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The Labour Government, the Treasury and the £6 pay policy of July 1975

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Abstract

The 1974-79 Labour Government was elected in a climate of opinion that was fiercely opposed to government intervention in the wage determination process, and was committed to the principles of free collective bargaining in its manifestoes. However, by December 1974 the Treasury was advocating a formal incomes policy, and by July 1975 the government had introduced a £6 flat rate pay norm. With reference to archival sources, the paper demonstrates that TUC and Labour Party opposition to incomes policy was reconciled with the Treasury's advocacy by limiting the Bank of England's intervention in the foreign exchange market when sterling came under pressure. This both helped to achieve the Treasury's objective of improving the competitiveness of British industry, and acted as a catalyst for the introduction of incomes policy because the slide could be attributed to a lack of market confidence in British counter-inflation policy.

*Note on sources: Where primary documents are obviously paginated, as in the case of committee minutes and memoranda, page numbers are included in the references. Page numbers are not included in the references where there is no obvious pagination in the original.

Introduction

The 1974-79 Labour Government was elected in a climate of opinion that was fiercely opposed to government intervention in the wage determination process and was highly dependent on the fiercest critics of incomes policy, the TUC, for its electoral support. In recognition of this context, the Labour Party's manifesto pledges in both February and October were sensitive to the demands of the TUC and based on an agreement known as the Social Contract. However, within eighteen months of its election in February 1974, the Labour Government had abandoned its commitment to voluntarism in collective bargaining and successfully negotiated a £6 per week flat rate pay increase with the TUC. Significantly, it was able to do this without provoking the widespread discontent that had met the third phase of Edward Heath's counter inflation policies in 1974 that had provoked the miners' strike, forced Britain onto a three-day week, and ultimately led to the defeat of the Conservative

Government on the issue of 'who governs Britain?' With reference to material from the National Archives, this article charts the re-orientation of counter inflation policy in the United Kingdom after the election of the Labour Government. It demonstrates how the Treasury was able to reconcile the objections of the TUC and the Labour Party with its own strong preference for incomes policy by adopting a policy of parsimonious intervention in the foreign exchanges. This involved a refusal to intervene decisively in the foreign exchange market to ease market pressure on sterling, assisting the achievement of a desired improvement in the competitive position of British industry and creating an impression of crisis that made it possible for the government to link the issue of sterling weakness with a lack of market confidence in British counter-inflationary policy. On this basis it was possible for the government to argue that a new incomes policy was absolutely necessary to reverse the decline in the rate. Therefore, while the Treasury's preference for incomes policy in this period is widely known, interpretations that have explained the introduction of the £6 pay policy as the product of market discipline or 'the convergence of interests of a small number of personalities for a limited period of time [that] allowed these "agents" to overcome the obstacles inherent within Britain's industrial relations institutions for a short period of time' (Buller and Flinders, 2005, 535), understate the coherence of British economic strategy in this episode. In contrast, this paper shows how exchange rate strategy and counter-inflation strategy were coordinated to help improve the competiveness of British industry and reduce the rate of inflation simultaneously by presenting a fall in the exchange rate that was part of economic strategy as an economic crisis. This introduction of the £6 pay policy therefore demonstrates the way in which the appearance of market discipline can assist governments in attempts to implement potentially unpopular measures by helping to ‘render the otherwise contingent necessary’ (Watson and Hay, 2003, 290).

Labour’s Economic Programme and the Treasury View

The keystone of the Labour Government’s rhetoric in the run up to the 1974 general elections was the Social Contract, which was a product of a rekindled relationship with the TUC and the meetings of the TUC / Labour Party Liaison Committee. The key document emerging from these meetings was *Economic Policy and the Cost of Living,* which called for statutory measures to control food prices as one element of a system of wide-ranging price controls, the redistribution of incomes and wealth, and a prompt return to voluntary collective bargaining (TUC / Labour Party Liaison Committee, 1973, 313-315). It has been common to view *Economic Policy and the Cost of Living,* on which the Social Contract was based, as representing a *quid pro quo* between the trade unions and the government (Harmon, 1997, 56), or a ‘deal in which the unions would support the Government’s attempts to fight inflation by curbing their wage demands [in return for] favourable industrial policy, unemployment relief and structural modernization’ (Koelble, 1987, 257). It has been noted that ‘no specific commitment to incomes policy was included in this document’ which is significant because it reflects the extent of ‘trade union wariness of such policies’ (Tarling and Wilkinson, 1977, 395).

