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PART C

CHANCELLORS SPEECHES 1987

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Sent transcript ? Ian Coppens

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DRAFT (1.10.87)

Keep until
Ex IMF Speech

P7

Dear

Although we did see a couple of drafts of the Chancellor's Washington speech before he left, virtually no discussion between us took place. Whether or not his proposals find favour abroad they raise questions about the conduct of monetary policy which could fruitfully be pursued in a meeting of Bank and Treasury officials.

Given our history of urging the claims of the exchange rate for consideration alongside the monetary aggregates, and of supporting UK adherence to the ERM, it will not surprise you that we have considerable sympathy for the Chancellor's approach. We certainly share some of his scepticism about the feasibility of computing equilibrium exchange rates, and about the market's finding them, and would agree that the markets are now much more susceptible to official influence.

How firm a base does the Louvre Agreement offer? Only one of the three countries whose exchange rates were covered by the Agreement there has subsequently intervened significantly.

How many rates would be collectively agreed? Paragraph 23 suggests that it might be just ($/Y and $/DM).

Would these core countries have any special say in the admission to the scheme of outer members pegging to their currency, and the rate at which they pegged? Would it be admissible to peg to a basket of the core currencies? Would the peg (or composition of the relevant basket) be published?

What are the privileges of outer membership which would be lost by lapsing from the "anti-inflationary club"? Is it envisaged that the exchange rates of the core currencies would be agreed by all members? Why would the G3 agree to this? How would ERM members participate in the "club", individually or collectively?

Why should the rates not be published - as they are in the ERM? While the resolve of the authorities to maintain any target is likely to be tested it is unlikely that private agents find it profitable to try to move a rate just to get outside a target zone.

In paragraph 25 flexibility is called for. Would the adjustment of the midpoint be unilateral for non-core members? Would a flexible unpublished exchange rate band represent an effective discipline? Would it provide the markets with sufficient information as to the authorities' intentions?

How would the medium-term basis of target setting and performance assessment work given the flexibility mentioned above and the difficulties encountered in getting the current performance indicators on to a medium-term basis? What information projection, or views would we in the UK constitute? Would there be a role for the IMF or OECD?

In paragraph 28 it is suggested that "appropriate" interest rate action should be taken in response to exchange rate pressure. Several times this year upward exchange rate pressure has coincided with domestic developments that have made us reluctant to reduce interest rates - presumably the "appropriate action". It may be instructive to consider this as an example of the conflicts liable to arise under the Chancellor's proposals - or in the ERM whose bands have harder edges which are a closer analogy to the DM3 cap.

(P7)

FROM: A P HUDSON

DATE: 2 October 1987

PS/CHIEF SECRETARY

cc PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Lavelle
Mr Cassell
Mr Scholar
Mr H P Evans
Mr Mountfield
Mr Peretz
Mr Odling-Smee
Mr Walsh
Mr S W Matthews
Miss O'Mara
Mr Culpin
Mr Pickford
Mr Cropper
Mr Footman (Bank)
Mr Norgrove (No.10)

Keep with IMF papers. Destroy any duplication

CHANCELLOR'S SPEECHES AT INTERNATIONAL MEETINGS

... I attach the final versions of the Chancellor's speeches at the International Meetings over the past week.

2. The first section of the speech for the Commonwealth Finance Ministers' meeting is typed from the Chancellor's notes. Most of the rest are the actual speaking copies, hence the few manuscript amendments.

APH

A P HUDSON

35/10/28

CHANCELLOR'S SPEECH TO COMMONWEALTH FINANCE MINISTERS' MEETING, BARBADOS, 24 SEPTEMBER 1987

Introduction

"Mr Prime Minister, colleagues,
Speaking as the Finance Minister of an island economy, let me begin by saying how happy I am to be on your beautiful island of Barbados, enjoying your famous Bajan hospitality. Although I cannot begin to match the tenure of office of Ronnie de Mel - it just sometimes seems like that - I warmly recall the first Commonwealth Finance Ministers' Meeting I attended as Chancellor, on another Caribbean island, Jamaica, in 1983.

The links between Britain and Barbados are long-standing and close. The evidence is all around us. And, in particular, we share a mutual devotion to democracy and cricket. I have to say, in Britain, 1987 has been a rather better year for the former than it has been for the latter. And now you are getting ready to celebrate, in a few weeks time, the twenty-first anniversary of your independence. I am sure it will be a great occasion, and I wish you well."

World Economy: Speaking notes

As yesterday's discussion reminded us, world a difficult place. But although some slowing down in world growth over past two years - perhaps not surprising given shocks (sharp fall in both oil price and dollar) - signs are that it is picking up again.

We have already seen some recovery in commodity prices from low levels reached last year, although unrealistic to expect them to return to the false levels of the inflationary 'seventies.

UK growth is fastest of all major industrialised countries.

Quite wrong to say world trade stagnating; growing at 3½ per cent this year, forecast by IMF to grow at 4½ per cent next year.

Given damage done by shocks, welcome exchange rate stability (Louvre etc).

Free Trade: Speaking Notes

Greatest threat is protectionism.

We have constantly fought for open markets (GATT etc).

Important to apply this also to agriculture; we have again been in the lead.

Reaffirming role of free trade will be clearly important theme for Heads of Government meeting in Vancouver.

Not just a matter of trade flows.

Must also remove impediments to capital flows.

Developing countries have much to gain from encouraging inward private investment, especially at present time, when some other sources of finance less readily available.

UK abolished exchange controls; London major international finance centre. Over past five years, $12 billion of direct private investment in developing countries. A massive amount by any standards.

Fund/Bank Issues: Speaking Notes

Importance of MIGA.

Array of other Fund and Bank decisions; must press ahead with:

- full implementation of IDA8
- GCI (welcome Baker)

IMF quotas less urgent but must in meantime fully maintain enlarged access.

Important to recognise that net capital flows from Fund and Bank together have been consistently positive, in recent years, and I expect them to remain so.

I NOW TURN TO IMP. QN OF INTERNATIONAL DEBT

INTERNA~~TIONAL DE~~BT

The problem of international debt has cast a shadow over the world economy for more than five years now.

When the debt crisis first broke some five years ago, many people feared that it would reach apocalyptic proportions. Fortunately, those fears have not been realised. The world economy is in better shape than it was in 1982 and it is now well into its fifth year of reasonably steady growth. At the same time, the banks have strengthened their capital base and made more realistic assessments of the quality of their sovereign loans, thus greatly reducing the threat of an international financial crash.

That said, the fact remains that, for most of the debtor countries, the amount of debt outstanding has actually risen in relation to the size of their economies. Countries with recent debt servicing difficulties have seen their debt to GDP ratio rise from 44 per cent in 1982 to 53 per cent this year. And the external position of many debtor countries is worse now than it was in 1982: the ratio of debt to exports for the same group of countries is now over 300 per cent, compared to less than 250 per cent in 1982.

/It ...

It is clear, therefore, that the debt problem will remain with us for many years to come. But the objective remains the same: to enable the debtor countries to restore their economies to health and to regain full creditworthiness and normal acess to the international capital markets. And the basic case-by-case strategy must remain the same, with necessary policy adjustments by the debtor countries supported by the creditors.

As I argued at the international meetings in Washington in the Spring, and as was subsequently agreed at the Venice Economic Summit in June, we need to distinguish between two different groups of debtors: on the one hand, the so-called middle income debtors, in Latin America and elsewhere, and on the other the poorest indebted countries, mainly in sub-Saharan Africa.

<u>The Middle Income Debtors</u>

Most of the middle income debtors are rich in natural and ~~human~~ other resources, and have made progress towards developing an industrial structure. They have the capacity to reform their economies so as to be able to service their debts, provided that world economic growth and an open trading environment are maintained.

/Apart ...

Apart from their potential to help themselves, the other characteristic of the major middle income debtors is that over two-thirds of their debt is owed to the commercial banks. That means that the management of ~~the~~ their debt is essentially a matter between the debtor countries and the banks, not for the governments of the industrial countries.

This conference has listened with great interest to the CARICOM proposals put forward by Prime Minister Seaga of Jamaica for special arrangements to be made to meet the problems of those middle income debtors whose debt is predominantly to the international financial institutions, (and I have subsequently discussed this with him) While there are sound reasons for the rules adopted by those institutions, this issue is clearly one we shall need to consider within the Bank and the Fund.

The Poorest Countries

But The problems of the poorest countries are quite different, both in scale and in kind, from those of the middle income debtors. The scale of their debt is typically a good deal higher in relation to their GDP. For the sub-Saharan African countries, the debt to GDP ratio is now 77 per cent, compared to 50 per cent for the middle income debtors. For the foreseeable future,

/they ...

they do not have either the resources or the industrial base to pull themselves round to renewed creditworthiness. And two-thirds of their debt is owed to other governments, and to some extent to international institutions, rather than to the commercial banks.

That is why, in the spring of this year, I launched an initiative for lightening the debt burden on the poorest, most debt-distressed countries in sub-Saharan Africa.

I urged the creditor nations to join together in reducing the debt burden for these countries, in three ways:

- first, by converting old aid loans into outright grants;
- second, by allowing much longer repayment and grace periods in rescheduling loans;
- and third, by reducing the interest rates charged on these debts to well below market level.

