MARTIN HOLMES

THE LABOUR GOVERNMENT, 1974-79

POLITICAL AIMS AND ECONOMIC REALITY

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CHAPTER I

The Short Parliament

WILSON'S DUAL INHERITANCE

It is not an exaggeration to claim that no post-war Prime Minister took office in more difficult circumstances than Harold Wilson on 4 March 1974. Apart from heading the first minority Labour Government since 1931 – with the consequent necessity of another general election in a short period of time – Wilson's inheritance was a dual one. Firstly, he inherited an appalling economic situation partly created by the policies of the 1970–4[1] Heath Government and partly inflicted externally by the world oil crisis. Secondly he inherited a Labour Party which in opposition had moved further leftwards than Wilson had hoped, and which, now in office, expected immediate radical socialist solutions. Put bluntly Wilson had to keep his party together as party leader as well as attending to prime ministerial policy determination in relation to the economic situation.

Wilson's Cabinet reflected his task of balancing left and right in the party. Michael Foot, whose career had seemed destined to end as a backbench voice of conscience on the left, was made Employment Minister. Tony Benn was appointed Industry Secretary, a crucial portfolio for the left, though in Mr Benn's case his move leftwards in the party had been comparatively recent and at a late stage in his ministerial career. Barbara Castle, who had retained her left-wing credentials after the *In Place of Strife* debacle of the late 1960s, was the Social Services Secretary. The left was therefore well represented in comparison to previous Labour Cabinets and had the added advantage of greatly increased support in the party and trade union movement as a whole. Thus Wilson later recalled that 'Foot was good Cabinet material, and he did a great job with the unions. When I told the union leaders Michael Foot was Secretary of State for Employment, Jack Jones had a broad grin on his face.'[2]

However many of the figures of stature and considerable ministerial experience in the Cabinet were on the right. Roy Jenkins returned to the Home Office, Tony Crosland was made Environment Secretary, Denis Healey became Chancellor, despite being an unimpressive Shadow Chancellor, and Reg Prentice was appointed Education Secretary. The rest of the Cabinet, including Foreign Secretary James Callaghan, were considered to be in the centre, though with hindsight, centre–right would be more accurate.

Wilson's task in moulding a collective will – in accordance with the traditional doctrine of collective Cabinet responsibility – was therefore made more difficult simply because he had to include a left–right balance. Whilst this arrangement was a strength in terms of internal Labour Party politics it was arguably a weakness in policy formation.

One cabinet minister recalled that:

> Wilson's main purpose was to keep the Labour Party together. The Cabinet reflected the divisions in the party and Wilson would give us lectures on the need to speak with one voice.
>
> 74–6 was a strong Cabinet of individual talents but it didn't pull together. It reflected the contradictions within the party. You could divide the Cabinet into three. The right – Jenkins, Lever, myself, sometimes Mason and Shepherd; the left – Benn, Foot, Barbara [Castle], Shore on some issues, and later Booth and Silkin. The soggy centre did what the PM decided, waiting to see which way the wind was blowing.[3]

Both aspects of Wilson's dual inheritance fed upon each other. For whilst the economic inheritance demanded tough measures, as was the case in all Western economies, the party's move leftwards reflected in the February 1974 election manifesto commitments, was essentially geared to economic circumstances intrinsically more favourable in terms of economic growth. The Cabinet battles and party disputes described by Harold Wilson[4] and Barbara Castle[5] could not escape from this central dichotomy.

In March 1974 the most immediate aspects of Wilson's dual legacy were dominated by the economic situation. The country was still on the three-day week imposed by Mr Heath; inflation was accelerating with wage rate rises up to 20 per cent;

unemployment was the highest since 1940; public expenditure was out of control and the balance of payments in chronic deficit. Mr Wilson could be blamed for none of these figures. Indeed Wilson is right to stress the serious balance of payments crises which had confronted him on both occasions he took office from the Conservatives. In mentioning the dimension of the balance of payments inheritance Wilson has argued, rightly, that:

> It seems to be almost a law of British politics that when Labour becomes the Government, we inherit a record balance-of-payments deficit, and, equally, that we bequeath a record surplus when we go out of office.
>
> In 1964 the out-turn for the year was a deficit of £356 million, the fourth quarter running at a rate close to £600 million. When we left office in 1970, we left a surplus for the year of £695 million which rose to £1,058 million in 1971, an all-time record. In the concluding months of 1973 the worsening of the overseas trade and payments figures had already led to emergency measures by the Conservative Chancellor of the Exchequer. The final figure for the year was a deficit of £909 million, which rose to £3·537 million in 1974. But the underlying trend, influenced of course by monetary movements, some of them speculative, was already disastrous before the end of 1973. Calculations by the Treasury showed that in the fourth quarter of 1973 the deficit was running at a rate of £4,000 million: of this only £90 million were accounted for by payments on high-priced oil. Thus the basic figures, disregarding oil, were by far the worst since trade and payments figures were first officially collected in 1822.[6]

This balance of payments legacy and the consequent problems of financing the external deficit were to bedevil the whole 1974–9 period of Labour administration. What made the problem worse was that the left was initially oblivious to it and it was not until 1976 that an 'alternative strategy' emerged with which the left could establish alternative policies that recognised the external constraints on the British economy.

The Wilson Government's first priority in dealing with the economic legacy was to solve the dispute with the miners and return the country to a full working week. Wilson later recalled that 'I came in with a State of Emergency – it was almost illegal to put a kettle on in a factory.'[7] Within two days of taking office the dispute was settled conceding the miners 29 per cent, more than they had expected when in July 1973 they put in for a 25 per cent increase.[8] Similarly the State of Emergency, which had lasted almost three months was ended and the three-day week abandoned. However Barbara Castle noted that even at the first real Cabinet meeting of the new government Michael Foot warned that the miners' settlement didn't mean that 'we had abandoned Stage III of Heath's incomes policy. That must stay until he had negotiated the basis of a voluntary agreement with the T.U.C., otherwise the flood-gates would be opened.'[9] Like the external payments problem, that of pay policy was to dominate the life of the government from the first Cabinet to the last. Similarly the party's leftward drift made an acceptable pay policy most difficult to procure.

If the economic crisis was Wilson's first part of the dual inheritance, the party's move to the left, and considerable manifesto commitments to radical change, was the second part. During its opposition years 1970–4 the left made significant advances.[10] Leaving aside the contentious issue of the EEC, the right was on the defensive throughout the 1970–4 period. A number of factors contributed to this development. There was a sense of disappointment that 1966–70 had been a wasted opportunity in that socialist policies had been sacrificed at the balance of payments and devaluation altars. There was the natural reaction to what was often regarded as a right-wing confrontationist Heath Government whose incomes policy restraints and Industrial Relations Act were to some on the left different not in principle but in degree from the Wilson incomes policy and *In Place of Strife* proposals. There was the growing march of the left in constituency parties where party activists tended to be more middle-class, intellectual, younger socialists rather than Labour's traditional working-class, trade-union stalwarts. Not that the unions themselves, and particularly national leadership, had been immune from a shift to the left. Hodgson rightly notes that:

> This radical shift in policy can only be explained by the leftward shift in the Party as a whole and the increased power and confidence of the trade unions. The latter, now nominally committed to the Labour Party's proposals for industrial

re-generation, did not want to repeat the disillusioning experience of 1964–70. By 1974, most of the major trade unions had Left or moderate-Left leaderships and an ideological commitment to the main planks of Labour Party policy. This was the counterweight to the veiled opposition to public ownership within the Labour Cabinet.[11]

