive, Bodleian Library, Conservative Central Office Papers, CRD4/4/172.

¹⁶¹ HC Deb 13 November 1990 vol 180 cc461-5.

¹⁶² Within two years, the snake had lost many of its component parts and was essentially a German-mark zone comprising Germany, Denmark and the Benelux countries. For a fuller account of these developments, see Ludlow, Peter, *The making of the European monetary system : a case study of the politics of the European Community* (London, 1982) Chapter 1, and Van Ypersele, Jacques, with the collaboration of Koeune, Jean-Claude, *The European monetary system : origins, operation and outlook* (Cambridge, 1985) pp.38-44.

¹⁶³ See Ludlow, *The making of the European monetary system* at pp. 88-94.

¹⁶⁴ Conclusions of the Presidency of the European Council of 6 and 7 July 1978 in Bremen, quoted in Ludlow, *The making of the European monetary system* at p.301.

¹⁶⁵ For full text, see Ludlow, *The making of the European monetary system* at pp. 122-125.

¹⁶⁶ See resolution at Articles 2 and 3.1

2.25% were allowed around the central rate.¹⁶⁷ The December 1978 arrangements were ‘...the initial phase of the EMS...’ with a final system to be developed within two years, including ‘...the creation of the European Monetary Fund...’

An exchange rate mechanism was, at first blush, anathema to a monetarist or economic liberal. Friedman, for example, had argued against the Bretton Woods regime for fixing exchange rates.¹⁶⁸ Powell contended that governments, just as they should renounce all forms of control over wages, should also ‘let the exchange rate go...wherever it wants to go’.¹⁶⁹ Indeed, in the 1970s, with the collapse of the Bretton Woods regime, a freely floating currency appeared to be a central part of the new monetarism.¹⁷⁰ John Biffen put the matter trenchantly: ‘A continuing free exchange rate...is absolutely central to any attempt to construct a liberal-economic policy...’¹⁷¹ Joseph concurred, arguing for a ‘clean float, publishing our money supply guidelines’.¹⁷²

However, other voices suggested that the matter might be more nuanced than a choice of ‘free’ versus ‘fixed’ rates. At an all-day discussion on economic policy in May 1975, the exchange rate was item one on the agenda, and the participants recognised that a ‘free’ rate was not without its problems...’¹⁷³ It was agreed to ‘recognise the necessity for living with a floating exchange rate... because it would be impossible to replace it with any other system in the foreseeable future...it does not solve any of the underlying domestic political problems.’ Subsequently, the ERG noted that floating could create difficulties for companies with long-term projects and that ‘the problems caused by floating exchange rates need further investigation.’¹⁷⁴ In parallel with these discussions, the Conservatives were also considering how to achieve their goals in the field of monetary policy. In practice, of course, this required the participation of the Bank of England and the Treasury. However, there were many in Conservative circles who doubted the abilities of these authorities. For example, Professor

¹⁶⁷ Ibid, Article 3.1.

¹⁶⁸ Friedman, ‘The case for flexible exchange rates’.

¹⁶⁹ See speech in London, 25/10/78, Cambridge, Churchill Archives Centre, the Papers of Enoch Powell, POLL 4/1/12 file 1 of 5.

¹⁷⁰ Congdon, *Monetarism: an essay in definition* at p.2.

¹⁷¹ Letter Biffen to Joseph 5.5.75, Oxford, Conservative Party Archive, Bodleian Library, the Papers of Keith Joseph, KJ 24/1.

¹⁷² Letter Joseph to Adam Ridley 28.2.77, Oxford, Conservative Party Archive, Bodleian Library, the Papers of Keith Joseph, KJ 10/5.

¹⁷³ Notes of an All-day Discussion on Economic Policy held at 61 Fentiman Road, 18.5.75, Oxford, Conservative Party Archive, Bodleian Library, the Papers of Keith Joseph, KJ 10/6.

¹⁷⁴ Minutes of Meeting 17 of the ERG, 17.6.76, Oxford, Conservative Party Archive, Bodleian Library, Conservative Central Office Papers, CRD 4/4/27.