/ I am ...

I am glad to say that there has been widespread acceptance of the need for special treatment for the poorest countries. This was recognised specifically at the economic summit in Venice in June. And I welcome the support which many speakers here have given to my proposals. Moreover, since I launched my initiative, both the IMF and the World Bank have put forward complementary proposals within their own fields for assisting the poorest countries.

The aim of all these initiatives is to bring a substantial measure of relief to the poorest of the debtor countries. The criteria for judging which countries are eligible will have to be determined as the steps in the initiative come to be implemented. But I propose that we should work on three broad principles, which, together, will clearly distinguish these countries from others.

- First, the countries we need to help are those suffering from acute poverty, whose GNP per head is very low indeed.

- Second, the countries must be implementing sensible economic policies, in line with an effective adjustment programme approved by the IMF or, in appropriate cases, by the World Bank.

/Otherwise ...

Otherwise we would simply be pouring good money after bad.

- And third, the countries must clearly be suffering from real and prolonged debt distress, as indicated by the disproportionate size of their debt obligations in relation to their export earnings.

On the specific proposals in the initiative I can report useful progress on the first two.

- First, the UK has largely completed the process of converting former aid loans into outright grants: we have already written off ~~one billion~~ £1 billion ~~pounds~~ of aid loans in this way. A number of other European countries have also made good progress on this front, and I warmly welcome Canada's recent decision to follow suit. I hope that the remaining creditor countries will do the same very soon.

- Second, creditor countries meeting in the Paris Club

/have ...

have already agreed longer repayment
and grace periods for rescheduled
loans to five countries. Two of them
have had their repayments spread over 20 years,
including a ten-year grace period, and I would
hope to see this sort of approach adopted in
similar cases in future.

The third element in the initiative - reduced interest rates on official debts - has proved the most difficult for other creditors to accept. But it is of critical importance if we are to make any real progress in easing the debt burden on the poorest countries.

This is not some kind of optional extra: it is absolutely essential. For the heartof the problem for the poorest countries is that, without some relief, they cannot even meet their interest payments. So these are added to their debt, and the burden mounts expaentially.

Since 1982 the debt burden of the sub-Saharan African countries has increased

/ by ....

by no less than 60 per cent. And the problem is still getting worse. I believe ~~It~~ it will continue to do so unless we reduce their interest charges, so that these countries can keep up with their current obligations and eventually start to repay their capital.

I understand why other creditor Governments were initially hesitant. But the objections that have been raised do not stand up to analysis.

- Many creditor govts are worried ~~are concerned~~ that countries outside the intended scope of the proposal would also seek interest rate concessions. But I have made clear all along that this is a specific proposal to deal with a specific problem. ~~Moreover~~, Resources in the creditor countries are ~~limited~~ not unlimited. I would hope ~~I hope~~ we can all agree that priority must be given to concentrating relief on the very poorest, most heavily indebted countries.

- Some of my creditor nation colleagues are concerned that allowing interest rate relief would give the

/wrong ...

wrong signal to the countries in question.

But, as I have made clear, the whole initiative is designed to apply only to countries that are implementing satisfactory economic policies.

What nobody has been able to rebut is the logic underlying the proposed interest rate concession. And the longer we wait, the worse the problem will be. We have talked for long enough. We need to take action.

In Washington, over the next few days, I shall therefore be urging my fellow Finance Ministers from the industrialised world to give their support to this initiative, so that we can meet the timetable which we set at the Venice summit, of completing discussions by the end of the year. I hope I shall have the full backing of this meeting of Commonwealth Finance Ministers as I do so. In particular, I ask you to endorse these key points:

- that the initiative should only apply to the poorest, most heavily indebted countries;

- that it should only apply where countries are

/implementing ...

implementing satisfactory economic policies;

- and that the interest rate concession is essential if real progress is to be made.

Proposals from Fund and Bank

Since I put forward my initiative, both the IMF and the World Bank have advanced complementary proposals, also concerned with the debt problems of the poorest countries.

The Managing Director of the IMF has proposed a tripling of the resources of the Structural Adjustment Facility which would provide more concessionary lending by the IMF in support of economic reform programmes. I particularly welcome the benefit this could bring to the countries of which I have been speaking.

The IMF is seeking contributions to this enlargement of the SAF from member governments. There are a number of issues still to be settled about the form of these contributions. But I can give a clear assurance that, provided all the other creditor countries are prepared to play their part too, the UK will contribute its share of the finance needed to enable the IMF to increase

/its ...

its lending at concessional interest rates. I have in mind a UK contribution of up to thirty million dollars a year, which would support an outstanding level of concessional lending of up to $500 million.

I also welcome the proposals by the World Bank to increase the share of aid that is given in support of policy reform, and to improve coordination among donors. We are ready to join in further discussions as to how this effort could be reinforced. The UK already directs a substantial part of its aid programme to support adjustment in sub-Saharan Africa, in close coordination with the Bank and Fund. Over the last two years, we have committed £161 million ~~one hundred and sixty one million pounds~~ in programme aid to sub-Saharan Africa, of which £138 million ~~one hundred and thirty eight million pounds~~ has been directed to Commonwealth countries.

<u>Conclusion</u>

There is now a growing international momentum behind the efforts to relieve the burdens of the world's poorest countries. From this Commonwealth Finance Ministers' Meeting, representing both rich and poor across all five continents let there come a united and clearcall for action by the

/wider ...

wider international community. Let our communique spell out our unequivocal support for the proposals I have set out before you today. Let us, from this Conference, give a signal to the world and to next week's meetings in Washington that the political will to forge an agreement is there.

SPEAKING COPY

CHANCELLOR'S SPEAKING NOTE FOR THE INTERIM COMMITTEE
MORNING SESSION, SUNDAY, SEPTEMBER 27, 1987

WHEN WE DISCUSSED THE PROSPECTS FOR THE WORLD ECONOMY IN APRIL, THERE WERE WIDESPREAD FEARS ABOUT THE WEAKENING IN GROWTH THAT WAS THEN APPARENT. I SAID THAT I BELIEVED THAT THIS WEAKNESS OWED MUCH TO THE DIFFICULTY OF ADJUSTING TO THE TWIN SHOCKS OF THE SHARP FALLS IN BOTH OIL AND OTHER COMMODITY PRICES AND--IN PARTICULAR--IN THE DOLLAR.

THIS IMPLIED THAT THE WEAKNESS IN GROWTH WOULD BE TEMPORARY. I AM PLEASED TO SEE THAT THIS IS BEING BORNE OUT. IN EACH OF THE TWO LARGEST ECONOMIES, THE UNITED STATES AND JAPAN, GROWTH HAS QUICKENED. AND THE PROSPECT IS FOR A CONTINUED STEADY GROWTH OF OUTPUT IN THE INDUSTRIALISED COUNTRIES AS A WHOLE.

THIS EXPERIENCE DEMONSTRATES ONCE AGAIN THE NEED TO KEEP IN PERSPECTIVE SMALL FLUCTUATIONS IN GROWTH RATES. THESE ARE BOUND TO OCCUR. WHAT MATTERS IS THAT SENSIBLE

MEDIUM-TERM POLICIES ARE PURSUED THAT ENCOURAGE THE CONTINUATION OF STEADY GROWTH.

THAT IS WHAT WE ARE SEEING. INDUSTRIAL COUNTRIES ARE NOW IN THE FIFTH YEAR OF EXPANSION. THERE IS LITTLE SIGN OF CAPACITY CONSTRAINTS AND NO REASON WHY THE UPSWING CANNOT BE SUSTAINED.

THIS HAS BEEN POSSIBLE BECAUSE OF OUR SUCCESS IN THE BATTLE AGAINST INFLATION. IT IS VITAL THAT THERE IS NO RETREAT FROM WHAT WE HAVE ACHIEVED OVER THE PAST SIX YEARS. IN 1980 THE AVERAGE INFLATION RATE OF THE INDUSTRIAL COUNTRIES WAS ALMOST 12 PER CENT. IT THEN FELL CONTINUOUSLY TO A LOW OF JUST UNDER 2½ PER CENT IN 1986. THIS YEAR HAS SEEN A SMALL UPTURN. BUT THAT WAS ENTIRELY PREDICTABLE. THE PATTERN OF OIL PRICE MOVEMENTS PRODUCED AN ADVENTITIOUS DROP IN INFLATION LAST YEAR, AND A VIRTUAL GUARANTEE THAT THIS YEAR'S RATE WOULD BE SLIGHTLY HIGHER.

BUT THE UNDERLYING SITUATION IS SATISFACTORY. MONETARY DISCIPLINE REMAINS IN PLACE. GROWTH IN UNIT LABOUR COSTS IN THE INDUSTRIAL COUNTRIES HAS BEEN CONSISTENTLY LOW. AND ALTHOUGH WE HAVE SEEN SOME RISE IN COMMODITY PRICES--OFTEN A USEFUL INDICATOR OF INFLATIONARY PRESSURES--THAT HAS BEEN FROM THE EXTREMELY LOW BASE REACHED LAST YEAR. THERE IS NO SIGN OF A RETURN TO THE FALSE LEVELS OF THE INFLATIONARY SEVENTIES.