These understandings of the Social Contract have led to analyses of the £6 pay policy that emphasise the role that external factors had in limiting the choices of the Labour Government in 1975. By comparing policy outcomes with commitments made by the Labour Party whilst in opposition it has been suggested that market pressure on sterling forced the government to implement an incomes policy despite the trade unions' and the Labour Party's objections to it in principle. David Coates (1980), for instance, explains the Labour Government's general departure from its manifesto commitments in terms of the government's dependence on those outside the British state, including international financiers. He notes that 'the Government's tragedy was to discover how incompatible the search for social justice was to be with the requirements of significantly placed groupings both inside and outside Britain' (ibid, 16), and goes on to argue that as inflation persisted 'it soon became obvious that the heady optimism about the social contract in the years of opposition had rested on an inadequate recognition of the degree to which determinants of rates of inflation, levels of employment, and standards of living lay beyond the control of the Government' (ibid, 24). Harmon (1997, 101), likewise notes that 'downward pressure on the pound had created a growing sense of urgency on the Government to take measures that would "restore confidence"', and that these measures included the introduction of 'a tougher "voluntary" incomes policy [that] sharply limited wage increases' (ibid, 101).

Such accounts however, fail to account for the fact that government policy is not simply a reflection of the principles and preferences of the party in office and agreements it makes with its supporters, but reflects a more complex matrix of interests within the state. Policy is also considered and shaped by a number of officials from the civil service with their own ideas and interpretations of the feasible and the practical, especially, in this instance, the Treasury. As a result, the application of such a narrow principal actor focus tends to emphasise the extent of change on the basis of a simple comparison between manifesto commitments and policy outcomes in a way that ignores the strategic preferences of the government more broadly defined. This, in turn, tends to reinforce the simplistic view that events in the foreign exchange markets in the summer of 1975 forced the Labour Government to introduce incomes policy when it otherwise would not have done. By including the preferences of the Treasury in the analysis, it is possible to see that there was a range of views on incomes policy within the British state, including those of the Treasury, which were strongly in favour of the early adoption of a formal incomes policy and needed to be reconciled with the opposition of the trade unions and the Labour Party.

The Treasury view was informed by the fact that government was faced with a large disequilibrium in the balance of payments, which stood in deficit of £3.3 billion when it was elected in February 1974 (Central Statistical Office, 1977, 46). In the longer-term, this meant that British resources would have to be directed into exports, and that the government would need to secure medium-term financing in order to cover its deficits until North Sea Oil came on-stream. This strategy was in turn dependent on overseas confidence in sterling, which was lacking in light of the fact that the Retail Price Index stood at 12.8 per cent in the first quarter of 1974, and had been increasing steadily (Central Statistical Office, 1976, 96-7). These factors meant that the desirability of pursuing an informal approach to incomes restraint would threaten confidence and undermine the possibility of correcting the problems that have led Healey (2006, 392) to describe his inheritance as 'an economy on the brink of collapse'.

Edmund Dell (1996, 410) notes that during the period between February and October 1974 when the Labour Government's electoral position had been especially weak, the Treasury had been politically sensitive with regards to the kind of policies that would be acceptable with the electorate, but that by October 1974, officials 'had at last concluded that existing policies were not sustainable'. The most explicit expression of this view was made in a paper written by the Permanent Secretary of the Treasury, Sir Douglas Wass, informing the Chancellor that 'we have *no alternative* but to attempt once more to break into the wage / price spiral by laying down a norm for the rate of pay increases' (TNA T 277/3053, PCC (74) 4, 20 December 1974, 2, my emphasis) in order to combat inflation, and that 'there is no longer any official support for existing policies' (ibid, p. 5). Just two months after the general election, therefore, the key institution in the government's economic policy making apparatus was advocating the rejection of the very essence of the Social Contract on which the Labour Party's recent electoral success had been based. In light of the TUC's and the Labour Party's distaste for incomes policy, its principal concern in the debate over re-introducing a norm for the rate of pay increases was how to overcome the domestic political objections that would undoubtedly emerge. On this matter Wass noted that the Chancellor 'may feel that it is politically out of the question for him to embrace the recommendations […] put forward', but that he 'now believe[d] that the economic costs of clinging to the existing policy outweigh the political costs of abandoning it' (ibid, 5).