Griffiths, in presenting a paper on monetary policy to the ERG, expressed the view that the Bank ‘...had failed to control the money supply though the reserve asset system’.¹⁷⁵ The outcome of the Bremen European Council meeting in July 1978 quickened interest for the Conservatives. The position of the British Government was decidedly guarded.¹⁷⁶ Thatcher’s stance in the House was non-committal.¹⁷⁷ In the background, however, strong views were being expressed as to the EMS concept. Thatcher received a letter from Nott, urging her ‘...to be exceptionally cautious...’ about Bremen, since ‘...a currency scheme of this kind would place yet another massive constraint on the free market...’¹⁷⁸ Thatcher responded the next day in manuscript:

I share your every doubt and would like to have been very lukewarm indeed about the whole thing. However (Heath had made a speech in favour, so she had not wanted to seem too far apart on Europe)...I therefore welcomed the concept but was very cautious on detail and pointed out that it was no substitute for running our own affairs in a sound financial way...¹⁷⁹

Such views were not isolated. On the same day, Biffen wrote to Thatcher arguing strongly against the Bremen proposals. He made clear that there was a ‘...fundamental question which, I fear, divides the Tory party and the nation...’, namely that what was proposed would lead to ‘...a demand for full monetary union and the cessation of the United Kingdom as a national monetary agency...’¹⁸⁰

¹⁷⁵ Paper of 10.12.75, Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/11/9/2; Minutes of Meeting of ERG (12), 11.12.75, Oxford, Conservative Party Archive, Bodleian Library, Conservative Central Office Papers, CRD 4/4/26.

¹⁷⁶ Reporting to the House of Commons on 10th July 1978, the Prime Minister put the matter thus: ‘The Government have taken the view throughout these discussions that monetary arrangements are not enough by themselves to ensure a zone of monetary stability. Any new system must be one which will last and will take full account of the economic as well as monetary interests of each member of the Community...It will be necessary to judge how far all these matters have been satisfactorily arranged when we are called upon to take a final decision on such new proposals as the Finance Council may put forward’: EUROPEAN COMMUNITY COUNCIL (BREMEN MEETING) HC Deb 10 July 1978 vol 953 Column 1026. See also, on the same day, Treasury off-the-record press briefing on EMS (“not the greatest thing since sliced bread”), <http://www.margarethatcher.org/archive/displaydocument.asp?docid=111586>, accessed 23.6.10, citing FCO30/3865.

¹⁷⁷ Albeit that she took the opportunity to score some political points as to Britain’s economic position: ‘although we welcome the concept of a currency stabilisation scheme, will the Prime Minister agree that no such scheme either will work or could ever be a substitute for running our own economy in a sound financial way...’EUROPEAN COMMUNITY COUNCIL (BREMEN MEETING) HC Deb 10 July 1978 vol 953, Column 1027.

¹⁷⁸ Letter Nott to Thatcher, 10.7.78, Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/1/2/15.

¹⁷⁹ Note on “Tuesday”, presumably Tuesday 11.7.78, at *ibid*.

¹⁸⁰ Biffen to Thatcher, 11.7.78, Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR

In the end, essentially two positions emerged within the Party. The first was the Biffen view of outright opposition. On 30th October, he delivered a speech in London, condemning the scheme. His speech was ‘...directed to those who wish to see the European Community strengthen liberal economics rather than champion greater government intervention...’¹⁸¹ Biffen had supplied a draft to Thatcher a few days beforehand.¹⁸² She responded thanking him for the speech, adding in manuscript ‘It is the best exposition we have had and I am particularly glad that it deals with the big issues...I confess (illegible) the fundamentals worry me greatly...’¹⁸³ Thatcher was also receiving regular confidential advice on financial matters from John Sparrow, a senior merchant banker, which was to similar effect.¹⁸⁴ The majority position, however, was quite different. On balance, Howe, Lawson, Nott and other key figures came down in favour of joining, from a stance of being ‘...neither Eurofanatic nor Europhobe...’¹⁸⁵ The consensus was recorded in a note from Howe to Thatcher of 31st October.¹⁸⁶ Howe identified a number of principles which were subsequently endorsed by the Shadow Cabinet.¹⁸⁷ The key ones were:

1. This is not, and should not be presented as, a straight pro- or anti-European issue.
2. Nor is it a question of making a straight choice between the philosophies of fixed or floating exchange rates.
3. We should pronounce in favour of the EMS – not as...ideal... but...to be welcomed for providing greater currency stability and encouraging convergence of economic policies.

2/1/2/2.

¹⁸¹ Speech of 30.10.78, Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/6/2/65. Thatcher highlighted this passage.

¹⁸² Note Biffen to Thatcher, 25.10.78, Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/1/2/2.

¹⁸³ Note of 27.10.78, Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/1/2/2.

¹⁸⁴ See Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/6/1/242 and 2/6/2/165. Sparrow wrote personally every week or fortnight: it does not appear that this advice was shared with colleagues. He was against joining, since ‘...I do not believe that it will bring any disciplinary advantages that could not be provided internally if there were the will to supply the discipline...’: letter of 20.10.78, Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/6/1/242.

¹⁸⁵ See Lawson’s memo to Thatcher and others of 30.10.78, para 1, Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/1/2/12A.

¹⁸⁶ Memo from Howe on the EMS, 31.10.78, Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/1/1/32.