THE CURRENT ACCOUNT IMBALANCES BETWEEN THE THREE MAJOR ECONOMIES ARE LESS SATISFACTORY. BUT IT IS EASY TO OVERSTATE THE PROBLEM.

THERE IS NO IRON LAW THAT DICTATES THAT THE CURRENT ACCOUNTS OF THE MAJOR INDUSTRIAL COUNTRIES SHOULD ALWAYS BE IN BALANCE. WE HAVE AN INTEGRATED WORLD ECONOMY AND WE ENCOURAGE THE FREE FLOW OF CAPITAL AND GOODS. INVESTMENT OPPORTUNITIES AND SAVINGS PROPENSITIES INEVITABLY DIFFER FROM COUNTRY TO COUNTRY AND IT IS NATURAL FOR THIS TO PRODUCE SUBSTANTIAL, AND OFTEN SUSTAINED, CAPITAL ACCOUNT FLOWS. THESE FLOWS ARE BOUND

TO HAVE THEIR COUNTERPARTS IN CURRENT ACCOUNT SURPLUSES AND DEFICITS.

BUT ALTHOUGH THERE MAY BE UNDERSTANDABLE REASONS WHY THERE SHOULD BE SUBSTANTIAL FLOWS OF CAPITAL IN ONE DIRECTION FOR SEVERAL YEARS, THERE ARE CLEARLY LIMITS TO THE ACCUMULATED EXTERNAL LIABILITIES OR ASSETS THAT CAN BE SUSTAINED WITHOUT CREATING MAJOR ANXIETIES FOR CAPITAL MARKETS. THAT IS WHY WE NEED TO CONTINUE TO MAKE PROGRESS IN REDUCING THE EXISTING IMBALANCES – AND, NEEDLESS TO SAY, WE NEED TO DO IT WITHOUT ANY RECOURSE TO PROTECTION

~~IT WOULD, HOWEVER,~~ BUT IT WOULD BE A MISTAKE TO ATTEMPT TO FINE TUNE POLICY TO MEET PRECISE CURRENT ACCOUNT OBJECTIVES. FOR ONE THING, THE BASIC DATA ARE TOO INACCURATE, AS THE IMPORTANT NEW IMF STUDY ON THE WORLD CURRENT ACCOUNT DISCREPANCY HAS SHOWN. I BELIEVE THE FUND STAFF SHOULD NOW TRY AND ALLOCATE THE DISCREPANCY, HOWEVER ROUGHLY, TO INDIVIDUAL COUNTRIES.

NOR ARE THE INACCURACIES IN THE BASIC DATA THE ONLY PROBLEM. CURRENT ACCOUNT PROJECTIONS SUFFER FROM VERY

WIDE MARGINS OF ERROR; AND IT IS ALMOST IMPOSSIBLE TO JUDGE IN ADVANCE THE STRENGTH OF COMPLEMENTARY CAPITAL FLOWS.

THE PRESENT COMBINATION OF DEFICITS AND SURPLUSES HAS EMERGED OVER SEVERAL YEARS IN WHICH THE GROWTH OF DOMESTIC DEMAND IN GERMANY AND JAPAN WAS CONSISTENTLY BELOW THE GROWTH OF OUTPUT, WHILE IN THE UNITED STATES IT WAS CONSISTENTLY ABOVE. THE PROCESS OF UNWINDING THE IMBALANCES REQUIRES A REVERSAL OF THE DIFFERENCES BETWEEN DOMESTIC DEMAND AND OUTPUT IN THOSE COUNTRIES. THIS IS BOUND TO TAKE TIME TO COMPLETE, BUT — AND THIS IS IMPORTANT — IT HAS NOW BEGUN.

IT WOULD BE A SERIOUS MISTAKE TO SEEK A SHORT CUT BY A FURTHER DOLLAR DEPRECIATION. IT WAS UNDOUBTEDLY NECESSARY TO CORRECT THE HUGE MISALIGNMENT OF THE DOLLAR IN 1985. BUT THERE IS NO CASE FOR GOING TO THE OPPOSITE EXTREME OF AN ARTIFICALLY LOW DOLLAR. THE BENEFITS TO THE CURRENT ACCOUNT WOULD BE SMALL COMPARED TO THE DAMAGE TO US INFLATION AND THE DISLOCATION TO THE WORLD ECONOMY.

THE MAIN LESSON FROM RECENT YEARS IS THAT WE SHOULD AVOID EXCHANGE RATE MISALIGNMENTS, NOT ENCOURAGE THEM.

THAT IS WHY WE REAFFIRMED THE LOUVRE AGREEMENT AT THE MEETING OF THE GROUP OF SEVEN YESTERDAY.

FINALLY, MR. CHAIRMAN, YOU HAVE ASKED US TO COVER SDR ALLOCATIONS AND ACCESS LIMITS IN THIS MORNING'S DISCUSSION. ON SDR ALLOCATIONS, I CAN BE VERY BRIEF. I SEE NO EVIDENCE WHATEVER OF AN OVERALL SHORTAGE OF LIQUIDITY IN THE WORLD. THE ENORMOUS GROWTH IN INTERNATIONAL CAPITAL MARKETS HAS GREATLY REDUCED THE CASE FOR SDRS THAT WAS MADE OUT IN THE 1970S. SO I SEE NO NEED TO CONSIDER SDR ALLOCATIONS NOW.

WE SHALL BE DISCUSSING THE REVIEW OF QUOTAS THIS AFTERNOON. ~~IT~~ THE EVIDENCE SEEMS TO ME CLEAR THAT THERE IS NO NEED TO TAKE ANY URGENT DECISIONS ON THAT NOW. BUT IT IS IMPORTANT IN THE MEANTIME THAT WE SHOULD RETAIN ENLARGED ACCESS, AT PRESENT LEVELS.

MR. CHAIRMAN, THE KEY TO LONG-TERM GROWTH IS THE SUPPLY PERFORMANCE OF OUR ECONOMIES. EXPERIENCE ALL AROUND THE WORLD HAS SHOWN HOW THIS CAN BE HELPED BY DEREGULATION, BY PRIVATISATION, BY INCREASING COMPETITION, AND BY FACILITATING ~~MAINTAINING~~ THE FREE FLOW OF GOODS, SERVICES AND OF CAPITAL. THESE SUPPLY-SIDE POLICIES NEED TO BE PURSUED WITHIN A STABLE FRAMEWORK OF FISCAL, MONETARY AND EXCHANGE RATE POLICY. PROVIDING WE DO THAT, WE CAN MAKE GRADUAL PROGRESS ON THE FURTHER REDUCTION OF THE IMBALANCES WHICH HAVE CAUSED SO MUCH CONCERN, AND SECURE FURTHER STEADY NON-INFLATIONARY GROWTH.

AS DELIVERED

CHANCELLOR'S SPEAKING NOTE FOR THE INTERIM COMMITTEE
AFTERNOON SESSION
SUNDAY 27 SEPTEMBER, 1987

MIDDLE-INCOME DEBTORS

WHILE IT IS TRUE THAT THE DEBT BURDEN FOR MANY COUNTRIES HAS RISEN, THE BASIC OBJECTIVE OF THE DEBT STRATEGY REMAINS THE SAME: TO ENABLE THE DEBTOR COUNTRIES TO RESTORE THEIR ECONOMIES TO HEALTH AND TO REGAIN NORMAL ACCESS TO THE WORLD'S CAPITAL MARKETS.

FOR THE MIDDLE-INCOME DEBTORS, THIS IS A REALISTIC OBJECTIVE. WITH THEIR NATURAL AND HUMAN RESOURCES, AND THEIR INDUSTRIAL BASE, THEY HAVE THE CAPACITY TO REFORM THEIR ECONOMIES AND SERVICE THEIR DEBTS, PROVIDED THAT WORLD ECONOMIC GROWTH AND AN OPEN TRADING ENVIRONMENT ARE MAINTAINED.

Two thirds of the debt of the middle-income countries as a whole is owed to the commercial banks. This means that the management of debt problems is above all a matter between the debtor countries and the banks.

Many schemes have been put forward for global solutions to the problems of debt, usually involving directly or indirectly an assumption of the banks' responsibilities by the governments of industrial countries. This is not on. It is for the banks and the debtor countries alike to face up realistically to their responsibilities. I welcome whole-heartedly the substantial increases that many major banks have made this year in their provisions against sovereign debt. This has been seen in the market as a proper commercial recognition of reality.

It is also consistent with a more market orientated approach to the ways in which middle-income debtors can meet their financial needs. The marketing of debt, debt-equity swaps, and debt buy-back schemes all have a

GROWING ROLE TO PLAY. IT IS FOR THE BANKS AND THE DEBTOR COUNTRIES, POSSIBLY WITH THE HELP OF THE INTERNATIONAL FINANCIAL INSTITUTIONS, TO DECIDE IF AND HOW THEY APPLY IN EACH CASE.

I AM GLAD TO SEE A MORE WELCOMING ATTITUDE ON THE PART OF GOVERNMENTS OF MANY DEVELOPING COUNTRIES TO INWARD PRIVATE INVESTMENT. BUT FURTHER SUBSTANTIAL ENCOURAGEMENT BY THESE GOVERNMENTS IS NEEDED. THERE IS CLEARLY THE POTENTIAL FOR GREATER INVESTMENT FLOWS FROM THE INDUSTRIALISED COUNTRIES. JAPAN, WITH ITS HIGH RATE OF SAVING, PROVIDES AN OBVIOUS SOURCE. A HIGHER PROPORTION OF CAPITAL FLOWS TO THE DEVELOPING COUNTRIES SHOULD TAKE FORMS IN WHICH RISKS ARE EXPLICITLY SHARED BETWEEN LENDERS AND BORROWERS.