The level of pay norm the Treasury aimed for was keenly aware of these political constraints, and set at 10 per cent, a figure based on 'the rather arbitrary assumption of the minimum that would stand any chance of acceptance' (Wass, 2008, 105). The difficulty was that whilst the view that the achievement of a 10 per cent pay norm was absolutely necessary if Britain was to be able to continue financing its balance of payments deficit in the medium term was not disputed at the political level, the Treasury was alone in believing that there was no prospect of this being achieved within the framework of a purely voluntary, no-norm policy (TNA T 338/314, Posner to Hopkin, 15 January). Wass informed the Treasury Policy Co-ordinating

Committee (PCC) in February that even though the Chancellor was concerned about the rate of inflation, he 'remained extremely sceptical about the efficacy of a policy change which involves a departure from the Social Contract' (TNA T 277/3054, PCC (75) 33 (revise) 26 February 1975, 1), and the Prime Minister was of a similar view. He informed Cabinet that because of the political difficulties of imposing a formal incomes policy, government leadership should remain the basis of incomes restraint as part of attempts to ensure that 'the TUC guidelines should be honoured in the spirit as well as the letter' (TNA CAB 128/56, CC (75) 10th Conclusions, 27 February 1975, 3), reflecting the fact that he had informed Healey that he would support him 'in anything [he] wanted – except a statutory incomes policy' (Healey, 2006, 394).

However, these political barriers to incomes policy – the need to reconcile the views of the labour movement, the Labour Party and the Treasury – were not insurmountable. Wass had noted in December that his recommendation may be acceptable in the event of an 'external crisis that would justify it' (TNA T 277/3050, PCC (74) 4, 20 December 1974, 5), suggesting that he believed political objections could be overcome if there was a fall in the exchange rate that could be attributed to a lack of market confidence in British counter-inflationary strategy. This would help to depoliticise the issue of incomes policy by providing a highly visible justification for intervention in the wage determination process. In this respect, the Treasury's proposed strategy reflected the proposition that governments can attempt to depoliticise certain aspects of policy by presenting them publicly as being 'beyond the scope of politics or the capacity for state control' (Flinders and Buller, 2006, 307). Such a strategy was feasible in light of the fact that sterling had shown periodic weakness, and desirable both because of the improvement in the competitive position of British industry that would result from depreciation, and the fact that the adoption of a decisive counter-inflation policy would appear to be absolutely necessary if a full-scale run on the pound was to be avoided.

Like inflation, the competitive position of British industry had proved to be a long-standing problem for British policy makers, and within the Treasury it was noted that ‘the classic way to improve export prices is of course to depreciate one’s currency’ (TNA T 277/3054, PCC (75) 33 (revise) 26 February 1975, 3). As such there was considerable official discussion about the practical implications of achieving a depreciation of sterling and the desirable extent of any change in the rate. In preparation of the April Budget, it was suggested that it might be desirable to try and affect a 20 per cent depreciation of sterling, however whilst one official in the Overseas Finance Division noted that an announcement ‘that the authorities would no longer intervene to buy sterling at a rate above, say, $1.90 would quickly trigger a depreciation to about that level’, it was also noted that such a strategy would both be imprecise and make the government appear to be directly responsible for the erosion of £5 billion worth of official reserves and £2.5 billion private holdings (TNA T 358/207, Walker to Barratt, 11 March 1975). More importantly from the point of view of the domestic counter inflation strategy, any depreciation that could be directly attributed to the government would create further barriers to the realisation of a credible incomes policy by placing strain on the wage bargaining process because of the inflationary impact of depreciation (ibid, 1). Furthermore, the international community was likely to see a depreciation of this extent as ‘going well beyond what was required in order to restore competitiveness’, and as such the step could well become ‘the first link in a chain reaction of possible competitive depreciations’ (TNA T 277/3055, PCC (75) 41, 13 March 1975, 4).