All these factors made policy formation a most acute process of right/left disagreement, which given the importance of the National Executive Committee, elected by party conference, in policy-making meant that the left made considerable progress. There was no attempt to resurrect the spirit of *In Place of Strife*. Indeed, repeal of the Industrial Relations Act and further measures to strengthen trade union powers were promised. Unemployment, which had passed the dreaded politically-sensitive 1 million mark under Heath, aroused great passion in the labour movement and many regarded full employment as attainable as long as a Labour Government was determined to attain it. The rebuilding of the bridges between the party and the unions, exemplified by the joint TUC/Labour Party Liaison Committee, led to a commitment to return to free collective bargaining especially as compulsory and statutory wage control was an evil then associated with the Heath Government's incomes policy. Furthermore the impetus for radical programmes for British industry based not on the 1964 encouragement of the 'white heat of the technological revolution' but on extension of public ownership and control, was accelerated by the Heath Government's extension of the public sector in industry through the nationalisation of Rolls Royce, the Upper Clyde Shipbuilders rescue and the 1972 Industry Act.[12]

In this way in February 1973 a joint TUC/Labour Party Liaison Committee 'Statement on Economic Policy and the Cost of Living' envisaged a Labour Government committed to

(a) what it termed 'a wide ranging and permanent system of price controls', particularly on food;
(b) a new approach to housing and rent that would include the repeal of the 1972 Housing Finance Act, the long-run municipalisation of private rented property, the public ownership of required building land, and the building of at least 400,000 houses a year;

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(c) the strengthening of public transport, and experiments with free public transport in major conurbations;
(d) a large-scale redistribution of income and wealth, by wealth taxes, gift taxes, and steeply progressive direct taxation;
(e) the end of prescription charges, and an immediate rise in pensions, with pensions thereafter to be annually updated in line with average earnings;
(f) the expansion of investment and the control of capital by further public ownership, by the extension of state supervision of private investment, and by new measures of control to prevent excessive investment overseas;
(g) the extension of industrial democracy, by bringing investment policy and closure policy into the scope of collective bargaining.[13]

Consequently at the 1973 Labour Party Conference the document 'Labour's Programme for Britain' outlined a future Labour Government's policy based on the extension of public ownership, a system of planning agreements with major companies, and the passing of a new Industry Act. These and other measures relating to social welfare, housing and pensions, formed the basis of what became known as the Social Contract whereby the government would carry out its stated – and agreed – programme of radical socialist reforms in return for voluntary wage restraint from the trade unions.

The Social Contract was thus born out of the turmoils of the Labour Party in opposition between 1970 and 1974. One junior minister at the time recalled that: 'The Social Contract flowered in the setting of the Heath Government. We could no longer assume a relationship between the government and the unions, so we had to do a deal.'[14] It represented a significant move to the left, away from Labour's 'managerialism', 'efficiency' and 'technology' of 1964–70 and was Wilson's inheritance from his party in March 1974. Although it was not clear at the time in the Labour Party that the Social Contract conflicted directly with Wilson's inheritance from the Conservatives and from the world oil crisis, it was not surprising that, for the time being, the government should seek to get the best of both worlds.

THE SOCIAL CONTRACT

Working closely with the trade unions, and particularly with Jack Jones of the T & GWU and Hugh Scanlon of the AUEW, the government was able to carry out many Social Contract obligations in a short space of time. Obviously the radical restructuring of industry envisaged under the Social Contract, and a return to full employment, were not amenable to fulfilment before the next election but a number of other measures were within the government's immediate powers to confer. Indeed the extent of the measures did not lend credibility to the view that minority governments must be hamstrung and impotent.

Following the settlement with the miners the Pay Board was abolished and the policy of compulsory wage restraint jettisoned in July. The Price Code and Price Commission were retained and a rent freeze imposed. Museum charges, introduced by the Conservatives, were abandoned as were the wasteful plans for a third London airport and a Channel tunnel. A new Ministry of Prices, Consumer Protection and Fair Trading was established with Shirley Williams, as Secretary of State, sitting in the Cabinet. Food subsidies were subsequently introduced in Denis Healey's first budget. The much hated Industrial Relations Act was repealed, itself a central, rather than a peripheral, part of the Social Contract.