FOR COUNTRIES SEEKING ADDITIONAL INFLOWS OF CAPITAL, THE APPROPRIATE POLICY FRAMEWORK MUST BE IN PLACE. BUT THE RECORD OF ADJUSTMENT TO DATE HAS BEEN MIXED. DESPITE ALL THE POLITICAL DIFFICULTIES, STRONGER ADJUSTMENT IS ESSENTIAL TO ATTRACT NEW INFLOWS. IN A FEW COUNTRIES,

NOTABLY MEXICO, WE CAN ALREADY SEE THE EFFECT OF POLICY REFORMS IN STEMMING AND THEN REVERSING CAPITAL FLIGHT - AN ACHIEVEMENT OF THE FIRST IMPORTANCE.

THE IFIS

THE INTERNATIONAL INSTITUTIONS CLEARLY HAVE AN IMPORTANT ROLE IN HELPING TO RESOLVE DEBT PROBLEMS, ABOVE ALL BY HELPING TO PUT IN PLACE THE CONDITIONS FOR SUSTAINABLE POLICIES TO ACCOMPANY THE PROVISION OF FINANCE. THE STRATEGY WE HAVE EVOLVED ENVISAGES AN INCREASING ROLE FOR THE WORLD BANK, AND A GENERAL CAPITAL INCREASE IS NOW URGENT. I THEREFORE WARMLY WELCOME THE ANNOUNCEMENT BY THE GOVERNMENT OF THE UNITED STATES THAT THEY CAN NOW SUPPORT A SUBSTANTIAL GCI, AND I HOPE THAT IT CAN BE AGREED AND PUT INTO PLACE AS SOON AS POSSIBLE.

MR. CHAIRMAN, THE DEBT STRATEGY HAS EVOLVED IN IMPORTANT WAYS SINCE WE LAST MET. I WELCOME THE INCREASED FLEXIBILITY WITH WHICH THESE PROBLEMS ARE BEING APPROACHED.

POOREST, AND MOST INDEBTED, COUNTRIES

THERE IS NOW WIDESPREAD AGREEMENT THAT THE PROBLEMS OF THE POOREST AND MOST HEAVILY-INDEBTED COUNTRIES, ESPECIALLY IN SUB-SAHARAN AFRICA, WHOSE DEBT IS MOSTLY TO GOVERNMENTS AND TO THE IFIs, ARE UNIQUELY DIFFICULT AND NEED SPECIAL TREATMENT.

AT OUR LAST MEETING IN APRIL I LAUNCHED AN INITIATIVE WITH THREE PROPOSALS FOR ADDITIONAL HELP TO THESE COUNTRIES, PROVIDED THEY ARE PURSUING SATISFACTORY ADJUSTMENT POLICIES.

- FIRST, THAT AID LOANS SHOULD BE CONVERTED INTO OUTRIGHT GRANTS;
- SECOND, THAT WE SHOULD GIVE LONGER REPAYMENT AND GRACE PERIODS IN RESCHEDULING LOANS;
- AND THIRD, THAT WE SHOULD LOWER THE INTEREST RATES CHARGED ON THESE RESCHEDULINGS TO WELL BELOW MARKET LEVELS.

THERE HAS BEEN VERY CONSIDERABLE PROGRESS ON THE FIRST TWO OF THESE PROPOSALS. MANY COUNTRIES INCLUDING THE UK HAVE ALREADY WRITTEN OFF AID LOANS; AND CREDITOR COUNTRIES IN THE PARIS CLUB HAVE AGREED LONGER REPAYMENT AND GRACE PERIODS FOR RESCHEDULED LOANS TO FIVE COUNTRIES.

IT IS THE THIRD ELEMENT IN THESE PROPOSALS, REDUCED INTEREST RATES, THAT HAS PROVED THE MOST DIFFICULT FOR OTHER CREDITOR COUNTRIES TO ACCEPT. BUT ONE WAY OR ANOTHER, IT IS ABSOLUTELY ESSENTIAL. OTHERWISE, EVEN WITH GENEROUS GRACE PERIODS, THE BURDEN OF DEBT WILL CONTINUE TO RISE RAPIDLY. THESE COUNTRIES DO NOT HAVE THE RESOURCES EVEN TO MEET THE INTEREST BURDEN ON THEIR DEBTS. AT SOME POINT, WE WILL HAVE TO FACE THE INEVITABILITY OF GIVING RELIEF; <u>SOME</u> BUDGETARY COST TO CREDITOR COUNTRIES IS UNAVOIDABLE. TO DELAY GIVING THAT RELIEF MERELY PROLONGS THE UNCERTAINTIES WHICH THESE VERY POOR COUNTRIES FACE, AND MAKES THEIR STRUGGLE TO ADJUST EVEN MORE PAINFUL.

LAST WEEK, THE COMMONWEALTH FINANCE MINISTERS' MEETING IN BARBADOS ENDORSED THE UK PROPOSALS AND - I QUOTE FROM THE COMMUNIQUE - "STRONGLY RECOMMENDED THEM TO THE CREDITOR COUNTRIES FOR EARLY APPROVAL".

COMPLEMENTARY PROPOSALS HAVE BEEN PUT FORWARD BY THE FUND AND THE BANK. THE MANAGING DIRECTOR HAS PROPOSED A SUBSTANTIAL ENLARGEMENT OF THE RESOURCES OF THE STRUCTURAL ADJUSTMENT FACILITY, SO AS TO PROVIDE MORE CONCESSIONARY LENDING TO THE POORER COUNTRIES. I WELCOME THIS APPROACH. IT HAS TO BE SEEN IN TANDEM WITH MY OWN PROPOSAL FOR DEALING WITH BILATERAL OFFICIAL DEBTS. I BELIEVE THAT THE UK PROPOSALS COULD AND SHOULD BE LINKED TO THE PROPOSED SAF ENLARGEMENT, BY THE POOREST, DEBT-DISTRESSED COUNTRIES BEING GIVEN SPECIAL ACCESS TO THE EXTRA SAF FUNDS. THE UK STANDS READY TO MAKE A CONTRIBUTION ON THE BASIS THAT ALL MAJOR COUNTRIES DO SO AS WELL.

Mr. Chairman, specific proposals for helping the poorest countries were welcomed by the Heads of Government at the Venice Summit. A conclusion was urged by the end of this year. It is vital we discharge this responsibility.

CHANCELLOR'S SPEAKING NOTE FOR THE DEVELOPMENT COMMITTEE
MORNING SESSION
SEPTEMBER 28, 1987

I HAVE READ WITH GREAT INTEREST THE REPORT BY THE PRESIDENT OF THE WORLD BANK THAT FORMS THE FOCUS OF OUR DISCUSSIONS.

THE WORLD BANK HAS A CRUCIAL ROLE TO PLAY. IT IS AN UNRIVALLED SOURCE OF PROFESSIONAL EXPERTISE AND KNOWLEDGE OF DEVELOPMENT AND DEVELOPING COUNTRIES. IT IS UNIQUELY PLACED TO PROVIDE ADVICE AND SUPPORT FOR ECONOMIC REFORMS TO SECURE STRUCTURAL ADJUSTMENT AND GROWTH.

THE SUCCESS OF THE BANK'S PROJECTS DEPENDS ON HAVING THE RIGHT ECONOMIC ENVIRONMENT IN PLACE, AND IN PARTICULAR IN REMOVING DISTORTIONS IN EXCHANGE RATES, INTEREST RATES AND PRICES MORE GENERALLY. IT IS IMPORTANT THAT, BOTH IN ITS PROJECT LENDING AND IN ITS PROGRAM LENDING, THE BANK SHOULD CONTINUE TO PROMOTE A FREEING OF MARKETS. THE BANK MUST ALSO STRENGTHEN ITS

EFFORTS TO ENSURE THAT THE PROJECTS AND PROGRAMS IT SUPPORTS DO NOT LEAD TO ENVIRONMENTAL DEGRADATION AND ARE SUSTAINABLE IN THE LONGER RUN. WE SHALL BE FOLLOWING THE PROGRESS IN THIS AREA CLOSELY.

WITH THE CONCLUSION OF ITS REORGANISATION, THE BANK IS NOW BETTER PLACED TO RESPOND TO THE NEEDS OF ITS BORROWERS. I BELIEVE THE EXECUTIVE BOARD SHOULD NOW CONSIDER HOW IT CAN PLAY A MORE EFFECTIVE ROLE IN GUIDING THE BANK, AND I LOOK FORWARD TO SEEING THE REPORT OF THE SPECIAL COMMITTEE OF EXECUTIVE DIRECTORS THAT HAS RECENTLY BEEN ESTABLISHED TO LOOK INTO THIS.