However, despite the practical difficulties of achieving a depreciation under the floating rate system, it is possible to see that the Treasury both had strong preferences for the early introduction of an incomes policy, and had identified a feasible strategy that would help to bring the views of the sceptical labour movement and Labour Party on incomes policy into line with its own. Far from being a constraint on policy making therefore, it was believed within the Treasury that market pressure on sterling was desirable because it could play an important role in altering expectations about what constituted a necessary and sufficient counter-inflation strategy, thereby helping to foster Party and union support for incomes policy whilst simultaneously helping the competitive position of British industry.

The Sterling Exchange Rate and the £6 Pay Policy of July 1975

Between 13 December 1974 and 24 January 1975 the Bank of England had spent $377 million of the foreign reserves on the exchange markets in support of sterling (TNA T 358/207, Hedley-Miller to Folger, 24 January 1975) in order to stabilise the dollar spot rate at $2.38. However, pressure on the rate was expected to re-emerge in advance of the spring Budget as market actors speculated on the likelihood of it containing decisive measures to tackle inflation. Transactions made by one middle-Eastern sterling holder at the beginning of April saw the pound slide to $2.37, prompting the Treasury to authorise the Bank of England to use up to $80 million for reserve switching operations (TNA T 358/207, Note for the Record, 7 April 1975; TNA T 358/207, Note for the Record, 8 April 1975).

The limited extent of the funds authorised for use in this way stemmed directly from the fact that it was the government's intention to secure a sterling depreciation in the region of 10 per cent over the coming year by relying on market pressure 'so that the main responsibility for depreciation is seen to lie elsewhere than with HMG' (TNA T 358/207, Walker to Mitchell, 11 April 1975). When pressure on sterling re-emerged on 22 April, in response to the Governor of the Bank of England's request for $200 million to help stop the slide, the Treasury made the point that because 'it is indeed our policy to get the rate down […] we ought not to slog away spending money to try and stop this happening' (TNA T 358/207, Barratt to Wass, 22 April 1975). It was the Treasury's view that there was no particular critical floor for the sterling exchange rate, and the head of Overseas Finance, Sir Derek Mitchell, noted that he did not regard '23 per cent [below Smithsonian] as a break-through to be avoided, particularly if this was going to involve substantial intervention' (TNA T 358/207, Mitchell to Hedley-Miller, 25 April 1975), making the case that any attempt to intervene substantially would put the reserves under unjustified strain given the overriding preference for devaluation (TNA T 358/208, Note of a Meeting, 5 May 1975). Sir Douglass Wass likewise noted that in his view, 'there need not be a commitment to massive intervention when [sterling] reached a particular level' (ibid).

The prevailing exchange rate strategy can therefore be described as one of 'parsimonious intervention' or of 'benign neglect', and whilst the Treasury had not instigated the slide in the pound, it made no decisive attempt to stop it both because depreciation was a central feature of medium-term economic strategy for the balance of payments and because its association with a lack of market confidence appeared to limit the range of options available to policy makers in the field of counter-inflation. This helped to legitimise the Treasury's preferences for incomes policy despite the overt hostility of the labour movement and the Labour Party to formal government involvement in wage determination, a process that gathered apace through the spring of 1975 as the Treasury had predicted. Over two days in the second week of May, the Bank used $313 million in support of the rate (TNA T 358/208, Note for the Record, 13 May 1975), and between April and June, the Bank's market intervention had come at a cost to the reserves of £641 million, with the end month total falling from £7,132 million to £6,491 million (TNA T 354/416, Reserves Objectives, 11 August 1975). During this period, sterling's dollar spot rate had slipped from $2.38 to $2.22 (Bank of England, 1975, Table 27), and whilst this was still short of the 10 per cent depreciation advocated within the Treasury, it began to argue that there was no end in sight to the market's scepticism about sterling resulting from the absence of a decisive counter inflation policy, even though it had made no decisive effort to halt the slide with substantial intervention in the foreign exchange markets.

In the second week of June, this argument was made explicitly in a note to the Permanent Secretary that argued:

> There has developed an expectation that the Government is 'going to act'. For as long as this expectation is disappointed, 25 per cent [below Smithsonian] will not be regarded by outside observers and operators as sustainable. If the exchange rate accordingly is going to be pulled down by market forces, mere money, as opposed to policy change, will not succeed in offering a sufficient opposing force (TNA T 358/208, Hedley-Miller to Wass, 11 June 1975).