The Act was supplanted by the Trade Union and Labour Relations Act 1974, which abolished the NIRC and repealed the Industrial Relations Act though retaining the provisions on unfair dismissal, provisions for industrial tribunals and conciliation. The legal powers of the unions in relation to trade disputes were also strengthened. Barbara Castle noted in her diary in April 1974 that Harold Wilson was acting as 'custodian of the Manifesto . . . playing it straight down the line of party policy. After being crucified for four years for his determination to keep the party together at all costs, he now was determined to justify himself by sticking firmly to the policy we had thrashed out between the Shadow Cabinet and the NEC.'[15] In view of the range of measures taken in the Short Parliament such an analysis was perfectly rational at the time.

Important though such measures were in political terms, attention rightly focused on Chancellor Healey's attempts to improve the economy. Healey's first two budgets in March and

July 1974 were presented not only to the background of the Social Contract obligations and the near certainty of an imminent general election but to the background of an economy seriously out of equilibrium. Difficult or unpopular decisions were therefore harder to take in political terms than is normally the case for a Chancellor presenting his first budget. It may be argued that the government was not prepared to face the economic realities in 1974. As one senior Treasury official put it, though not in a disparaging way, 'when the rest of the world was deflating in 1974–5 we were not'.[16] Similarly Keegan and Pennant-Rae noted that:

> While the Government was trying to avoid unpleasant policy decisions, two things were taking their toll. The rest of the world was not reacting to the oil crisis in the manner prescribed by Whitehall Keynesians; instead there was a huge cutback in demand, with countries like Germany and, especially, Japan throwing all their efforts into balancing their payments, come what may. The world found itself in the midst of the worst recession since the war, and the UK – through lack of demand for exports – was dragged into this whether it liked it or not. Meanwhile business confidence at home was shattered by inflation and the problems it posed for making future plans for investment in new factories and plant. The UK went into recession anyway, but after most other countries.[17]

Ironically, of Denis Healey's two pre-October election budgets the first in March seemed more aware of the seriousness of the economic situation than the second in July. In general Joel Barnett is right to claim that 'the first months of the new government were characterised by our spending money which in the event we did not have'.[18] One minister recalled that 'Public expenditure in a sense was similar to 1964 when we assumed we could be successful and obtain benefits before it was shown they were there. Both governments started without full majorities and so couldn't take a long view.'[19] The March budget may be described as mildly deflationary.

Pensions were substantially increased, in accordance with the Social Contract and following Jack Jones's prolonged campaigning for higher pensions in real terms, as were unemployment, sickness and other short-term benefits. Food subsidies were raised to £500 million and housing subsidies were raised by £70 million, increases which, falling equally on those with low and high incomes, are not necessarily defensible on socialist grounds. However, as Harold Wilson put it, 'the need to cut the public sector borrowing requirement, particularly after the previous increase, inevitably meant a massive increase in taxation'.[20] VAT was therefore extended to confectionery and similar goods and to petrol and other road funds. Together with traditional, ritualistic increases in taxes on drink and tobacco, indirect taxation was raised by £680 million.

Among the changes in direct taxation personal allowances were increased at a cost to the Exchequer of £684 million and the basic rate of income tax was raised by 3p in the £ along with what the Conservatives regarded as draconian increases in the tax of higher earned income and investment income. These changes were to yield £954 million and with increased social expenditure by £700 million offset by a £1400 million tax yield the Chancellor could reduce the PSBR by £1500 million from the 1973–4 figure of £4250 million. However it may still be argued, with hindsight, that the PSBR remained too high given the economic situation of a vast balance of payments deficit and rising inflation. When, later, the PSBR turned out to have been £4 billion short of the real figure, Joel Barnett was right to note that the 'whole course of the next five years might have been changed had we decided we could not plan for such a high PSBR and therefore not increased public expenditure to the extent we did'.[21] If Mr Barnett is right, which the evidence suggests, the IMF crisis, with the political agony of spending cuts for a Labour Government, could have been avoided. It is a truism in British politics that increasing public expenditure is easier than reducing it when departmental ministers and other vested interests seek to preserve their domain. The whole tone of Barbara Castle's diaries are testimony to this fact.