THE AGENDA FOR THE WOLD BANK IS AN IMPOSING ONE. IT WILL NOT BE ABLE TO PERFORM THE FUNCTIONS WE REQUIRE OF IT UNLESS ITS MEMBERS PROVIDE IT WITH THE RESOURCES IT NEEDS. IDA 8 WILL BE THE ESSENTIAL SOURCE OF CONCESSIONARY FINANCE FOR THE POOREST DEVELOPING COUNTRIES. NOW THAT WE HAVE REACHED AGREEMENT ON ITS SIZE, THE UK WILL DO ITS PART IN GETTING ITS CONTRIBUTION TO IDA 8 THOUGH QUICKLY. WE MUST NOW ACT, TOO, ON A

GENERAL CAPITAL INCREASE FOR THE BANK. THE NEED IS URGENT. THE UNITED KINGDOM IS LOOKING TO AN EARLY CONCLUSION ON A SUBSTANTIAL INCREASE. I WELCOME THE PROPOSALS BY THE BANK TO INCREASE THE SHARE OF IDA THAT IS GIVEN IN SUPPORT OF POLICY REFORM, AND TO IMPROVE COORDINATION AMONG DONORS. WE ARE READY TO JOIN IN FURTHER DISCUSSIONS AS TO HOW THIS EFFORT COULD BE REINFORCED.

TRADE AND AGRICULTURE

EVEN MORE IMPORTANT FOR THE DEVELOPING COUNTRIES IS THE NEED TO OPEN UP MARKETS AND ENCOURAGE WORLD TRADE TO EXPAND FASTER. PROTECTIONISM IMPOSES COSTS ON ALL OF US. ON PRODUCERS IN DEVELOPING COUNTRIES, WHOSE EXPORT MARKETS ARE RESTRICTED. ON CONSUMERS WHO CANNOT BUY WHAT THEY WANT FROM WHERE THEY WANT AT THE LOWEST PRICES. IT MAKES NO SENSE TO ENCOURAGE DEVELOPING COUNTRIES--AND ESPECIALLY THE VERY POOREST--TO INCREASE THEIR EXPORTS IF AT THE SAME TIME WE CLOSE OUR MARKETS TO THEM.

THE URUGUAY GATT ROUND HAS GOT OFF TO A GOOD START: BETTER THAN AT THE SAME POINT OF THE TOKYO ROUND. THE NEXT IMPORTANT MILESTONE IS THE PRESENTATION OF SUBSTANTIVE PROPOSALS IN GENEVA THIS AUTUMN, IN PREPARATION FOR NEXT YEAR'S DETAILED NEGOTIATIONS. THE UNITED KINGDOM IS FULLY COMMITTED TO THIS PROCESS. BUT OTHERS MUST ALSO PLAY THEIR PART; INCLUDING THE MORE ADVANCED DEVELOPING COUNTRIES, WHO HAVE GAINED SO MUCH FROM GATT IN RECENT YEARS AND MUST NOW TAKE ON A GREATER SHARE OF ITS OBLIGATIONS.

ABOVE ALL, AGRICULTURE NEEDS TO BE PROPERLY EXPOSED TO MARKET FORCES. OVER THE PAST EIGHTEEN MONTHS IT HAS MOVED RIGHT TO THE TOP OF THE INTERNATIONAL AGENDA. FOR THE FIRST TIME, IT HAS BEEN INCLUDED IN A GATT ROUND. WE ARE ALL COMMITTED TO PRESENTING COMPREHENSIVE PROPOSALS BY THE END OF THIS YEAR; AND SOME COUNTRIES HAVE ALREADY DONE SO. A FREER MARKET FOR FARM PRODUCE IS CRUCIAL FOR DEVELOPMENT, AND ABOVE ALL FOR THE DEVELOPMENT OF THE POORER COUNTRIES, WHOSE GROWTH--AS THE WORLD BANK HAS SHOWN--HAS LAGGED SO CONSPICUOUSLY IN THE PAST DECADE

BEHIND THAT OF THOSE DEVELOPING COUNTRIES WITH A MANUFACTURING BASE.

ACTION IS NEEDED BY DEVELOPING COUNTRIES AND INDUSTRIAL COUNTRIES ALIKE. DEVELOPING COUNTRIES CAN MAKE MAJOR GAINS BY NOT OVERTAXING THEIR FARMERS AND BY PAYING THEM THE WORLD MARKET PRICE FOR THEIR PRODUCE. BUT IT IS ABOVE ALL ESSENTIAL THAT THE EXCESSIVE LEVELS OF SUPPORT FOR AGRICULTURE IN OECD COUNTRIES ARE CUT BACK SHARPLY. THAT WILL PROVIDE VITAL HELP TO THE FOOD PRODUCERS IN THE POORER COUNTRIES. THE POTENTIAL GAINS ARE ENORMOUS. LAST YEAR'S WORLD DEVELOPMENT REPORT ESTIMATED THAT DEVELOPING COUNTRIES COULD GAIN $20 BILLION A YEAR FROM LIBERALISATION OF WORLD AGRICULTURE--FIVE TIMES THE PROJECTED ANNUAL FLOWS FROM IDA 8.

WE MUST CONTINUE TO KEEP THIS ISSUE IN THE FOREFRONT OF OUR AGENDA. IT IS TOO SERIOUS A MATTER TO BE LEFT TO AGRICULTURE MINISTERS ALONE.

PRIVATE INVESTMENT

WE MUST ALSO LIBERATE INVESTMENT FLOWS, AS WELL AS TRADE. I AM PARTICULARLY GLAD TO SEE THE INCREASING RECOGNITION AMONG SOME DEVELOPING COUNTRIES OF THE VALUE TO THEM ON INWARD INVESTMENT. AND THE PRESIDENT'S REPORT DRAWS ATTENTION TO THE IMPORTANCE OF THIS. BUT A GREAT DEAL MORE REMAINS TO BE DONE. ACTION BY HOST GOVERNMENTS TO MAKE INWARD INVESTMENT WELCOME AND TO PROVIDE AN APPROPRIATE ECONOMIC ENVIRONMENT IS ESSENTIAL IF THE BENEFITS FROM THESE FLOWS ARE TO BE REALISED.

THESE CAN BE VERY SUBSTANTIAL. THE UNITED KINGDOM ABOLISHED ALL ITS EXCHANGE CONTROLS IN 1979. AND OVER THE LAST FIVE YEARS, NET PRIVATE DIRECT INVESTMENT IN DEVELOPING COUNTRIES HAS TOTALLED $12 BILLION.

THE WORLD BANK GROUP HAS AN IMPORTANT ROLE TO PLAY IN ENCOURAGING PRIVATE INVESTMENT FLOWS. I WELCOME THE SETTING UP OF THE MULTILATERAL INVESTMENT GUARANTEE AGENCY. THE UK WAS AN EARLY SIGNATORY AND WE HAVE

ALREADY EMBARKED ON THE PARLIAMENTARY PROCEDURE FOR RATIFICATION. I HOPE THAT MIGA CAN BEGIN ITS OPERATIONS AS SOON AS POSSIBLE.

I AM ALSO GLAD TO SEE THE IFC CONTINUING ITS INNOVATIVE AND WIDE RANGING APPROACH, PROMOTING BOTH DIRECT AND PORTFOLIO INVESTMENT AND GIVING ADVICE.

THE POOREST COUNTRIES

I TURN NOW TO THE PROBLEMS OF THE POOREST COUNTRIES WHICH WE ALL AGREE TO BE DIFFERENT, BOTH IN SCALE AND IN KIND, FROM THOSE OF THE MIDDLE INCOME DEBTORS. THE SIZE OF THEIR DEBT IS TYPICALLY A GOOD DEAL HIGHER IN RELATION TO THEIR GDP. FOR THE SUB-SAHARAN AFRICAN COUNTRIES, THE DEBT TO GDP RATIO IS NOW 77 PER CENT. FOR THE FORESEEABLE FUTURE, THEY WILL NOT BE WITHIN SIGHT OF CREDITWORTHINESS. AND TWO-THIRDS OF THEIR DEBT IS OWED TO OTHER GOVERNMENTS AND TO INTERNATIONAL INSTITUTIONS, RATHER THAN TO THE COMMERCIAL BANKS.

THAT IS WHY, AT THE SPRING MEETINGS, I LAUNCHED A THREE-POINT INITIATIVE FOR LIGHTENING THE DEBT BURDEN ON THE POOREST, MOST DEBT-DISTRESSED COUNTRIES IN SUB-SAHARAN AFRICA, PROVIDING THEY FOLLOW APPROPRIATE ADJUSTMENT POLICIES. I PROPOSED:

- FIRST, CONVERTING AID LOANS INTO OUTRIGHT GRANTS;

- SECOND, ALLOWING LONGER REPAYMENT AND GRACE PERIODS IN RESCHEDULING LOANS;

- AND THIRD, REDUCING THE INTEREST RATES CHARGED ON THESE DEBTS TO WELL BELOW MARKET LEVEL.

THERE HAS BEEN USEFUL PROGRESS ON THE FIRST TWO OF THESE BUT THE PROPOSAL FOR REDUCED INTEREST RATES ON OFFICIAL DEBTS IS PROVING MORE CONTROVERSIAL. I BELIEVE IT IS OF CRITICAL IMPORTANCE IF WE ARE TO MAKE ANY REAL PROGRESS IN EASING THE DEBT BURDEN OF THE POOREST COUNTRIES.