The legitimacy and voracity of this argument was strengthened by the statements of external actors, and the impression of an urgent need to act was reinforced in light of the Kuwaiti and Saudi Arabian monetary authorities indication that sterling's decline was approaching the limit of their tolerances, and that they would substantially diversify their sterling holdings if the rate fell below $2.20 (TNA T 277/3056, PCC (75) 65, 18 June 1975, cover note; Burk and Cairncross, 1992, 26).

In the context of the sliding pound this argument for action on incomes carried a significant degree of resonance at the political level, helping to convince staunch political opposition that the principle of pure voluntarism entrenched in the Social

Contract was unsustainable, even in the short-run. Most importantly, the Chancellor was convinced that the case for formal intervention in the wage determination process should be put to Cabinet even though his Treasury, whilst not complicit in causing the slide, had clearly acquiesced in its occurrence. On 12 June Healey informed his colleagues that the present weakness in sterling was occurring ‘against a background where British wage settlements were being made at four times the level of settlements in West Germany, and where British inflation was likely to run at more than double the level of settlements in our principal competitor countries’ (TNA CAB 128/56, CC (75) 27th Conclusions, 12 June 1975, 4-5). By making an explicit link between the level of wage settlements, the rate of inflation and the performance of sterling on the foreign exchange markets, the Chancellor argued that ‘there was an urgent need for a new incomes policy’ (ibid, 5) in an attempt to convince other Cabinet members that there was no alternative to the incomes policy that the Treasury had desired since December 1974 if sterling was not to be fundamentally weakened and the level of the foreign reserves was not to be dangerously undermined.

Whilst Healey was convinced of the need for decisive action as a result of the slide in the exchange rate, others in the Cabinet required more persuasion, and Wass (2008, 112) recalls that even as pressure on sterling and the foreign reserves grew, Michael Foot ‘nailed his colours to the mast of the TUC guidelines’. However, events on the exchange markets had contributed to a softening of opinion on incomes policy within the TUC, and whilst some union leaders, including Jack Jones of the Transport and General Workers’ Union, and Hugh Scanlon of the Amalgamated Union of Engineering Workers, were concerned about committing themselves to a policy that they would not be able to deliver (see TNA PREM 16/342, Note of a Meeting, 20 June 1975), the government had been engaged in productive discussions with the TUC on incomes policy since the beginning of June, when Denis Healey and Michael Foot had met with the General Secretary of the TUC, Len Murray, about the possibilities of reducing inflation to 15 per cent through the application of either a percentage norm, a flat rate, or a threshold system (TNA PREM 16/342, 'Future Pay Policy – Mr. Murray's Initiative, 4 June 1975). Meanwhile, in the Downing Street Policy Unit, headed by Bernard Donoughue, there was an ongoing consideration of the form a potential incomes policy should take. Joe Haines, the Downing Street Press Officer, had made the case that for the purpose of acceptability an incomes policy would need to be simple so that everybody could understand its implications clearly. As such, he favoured a flat rate system, on the grounds that everybody 'would understand what they could buy with £5 or £6' (Donoughue, 1987, 63).

By 19 June however, the Cabinet Secretary, Sir John Hunt, was referring to the £6 flat rate formula as the 'Jack Jones formula' (TNA PREM 16/342, Hunt to Wilson, 19 June 1975) in his briefs for the Prime Minister, indicating that there was a significant degree of co-operation with trade unionists, and even initiative on their part, in the search for an acceptable incomes policy solution. Nevertheless, when Healey put his case to the TUC decisively in a meeting on 20 June, arguing that it was absolutely essential for a 10 per cent wage norm to be applied and adhered to if confidence in sterling was to be restored and a run on the pound avoided (TNA PREM 16/342, Note of a Meeting, 20 June 1975), the TUC was responsive in a manner that was simultaneously sympathetic and pessimistic. Scanlon argued that neither the TUC nor the CBI had the power to ensure that a wages policy of this severity would be adhered to, and that from his own union's perspective, he 'could not go along with anything that implied a reduction in the standard of living of [his union's] members' (ibid). Jones also expressed doubts that it would be possible to achieve a norm of anything lower than 20 per cent (ibid).