¹⁸⁷ Meeting of Shadow Cabinet 15.11.78, SC(223), Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR2/6/1/163. Thereafter, these principles were repeated in CRD briefings as if they had statutory force: see Briefing Note of 28.11.78, Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/6/2/65 and Briefing PFC (78) 12, 28.11.78, Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/11/9/11.

4. The political case for this conclusion is a strong one: the alternative means surrendering the direction of the EEC and its policies to the Franco-German high table.¹⁸⁸

The fundamental attraction of the EMS was the belief that the stern men of the Bundesbank would exert a control over monetary policy, and, therefore, inflation, which would simply not be possible if matters were left to the Bank and the Treasury. This reasoning is apparent from the advice given by both Lawson and Howe. The former referred at the 23rd October meeting to ‘...the external discipline that would be impressed on the conduct of UK economic policy...’¹⁸⁹ He also prepared a lengthy memorandum on 30th October, which weighed every conceivable argument before coming down in favour of joining.¹⁹⁰ For Lawson, a key attraction was ‘A greater degree of convergence...towards the German inflation rates, - is clearly desirable. An additional external discipline...that reinforces the sound money policies necessary to achieve such a convergence is also desirable...’¹⁹¹ The same rationale is evident in Howe’s memorandum of 31st October. The EMS would provide a happy marriage of internal and external economic and monetary disciplines, since ‘...Fundamentally, we do believe in German principles of economic management and should be able to get ourselves alongside them...’¹⁹²

By the end of 1978, therefore, minds were made up. The Government had decided to stay out. The Conservatives deprecated this decision, and argued for membership of the EMS. When the Commons debated the matter in November, the Conservative line was clear and reflected the internal discussions set out above. Howe rejected a floating exchange rate, in favour of ‘...a set of rules applying nationally as well as internationally which will be respected...’¹⁹³ The Conservatives were ‘...attracted...to the scheme...it would commit this country to a standard of monetary discipline, including a firm commitment to the elimination of inflation, of a style which has served West Germany well.’¹⁹⁴

The European Council met at Brussels on 4th and 5th December 1978. The

¹⁸⁸ Memo from Howe on the EMS, 31.10.78, Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/1/1/32. Thatcher’s copy of this document, *ibid.*, is heavily underlined and annotated to indicate her disagreement.

¹⁸⁹ Note of Meeting on 25.10.78, Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/1/1/32.

¹⁹⁰ Lawson memo of 30.10.78, ‘The European Monetary System’, Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/1/2/12A.

¹⁹¹ *Ibid.* para 13.

¹⁹² Memo from Howe on the EMS, 31.10.78, Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/1/1/32, p.2.

¹⁹³ EUROPEAN MONETARY SYSTEM HC Deb 29 November 1978 vol 959 column 480.

¹⁹⁴ *Ibid.*

Government revealed its hand, informing the other Member States that it would not be joining the EMS.¹⁹⁵ The Conservatives described this as ‘...a sad day for Europe and for Britain...The Prime Minister...is evidently content to see us relegated to the Community’s Second Division...’¹⁹⁶ Thereafter, the EMS issue moved away from the centre of domestic political debate. Nonetheless, during the campaign leading to the May 1979 election, the Conservatives reiterated their commitment to the EMS.¹⁹⁷ At the same time, they were drafting a Manifesto for the direct elections to the European Parliament due in June 1979.¹⁹⁸ The Manifesto contained a clear commitment to join the system.¹⁹⁹

The EMS episode illustrates Conservative nervousness about the achievability of monetarism in one country.²⁰⁰ Tory motivation to join centred upon a mistrust of the ability of Britain’s monetary authorities to bear down upon inflation, and, above all, a desire for the application of ‘...German principles of economic management...’²⁰¹ However, it also showed that there was a fundamental disagreement at the heart of the Party: could inflation be countered by monetary discipline alone, or was it necessary to substitute one form of control (the exchange rate) for another (prices and wages)?

¹⁹⁵ See statement to House of Commons by the Prime Minister on 6.12.78, Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/6/2/65.

¹⁹⁶ Statement by Howe and Pym, 6.12.78, Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/6/2/65. See also, to similar effect, Thatcher in the House of Commons, EUROPEAN COMMUNITY COUNCIL (BRUSSELS MEETING) HC Deb 06 December 1978 vol 959 cc1424.

¹⁹⁷ See CRD Manifesto Briefing Notes 5.4.79, p.198, Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR1/11/5 and CRD Press Conference briefing notes of 20.4.79, item 5, Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/7/1/51.

¹⁹⁸ See letter from CRD to Thatcher of 2.5.79, Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/7/2/2. A Steering Group was appointed for this purpose: the group was Pym, Whitelaw, Joseph, Maude, Howe, Hurd and Thorneycroft.