THE HEART OF THE PROBLEM FOR THE POOREST COUNTRIES IS THAT, WITHOUT SOME RELIEF, THEY CANNOT EVEN MEET THEIR INTEREST PAYMENTS. SO THESE ARE ADDED TO THEIR DEBT, AND THE BURDEN MOUNTS EXPONENTIALLY.

SINCE 1982 THE DEBT BURDEN OF THE SUB-SAHARAN AFRICAN COUNTRIES HAS INCREASED BY NO LESS THAN 60 PER CENT. AND THE PROBLEM IS STILL GETTING WORSE. IT WILL CONTINUE TO DO SO UNLESS WE REDUCE THEIR INTEREST CHARGES, SO THAT THESE COUNTRIES CAN KEEP UP WITH THEIR CURRENT OBLIGATIONS. THE LONGER WE WAIT, THE WORSE THE PROBLEMS WILL BECOME.

THIS MEETING SHOULD KNOW THAT THE UK PROPOSALS I HAVE SET OUT AGAIN TODAY WERE ENDORSED BY THE COMMONWEALTH FINANCE MINISTERS' MEETING AT BARBADOS LAST WEEK.

THE MANAGING DIRECTOR OF THE FUND HAS MADE A COMPLEMENTARY PROPOSAL FOR A SUBSTANTIAL ENLARGEMENT OF THE STRUCTURAL ADJUSTMENT FACILITY. I WELCOME THIS.

The SAF is of special importance to the poorest and most debt-distressed countries as was recognised at the Venice Economic Summit in June. I believe that the new SAF money should be geared particularly towards the needs of these countries. They should given specially favourable access to the extra SAF funds. I hope that the Executive Board of the Fund, in developing the criteria for access, will consider how this might be achieved.

Increased resources for the poorest countries will only help if accompanied by economic adjustment and reform. That is why both proposals need adequate conditionality. Otherwise we throw good money after bad. I believe this is increasingly recognised by the developing countries themselves.

While in the face of daunting problems a few of these countries have largely abandoned their reform efforts, some are making real PROGRESS. The World Bank paper before us shows that in the Gambia and in Tanzania the financial performance of their public enterprises

HAS IMPROVED SIGNIFICANTLY IN RECENT YEARS; AND IN GHANA, GREATER INCENTIVES FOR FARMERS HAVE STIMULATED FOOD PRODUCTION.

THESE EXAMPLES ARE EVIDENCE THAT, DESPITE THE ENORMOUS SCALE OF THE PROBLEMS, REAL PROGRESS CAN BE MADE. SUCH EFFORTS NEED TO BE REINFORCED.

CONCLUSIONS

I HOPE THAT THIS COMMITTEE CAN GIVE THREE CLEAR MESSAGES IN ITS COMMUNIQUE. FIRST, THAT GOVERNMENTS MUST TAKE EARLY STEPS TO REDUCE BARRIERS TO TRADE AND SUBSIDIES FOR AGRICULTURE. SECONDLY, THAT AN EARLY AND SUBSTANTIAL INCREASE IN THE WORLD BANK'S CAPITAL SHOULD BE PUT IN PLACE SO THAT IT CAN PLAY ITS FULL PART IN ASSISTING LONG-TERM DEVELOPMENT. THIRDLY, THAT THIS COMMITTEE ACCEPTS THE OVERRIDING PRIORITY OF HELPING THE LOW-INCOME HEAVILY INDEBTED COUNTRIES IN SUB-SAHARAN AFRICA, BOTH MULTILATERALLY THROUGH THE SAF AND BILATERALLY THROUGH THE LINES I HAVE INDICATED.

(NB Ch spoke from note below)

NOTE FOR THE RECORD

cc: Distribution

DEVELOPMENT COMMITTEE

INFORMAL SESSION - CHANCELLOR'S STATEMENT

28 September, 1987

Opening the discussion on seriously indebted low-income countries, the Chancellor emphasised the utmost importance and urgency of the issue. The essence of the problem was the combination of acute poverty and very heavy indebtedness in some LICs. While their debt was much smaller than that of many Latin American nations in absolute terms it was massive compared with their capacity to service it. Since most of these countries' debt was either ODA or officially guaranteed export credits, creditor governments had a particular responsibility to ease the situation.

2. The development of the current situation was attributable to mistakes by both debtors and creditors: debtors had failed to pursue sensible economic policies, while creditors had made loans which did not contribute to economic development when it should have been apparent that they could not be repaid.

3. The heavily indebted LICs represented a special case which merited special treatment, as had been stated in the Venice Summit communique (from which the Chancellor quoted the relevant passage). The argument that special treatment could not be given because of the risk of contagion would not wash, since the G7 had explicitly accepted that these countries were a special case. This was further demonstrated by the inclusion of this issue as a separate item on the Development Committee agenda.

4. As with the major debtors, any solution to the problems of LIC debtors would have to include appropriate economic policies, including trade liberalisation, freer markets and encouragement of inward direct investment. But these countries also had special needs which required RTA on outstanding ODA loans and Paris Club rescheduling (where economic policies were appropriate) on very generous terms, including long maturities and concessional interest rates, to reduce the debt burden. An enhanced SAF would also make a substantial contribution, particularly if it were skewed towards the very poor and debt-distressed countries of Sub-Saharan Africa.

5. The objections which had been put forward by some were based on too short-term a view of the situation. The short-term budgetary cost of the measures, though not heavy, would be significant; but this cost would be borne sooner or later anyway. By accepting the cost sooner rather than later it would be possible to attach policy conditionality.

6. While there had been a number of initiatives relevant to these countries, these should be regarded not as rivals but as complements. The Paris Club, the IMF and the World Bank should all work together. The Chancellor urged Committee members to treat the issue with the urgency and importance it deserved, and to fulfill the commitment of the Venice Summit communique by the end of the year.

David Woodward
29 September, 1987

Distribution:

PPS
Governor
Sir G. Littler
Mr. Caines
Mr. Loehnis
Mr. Evans
Mr. Ware
Mr. Richardson

Mr. Lankester
Mr. Faint
Mr. Foot
Mr. Gibb
Mr. Leader
Mr. King

The very poorest

1. Nature of the problem
   - grinding poverty
   - heavily indebted; mostly aid loans, export credit and to IFIs.

2. Faulty policies on both sides
   - debtors have failed to pursue adjustment policies, distorted markets, rejected inward investment
   - creditors have pushed export credit support for inappropriate policies (including military), designed to boost own industry

3. Now widely ~~adopted~~ accepted as special case, needing special help. Venice etc.

4. Solutions:
   - ~~free trade and agriculture~~
   - free markets, appropriate policies, inward investment } Capital & [illegible]
   - CFM | for ODA debts: write off
   - for other bilateral: reschedule and cut interest
   - for IFIs: SAF, skewed.

   + Conditional.

5. Avoid short-termism:
   - by debtors, who see simple rescheduling as solving problems
   - creditors, who see short-term budgetary costs.

6. Must pull initiatives together:
   - Paris Club and Fund/Bank must work together
   = Fund and Bank staff to work up agreed criteria for determining eligibility.

Urge a conclusion on discussion on
Rest proposals within this year

BOARDS OF GOVERNORS • 1987 ANNUAL MEETINGS • WASHINGTON, D.C.

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL FINANCE CORPORATION
INTERNATIONAL DEVELOPMENT ASSOCIATION
INTERNATIONAL MONETARY FUND

Press Release No. 44

September 30, 1987

HOLD FOR RELEASE
UNTIL DELIVERY

Statement by the Hon. NIGEL LAWSON,
Chancellor of the Exchequer and Governor of the Fund
for the UNITED KINGDOM, at the Joint Annual Discussion

I welcome the progress that we have made at these meetings on a number of issues of great importance. We have reaffirmed the Louvre agreement. There is now full support for an early and substantial general capital increase for the World Bank. And there is increasing recognition that within the general debt strategy, special action is required to help the very poorest and most heavily indebted countries, particularly in sub-Saharan Africa.

At the meetings of the Interim and Development Committees this April, I put forward a three-point proposal for assisting these countries, provided they pursue appropriate adjustment policies: the conversion of aid loans into outright grants; longer repayment and grace periods on Paris Club reschedulings; and reductions in the rates of interest on those reschedulings.

The Managing Director of the International Monetary Fund and the President of the World Bank have put forward complementary proposals for helping the poorest countries by concessional interest rates, including a substantial increase in the size of the Fund's structural adjustment facility (SAF). I support these proposals, and believe that heavy indebtedness should be a major factor in determining the allocation of funds under any enlargement of the SAF.

It is of the first importance that we make a real effort to reach agreement on all these proposals at the earliest possible date.

The U.K. Economy

I now turn to the experience of my own country during the past year. Since the sharp fall in the oil price in 1986, the growth rate of the U.K. economy, so far from slowing down as was expected, has actually picked up. At the same time, the growth rate for the major industrial countries as a whole has been below expectations. At first sight, this seems paradoxical. The industrial countries in aggregate were significant beneficiaries from lower oil prices, whereas the United Kingdom, as a major oil producer and exporter, stood to lose significantly.