This truism was demonstrated in Mr Healey's July 'mini-budget'. The best thing that can be said about the 'mini-budget' is that it had inevitably to be an election budget. However its economic effects were, and still are, less defensible. Partly because of the wage threshold increases[22] still operating from the Heath incomes policy, for which Mr Healey was not, of course, culpable, the Chancellor decided to cut the VAT rate from 10 per cent to 8 per cent in the hope of reducing the price-inflationary threshold increases. Similarly food subsidies were extended by £50 million in the hope of bringing down the retail price index. These measures, along with the doubling of the regional employment premium at a cost of £118 million simply provided an added inflationary boost to the economy which, given the balance of payments situation and the quadrupling of oil prices required an opposite solution. Harold Wilson has rightly argued that 'inflation is father to unemployment'[23] and defends his government's action over the July 'mini-budget'. But the real effects were to make both inflation and unemployment worse. As Samuel Brittan has analysed with particular clarity:

> Mr. Healey has deliberately tried to maintain employment at a time of accelerating inflation by raising home demand. His pre-election cut in consumer taxes in July [1974] never received the critical censure it deserved. He may have succeeded for a time in keeping the British unemployment percentage below that of other countries, but at the expense of greater and more prolonged unemployment in the period still ahead of us. A fiscal stimulus can sometimes act for a short time to sustain demand, although it will eventually peter out if not backed by a corresponding expansion of the money supply.[24]

Similarly Joel Barnett admits that as a consequence of the July measures 'there can be little doubt we planned for too high a level of public expenditure in the expectations of levels of growth that, in the event, never materialized'.[25] The July measures, with the centrepiece of holding down unemployment to below 800 000, were a classic example of the government fulfilling its side of the Social Contract and indeed justifying its action in terms of the *success* (my emphasis) of the Social Contract. Significantly Barbara Castle reveals in her diaries that before the March budget Denis Healey had stated that he would look again at restoring public expenditure cuts if unemployment started to rise.[26] The government was therefore prepared to react in the entirely conventional Keynesian way to rising unemployment irrespective of the causes of unemployment and other overriding economic commitments. That other Western industrialised countries were taking an opposite path was irrelevant to those like Harold Lever who commented that 'when I look at what other countries are doing I congratulate the Chancellor on his courage'.[27] One cabinet minister recalled that 'there was enormous sensitivity to unemployment after Heath's 1 million, and this led to a feeling we had to protect jobs at any cost. Benn was attracted to concepts like Meriden and Jones and Scanlon also wanted job protection. We fell over ourselves carrying out the Social Contract obligations – very rapid increases in public expenditure, pensions, rent control and food subsidies – without getting wage restraint in return.'[28]

One cabinet minister, recalling the ease with which public expenditure was rising, noted with surprise that 'when I went to the Treasury for £60 million for the Belfast Harland & Wolff Shipyard I got it'.[29] In general the Social Contract period was an Indian summer for spending ministers until the realisation dawned that the unions were unable, or unwilling, to deliver their side of the bargain. However when the £6 pay policy eventually emerged in July 1975 it may be argued that the early Social Contract phase had at least accustomed union leaders to the philosophy of a *quid pro quo* with the government. Thus one minister argued that 'the Social Contract did one useful thing in that it involved the unions and made them feel responsible which made subsequent deals later possible'.[30]

However in July 1974 when Phase III of the Heath policy elapsed, the Social Contract obligations on wages were firmly in the unions' hands. The political will, however, both on the government's side and, more naturally, from the TUC was lacking to make inflation control a priority if such necessary measures could prove damaging in an election run-up. The electoral restraint in the summer of 1974 was a significant factor. But it would be wrong to claim it was the only factor.

An equally important consideration was that the Labour Party in opposition had not developed a coherent anti-inflationary strategy beyond criticising the Heath incomes policy as unfair and calling for stricter prices and rent controls. A prices policy in accordance with the reformist spirit of the Social Contract did exist but – and this is the key point – both compulsory wage control and deflationary measures were strictly ruled out. Wage control and cutting public expenditure were heretical to the Social Contract. The emphasis was on voluntary restraint under free collective bargaining (itself arguably a contradictory concept) together with expansionist policies to reduce unemployment. Inflation control was simply not a political priority under the

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