¹⁹⁹ ‘MONETARY CO-OPERATION...it...makes sense for the Member States to co-operate more closely in the economic sphere. That is why we regret the Labour Government’s decision – alone amongst the Nine – not to become a full member of the new European Monetary System. We support the objectives of the new system, which are currency stability in Europe and closer co-ordination of national economic policies, and we shall look for ways in which Britain can take her rightful place within it.’ *Conservative Manifesto for Europe*, 1979 (Conservative Central Office, London, May 1979). See also, CRD European Manifesto Briefing Notes 15/5/79, item 24, Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/7/2/2.

²⁰⁰ Ironically, within a very short time, membership of the EMS was to be a rallying cry for those who entirely rejected ‘Thatcherism’: see CRD Internal note on Ian Gilmour’s “Alternative Economic Strategy”, 8.10.81, Oxford, Conservative Party Archive, Bodleian Library, Conservative Central Office Papers, CRD 4/4/30. Gilmour put forward a six-point strategy, of which one point was to join the EMS immediately.

²⁰¹ Memo from Howe on the EMS, 31.10.78, Cambridge, Churchill Archives Centre, the Thatcher Papers, THCR 2/1/1/32, p.2.

Conclusions

Throughout the 1960s and 1970s, policymakers of both parties sought to deal with inflation through Prices and Incomes Policy. They believed that it was both possible and desirable to control wages and prices. Events during the 1970s, in particular, made many doubt whether such policies were, in fact, effective in reducing the rate of inflation. These doubters were, by 1979, probably in a majority in the Conservative Party. However, such had been the centrality of these policies that the Party was cautious in its public pronouncements. It appeared counter-intuitive, and electorally dangerous, to renounce what had been the principal weapon against rising prices at a time of unprecedented inflation. Moreover, there were many within the Party who now doubted whether it was desirable to implement such controls, even if they could somehow be made effective. Prices and Incomes Policy proceeded from the premise that one should substitute for the judgement of the market a fairer and more rational distribution. To Aubrey Jones, it was the answer to the question ‘how does one render acceptable inevitable inequalities in income?’²⁰² But some - and certainly many of his former Conservative colleagues - were not sure that this was even a question worth asking.

There was less clarity as to what, if anything, would be put in place of Prices and Incomes Policy. Certainly, the Conservatives subscribed enthusiastically to the new orthodoxy that strict control of the money supply was necessary. However, many recognised that this might not be enough, on its own, to conquer inflation. It was hoped, but in rather vague terms, that frank explanation of the Government’s economic policies might induce a change in behaviour, but there was little attempt to flesh out this idea. What was left was a chasm between those like Friedman, Powell, and Thatcher who rejected the case for any controls at all, and the Howe/Lawson view that tying the exchange rate to (in effect) the Deutschmark would provide the necessary support to internal monetary discipline. This issue was, in due course, to divide the Thatcher Governments of the 1980s.

However, we should not get ahead of ourselves. The renunciation of wage and price controls, in however muffled a fashion, was a significant moment. It was a strong indication

²⁰² See article in *The Observer*, 20/3/77, p.14. The Chairman of the National Board for Prices and Incomes, throughout its life from 1965 to 1970, was Aubrey Jones, who had served as a Minister under Macmillan. He emerged from his NBPI experience convinced that ‘the creation of the (NBPI) was an inevitable outcome of historical trends made manifest’: Jones, Aubrey, *The new inflation: the politics of prices and incomes* (London, 1973) at p.52.

of a much less interventionist approach to economic policymaking.²⁰³ From now onwards pay would reflect individual performance, rather than notions of collective fairness.²⁰⁴ As a prophetic member of the Number 10 Policy Unit observed in October 1978, ‘...sooner or later the British Trade Union Movement will have to face the fact that it can have an incomes policy and social justice or it can have no social justice and no incomes policy; but what it cannot have is social justice with no policy...’²⁰⁵

²⁰³ As to what lay ahead, see Deakin, Simon, Michie, Jonathan, and Wilkinson, Frank, *Inflation, employment, wage-bargaining and the law* (London, 1992) pp.23-33.

²⁰⁴ See Greenhill, Richard, *Performance related pay for the 1990s: pay policy, benefits, rewards, profit sharing, profit-related pay share, incentive schemes* 2nd ed. (Cambridge, 1990). In fact, legislation to encourage such arrangements began with (Labour’s) Finance Act 1978: *ibid.* pp. xvii/xviii.

²⁰⁵ Memo David Lipsey to Donoughue and others, 5/10/78, Cambridge, Churchill Archives Centre, the Papers of Lord Donoughue, DNGH 1/1/26.