What has happened is that the U.K. economy has adjusted more smoothly to the fall in oil prices than many thought possible. The latest Fund forecast puts U.K. growth at 3.4 percent this year--the fastest growth of all the major industrial countries. And U.K. manufacturing productivity, currently rising at about 6 percent, has continued to exceed expectations, thus containing the growth of unit labor costs.

The United Kingdom's strong growth performance has not been brought about by any fiscal stimulus. The public sector borrowing requirement has in fact been reduced to less than 1 percent of GDP. We have been able to bring down tax rates by maintaining a declining path for public expenditure as a proportion of GDP. Nor has there been any relaxation of monetary policy. Interest rates have been held at levels necessary to maintain sound anti-inflationary conditions. In short, it is the enterprise economy that has done the trick. One consequence of this improved performance has been a significant drop in unemployment, which has fallen by 400,000 over the last 14 months.

The strong growth of U.K. output and demand has caused some to suggest that the U.K. economy is in danger of overheating, while others are forecasting a slowdown. Some manage to combine both predictions. But while, as in most countries, inflation is a bit higher than last year when the impact of falling oil prices was greatest, there has been no significant change in underlying inflationary pressure.

The United Kingdom is now well into its seventh year of steady growth at 3 percent a year. During that period there have been minor fluctuations, and after the slight spurt this year, I would expect something closer to the 3 percent average rate next year.

The Background to the Louvre

I now turn to the evolution of exchange rate policy.

For the first 25 years after World War II, exchange rate stability was achieved through the Bretton Woods system. This formed a cornerstone of the postwar economic order, not least as a force for financial discipline. But it began to break down in the late 1960s, and by the early 1970s it had collapsed altogether. Thereafter, with countries pursuing divergent economic policies, and many suffering from high and volatile inflation, a system of floating exchange rates was virtually inescapable. Indeed, many at the time believed this new flexibility to be desirable.

With hindsight, some of the arguments for free floating seem much less compelling. And the belief that markets would provide a stabilizing influence, through the operations of medium-term speculators, has not been borne out.

In particular, we have seen wild gyrations in the dollar that have clearly not been a reflection of economic fundamentals, which are essentially slow moving. Few could seriously argue that two deutsche mark to the dollar was "correct" in 1979, and again at the end of 1986, and yet that three deutsche mark to the dollar was "correct" in 1985. Moreover, these gyrations have damaged growth in world trade. Businesses have had to divert scarce management time and skills to coping with currency fluctuations, rather than improving company performance. And the major uncertainties about exchange rate movements inhibited risk taking and required a switching of resources at a pace that was wholly unrealistic.

The explanation for these gyrations in the dollar derives in large part from the nature of the foreign exchange markets. We now have global 24-hour markets in which turnover has increased dramatically, with only a small part of that related to commercial transactions. This presents particularly acute problems for the dollar, which still dominates the world's money markets. In 1986, on the London foreign exchange market, 97 percent of all transactions were in dollars.

Of course, all financial markets have a certain amount of speculative froth. But to function well they need some players to take a longer view, and so provide a stabilizing influence. In foreign exchange markets, they have been conspicuous by their absence.

This means that once the dollar starts to move in one direction, it can continue in the same direction for months and even years, even if there is a general consensus that the rate is out of line. This is what happened in 1984 and early 1985. Almost everybody agreed that the dollar was overvalued, and that, in the long run, it was bound to fall. But they continued to buy dollars in the belief that, in the short run, it would move even higher--which is, of course, what consequently occurred.

The result is that trends have been greatly magnified. Capital movements have generated fluctuations in the dollar; but equally, fluctuations in the dollar have themselves generated further capital movements. This is how exchange rates have often acquired a momentum of their own, which has not been reversed until they have reached extreme levels of over- or undervaluation.

Background to Plaza

It was a growing concern about this process that led to a small group of us to meet in the Plaza Hotel in September 1985. We shared three perceptions:

- first, that the gyrations in exchange rates had proved damaging;

- second, that the immediate problem was that the dollar was much too high; and

- third, that the time was right for the authorities of the major countries to give the markets a clear lead.

The Plaza agreement marked an important step toward a more managed system. In private, we discussed the scale of fall we saw as desirable, and although no figures were given in public, everyone was aware that we were looking for substantial changes. We agreed to cooperate to bring that about. And that agreement played an important role in securing a continuing fall in the dollar over the succeeding 15 months.

The Louvre

The Louvre accord earlier this year marked another important step forward--Plaza II, as I called it at the time to emphasize the continuity. By then the broad objectives agreed at Plaza had been achieved. The yen and the deutsche mark had appreciated by as much as 50 percent or so against the dollar.

We agreed that, given the policies being followed, the dollar was by then broadly in line with economic fundamentals and that the interests of the world economy would best be served by a period of stability, to allow time for the major economies to adjust to the exchange rate changes that had occurred. We were not, of course, thinking in terms of rigid exchange rates, but we did discuss the scale of fluctuation, around the then current levels, which we would not wish to see exceeded. Figures were agreed in private, but not, of course, revealed in public.

In spite of widespread skepticism when it was first concluded seven months ago, the agreement has proved a success.

Managed Floating

The move to managed floating has been made possible by two fundamental changes:

- First, we have at last returned to a world of low inflation. The average inflation rate for the major seven economies has fallen from 12 percent in 1980 to about 3 percent today. In the process, inflation differentials have been narrowed considerably.

- Second, there is now a clear consensus among the major countries about the approach to economic policy. And we all agree on the need for a greater reliance on market mechanisms within the framework of a firm monetary and fiscal policy.

We have been able to make this regime work because:

- We have chosen the right time to give a lead to the markets. In this sense we have been working with, rather than against, the grain of the markets.

- We have been prepared to commit ourselves publicly to appropriate and consistent domestic policies.

- In particular, we have all been prepared in practice to give significant weight to exchange rates in the conduct of monetary policy.

- We have been prepared to back up our agreement with coordinated intervention, sometimes on a substantial scale.

- We have deliberately not revealed details of our arrangements. And we have worked within margins of a size sufficient to allow us the necessary tactical room for maneuver.

A Regime for the Future

I believe that we can and should use the experience we have gained to build a more permanent regime of managed floating. I do not see the past two years simply as a temporary phase. Our objectives should be clear: to maintain the maximum stability of key exchange rates, and to manage any changes that may be necessary in an orderly way.

Let me make it clear that I am not suggesting that we can or should return to Bretton Woods. That system was undermined by its rigidity; the margins were too narrow; it required a predictable and mechanical response from the authorities that made them an easy target; necessary realignments were postponed too long, and consequently, when they came, they were inevitably large.

For the future, it is important, therefore, that we continue to keep an adequate degree of flexibility in terms of the width of the bands within which currencies are able to fluctuate. And, if and when the time comes to adjust one of the rates, that adjustment should be made by moving the midpoint within the confines of the existing range. This means that the markets are not given a one way bet, and the authorities retain tactical flexibility.

As I have already emphasized, what made the Plaza and Louvre agreements possible was that the countries participating were, and remain, in effect, members of an anti-inflationary club, with a clear commitment to taking whatever steps are necessary to curb their own inflation. It is vital that that commitment continues, individually and collectively. A resurgence of inflation in any individual country would make it difficult for that country to remain within the club.

At the same time, we must also ensure that there is no persistent inflationary (or for that matter deflationary) bias for the group as a whole. This can be helped by:

- the development of indicators for the group as a whole; these will be mainly financial but special attention should also be given to the trend of world commodity prices;

- a nominal framework for policy, in terms either of a path for GDP growth for the group as a whole, or one for the average inflation rate; and

- a medium-term perspective when setting out the path and in gauging actual performance. We should not become involved in an exercise in short-term fine tuning.

In recent meetings we have put a lot of effort into developing performance indicators for individual countries. I have to say that I have considerable doubts whether we can usefully take that exercise much further. I believe it would be far more useful to devote our efforts to monitoring the performance of the group as a whole, so that we can ensure that we maintain the correct noninflationary policy stance.

Current Account Imbalances

Some fears have been expressed that the Louvre agreement will be undermined by the persistence of current account imbalances between the major countries. I do not believe this need be so.

What we are seeing is not altogether surprising. It is the familiar J-curve effect, and although the imbalances remain large, trade volumes are adjusting.

In any case, there is no law that dictates that the current accounts of the major industrial countries should always be in balance. We have an integrated world economy and we encourage the free flow of capital and goods. Clearly there are limits to the accumulated external liabilities or assets that can be sustained without creating major anxieties for capital markets. But investment opportunities and savings propensities inevitably differ from country to country and it is natural for this to produce substantial, and often sustained, capital account flows. These flows necessarily have their counterparts in current account surpluses and deficits.

The present combination of deficits and surpluses has emerged over several years during which the growth of domestic demand in the Federal Republic of Germany and Japan has been consistently below the growth of output, while in the United States it has been consistently above. The process of unwinding the imbalances requires a reversal of the differences between domestic demand and output in those countries. This is bound to take time to complete, but--and this is important--it has now begun.

It would be a serious mistake to seek a shortcut by a further dollar depreciation. It was undoubtedly necessary to correct the huge misalignment of the dollar in 1985. But there is no case for going to the opposite extreme of an artificially low dollar. The benefits to the current account would be small compared to the damage to U.S. inflation and the dislocation to the world economy. The main lesson from recent years is that we should avoid exchange rate misalignments, not encourage them.