As the prospect of reaching a sufficient agreement on pay with the trade unions looked to be stalling on practical grounds, despite the fact that the Treasury and the Labour Government had between them been able to negotiate objections on principle because of sterling's apparent weakness, events on the foreign exchange markets at the end of June once again helped the government to negotiate obstacles to the implementation of a credible pay norm. On 30 June sterling fell four cents against the dollar, breaking the threshold that the Kuwaiti and Saudi Arabian monetary authorities had identified as the limit of their tolerances and settling at $2.18. This immediately prompted Derek Mitchell to advise that the government should prepare to make 'a very early announcement of incomes policy' (TNA T 358/209, Note of a Meeting, 30 June 1975), and discussion at a ministerial level was scheduled for Cabinet on the following day.

The view in the Downing Street Policy Unit was that the Cabinet was 'being faced with an attempt by the Treasury to stampede it into a statutory pay policy against every pledge we have given', a view which was reinforced 'by the knowledge that no money at all was spent in defence of the pound on Monday' (TNA PREM 16/843, Donoughue and Haines to Wilson, 1 July 1975). These concerns however, did not resonate with the Cabinet, which was convinced by the need for early action by sterling's weakness even though the Treasury had clearly allowed it to develop by severely limiting the Bank's ability to intervene in support of the rate when pressure emerged throughout the spring. It was agreed at the meeting that the Chancellor should address the House of Commons on the afternoon of 1 July expressing the government's determination to get inflation down to 10 per cent by the third quarter, and that if this could not be achieved by voluntary means, the government would be prepared to legislate (TNA CAB 128/57, CC (75) 31st Conclusions, 1 July 1975, 6-7).

The Chancellor's statement had the desired effect on the market, stabilising the rate, which remained in a band between $2.17 and $2.20 throughout July (Bank of England, 1975, Table 27), and freeing the government to spend the remainder of the summer working out the precise details of the incomes policy which culminated in the acceptance of the £6 flat rate (Donoughue, 1987, 67). Donoughue (ibid, 67) recalls that with the Chancellor's statement on 1 July 'the famous Treasury "bounce" technique had been launched with the Bank of England as a powerful ally', however archival evidence makes it clear that the Treasury did not 'bounce' the Cabinet towards incomes policy in a knee-jerk reaction to a sterling crisis, but that it used its exchange rate strategy in a sophisticated way in order to overcome the political objections to incomes policy that were expressed by the TUC and elements of the Labour Party, whilst simultaneously assisting the balance of payments by improving the competitiveness of British industry.

Conclusions

During the 1974-79 Labour Government there were a number of conflicts of interest within the British state that were reflected in the TUC's antipathy to government intervention in the wage determination process, the Labour Party's dependence on its members for electoral support, and the Treasury's belief that a formal incomes policy was absolutely essential if the government was to be able to continue financing its balance of payments deficit in the medium-term until North Sea Oil came on stream. However, identifying the potential of financial markets to discipline national governments with currency speculation until policies deemed necessary and sufficient are in place does not accurately capture the dynamic of how changes in the United Kingdom's counter inflation policy occurred in 1975. The same can be said of attempts to explain the £6 pay policy in terms of the temporary convergence of the views of key actors for a short period of time, and those that emphasise the role of Treasury subterfuge. Rather, it is the case that two fundamental features of British economic strategy were coordinated in order to reinforce one another; weakness in the pound sterling, whilst originating in light of the government's apparent reluctance to act decisively on the issue of inflation, did not force a reluctant government into the application of the £6 pay norm in July against its wishes. Rather, sterling weakness was convenient for the government in two ways. Firstly, the depreciation helped to improve the competitiveness of British industry and was therefore inherently desirable for the medium-term balance of payments position. But secondly and most significantly, acquiescence to weakness in the pound on the part of the Treasury helped to create an impression of crisis that contributed to the reconciliation of the labour movement and left-wing elements of the Labour Party to the necessity of an incomes policy, which the Treasury had been advocating since December 1974. As Burnham (2001, 135) notes, it is appropriate to think of market forces 'as providing the strongest possible justification governments can muster for maintaining downward pressure on wages to combat inflation' as part of a process through which governments can use the logic of markets to help to 'restructure (that is, lower) expectations' (ibid, 147). In this way, the Treasury's exchange rate strategy, executed by and attributed to independent market forces, played a significant role in reconciling the preferences of divergent actors within the United Kingdom, and allowed the government to implement the £6 pay policy in July 1975 without provoking the kind of political backlash that befell the previous administration in its attempts to implement similar policies.

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