Conclusion

In conclusion, I believe that external stability should now complement the internal financial stability that we have already achieved. It will remedy a major weakness in the world financial order and provide a sounder basis for the prosperity we all seek.

MR 4/21

CONFIDENTIAL

(until 6.45pm, 26 October)

P7

FROM: A P HUDSON

DATE: 26 October 1987

SIR P MIDDLETON

cc: Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir T Burns
Sir G Littler
Mr Cassell
Mr Monck
Mr A Wilson
Mr Scholar
Mr Burgner
Mr Peretz
Mr D J L Moore
Mrs Lomax
Mr R I G Allen
Mrs Brown
Mr P R C Gray
Mr Ilett
Miss O'Mara
Mr Pickford
Mr Neilson
Mr Cropper
Mr Tyrie
Mr Call

STOCK EXCHANGE SPEECH, 26 OCTOBER

... I attach the final version of the Stock Exchange speech.

APH

A P HUDSON

FINAL

CHANCELLOR OF THE EXCHEQUER'S SPEECH TO STOCK EXCHANGE CONFERENCE, 26 OCTOBER

It is always rash to pronounce on market movements before the dust has settled.
But it would be perverse if I were not to take the opportunity of this occasion to make some comment on the events in the equity markets of the world over the past ten days.

I speak as one who believes profoundly in the market economy, of which free financial markets are a vitally important part.
But that does not mean that I believe markets to be infallible: no institution composed of fallible human beings possibly could be.

It was Churchill, I think, who justified his devotion to Parliamentary democracy on the grounds that all other systems of Government were infinitely worse.
So it is with the market economy.

One well-known characteristic of financial markets is their tendency to overshoot.
We have seen this in recent years with the movement of the dollar in the foreign exchange market - though it is notable that throughout the recent falls in the equity market, not only has the bond market been firm, but the foreign exchange market has been remarkably stable.

Over the past five years, share prices in both New York and London alike have more or less trebled <u>in real terms</u>, rising far faster than company profitability and creating a growing gap between the return on equities and the return on bonds.

It was neither unexpected nor in any way unprecedented that sooner or later there would be a sizeable correction.
What has attracted attention is the speed of the correction once it began.

It may be that this rapidity of movement is an inevitable characteristic of today's global markets and modern information technology.

It is at least equally likely, however, to have been exaggerated by the fact that this was the first major correction to have occurred since the new markets came into being.

Clearly, the experience will need to be carefully analysed in tranquillity, and lessons drawn.

The electronic automation and globalisation of the herd instinct is not an impressive sight.

But meanwhile it is abundantly clear that market corrections of this kind do not require there to have been any change in economic fundamentals. Still less do they imply that the world's economies are fundamentally unsound.

Indeed, so far as the British economy is concerned, at no time since the War has it been in better health.

Essentially, what has occurred is that the view now prevails that the markets had earlier got ahead of themselves.

I am not, of course, saying that there is no cause for concern on the world economic scene.

Indeed, it would be distinctly odd if I were, given that there have been few more consistent critics than I of the huge United States budget deficit, which far exceeds that country's capacity to finance it from its own resources.

It was in my speech to the Annual Meeting of the IMF three years ago that I warned that the budget deficit needed to be vigorously tackled "if the process of adjustment is not to end in tears".

This was at a time, incidentally, when I was being assailed on almost all sides for refusing to pursue a similar deficit financing policy in this country.

The fact that the United States suffers from its twin deficits and rapidly growing foreign indebtedness no doubt explains why the worldwide fall began on Wall Street.

What is less readily explicable is why the London market should be following (and attempting to second-guess) Wall Street quite so slavishly.

It is, perhaps, ironic that concern over the US federal deficit did not become a significant market factor until a few days after the end of a financial year in which the United States has at long last succeeded in substantially reducing its deficit - by $73 billion, or almost one third of its previous year's level.
Further reduction, however, is still required, and it is encouraging that President Reagan now appears to be fully seized of the need.

What is not required in current world circumstances, however, is either a lurch into protectionism or undue monetary tightening.
It was this which, quite unnecessarily, turned the 1929 Wall Street crash into the depression of the 1930s.
I believe that lesson has now been widely learned.
But it would certainly be helpful if the German monetary authorities were to show more obvious awareness of this.

But in general, co-operation between the finance ministers and central bank governors of the major economic powers has improved enormously over the past four or five years, and that is something which will stand us in good stead at the present time.
Indeed, with skill, I believe we can turn what has happened to positive advantage.
That may be of little immediate consolation to those who have been obliged to realise sizeable losses over the past ten days, or will soon have to do so.
But it is, after all, what matters most.
And meanwhile the City of London has the opportunity to demonstrate to the world, that so far from being simply a fair-weather market, it can handle a storm better than any other financial centre in the world.

But to return to the subject matter of this Conference.

As I said in my Mansion House Speech last October, bad blood between industry and finance is bad for Britain, and we must all work to eradicate it.
So I welcome what has been done over the past year to improve communications between the City and industry.

It is reassuring evidence that, in an exceptionally busy year, the Stock Exchange has not lost its sense of priorities.
For while the City is big business in its own right, it is a business that exists to serve industry - as you recognise in the title of this Conference - just as much as investors.

The economic importance of the new markets.

The financial services sector, broadly defined, has been one of the most conspicuous success stories of recent years.
Its contribution to national output has risen steadily, reaching 15 per cent last year, rather more than twice that of North Sea oil at its peak.
The result has been over half a million new jobs since 1979.
More than 2½ million people now work in the financial sector as a whole.
That is nearly a tenth of the total workforce - twice as many as in agriculture and mining put together.

"The City" has always been a major source of overseas earnings.
Last year it set a new record of £9½ billion - 40 per cent up on the previous year, itself a record.
And within that, the securities industry's total has nearly doubled in two years.

These figures - which pre-date the Big Bang - are one indication of the increasing international nature of London's capital markets.
The changes that took place a year ago today marked a further step in that direction.
Another important advance was the formation of the International Stock Exchange last November.
It is not surprising that the forward strategy which has just been outlined to you has a strongly international flavour.

The success of London as an international financial centre is extremely valuable in itself: for the jobs it brings, for the wealth it creates, and for the opportunities it offers to British financial firms to grow into world class players.

No less real are the benefits for the rest of British industry of having a major financial centre here in London.
The top UK companies gain from ready access to overseas sources of capital; and all issuers benefit from a primary market whose capacity is enhanced by a more active and liquid secondary market.

But perhaps the main effect of Big Bang and all that has been to strengthen London's position as an international financial centre: and a continuing international emphasis is inevitable, if London is to retain a major role.
Unlike Tokyo and New York which can rely - at least for a time - on the sheer size of their domestic markets, London must be first and foremost an international market place.
This has been true for years in banking: it is increasingly true in equities too.
In terms of the market value of listed domestic companies, London ranks third in the world, behind New York and Tokyo, but it tops the world league - by some distance - as a centre for trading international equities, and its lead is growing.

Over the past year international equity turnover in London has leapt ahead: it is now equivalent to around 50 per cent of the turnover in domestic equities.
Reliable statistics are still hard to come by, but there is no doubt that an increasing amount of business in overseas equities is being done in London.

Regulation

With the growing integration of financial markets, not even the largest centres are immune from competitive pressures - a point that seems to be dawning on the Americans, to judge by Secretary Baker's recent remark that "US bankers, ham-strung by laws here, are moving their business (and jobs) abroad, particularly to London".

Mr Baker's comments put some perspective on recent complaints about over-regulation here in London.
Of course, we take very seriously the risk that inappropriate or heavy-handed regulation could stifle the growth of our markets.

But I am in no doubt that <u>effective</u> regulation will enhance London's standing.

The recent falls in the world's stock markets have underlined one crucial point: the need for players in these markets to have adequate financial resources.
As I said at the Mansion House last year, the system will be better able to weather the occasional storm if those who profit from freer markets take the opportunity to strengthen their capital base.
By the same token, London's international position will not be hampered by capital requirements that are based on a <u>realistic</u> appraisal of market risks.
Quite the reverse.

The challenge for the regulators - and it is a stiff one - is to develop a regime that is both firm and flexible.
There is bound to be a period of learning.
The Government, for its part, intends to keep a very close eye on the way the new system is developing.
Much of the hard work will inevitably fall to the practitioners.
And recalling the City's enthusiasm for practitioner-based regulation, I am sure you would not have it otherwise.

But what needs to be much more clearly understood is that practitioner involvement must go far beyond the efforts of a handful of public spirited individuals on the SIB or the SROs.

The deferral of Section 62 of the Financial Services Act will give the SROs a breathing space to get their rules right.
It is important to put that breathing space to good use.

<u>City and Industry: "short-termism"</u>

Over a year ago, I raised the question of short-termism in both industry and the financial world.
I referred to complaints from industrial managers that institutional shareholders were unwilling to countenance long-term investment or sufficient expenditure on research and development; but I also pointed out that in some cases it was industrialists themselves, in their capacity as pension fund trustees, who were

- putting pressure on financial managers to meet short-term performance targets in running long-term funds.

The recent CBI Task Force Report, "Investing for Britain's Future", agreed that short-termism is indeed a problem for British industry - though it also concluded that the City was not to blame.

It is undoubtedly true that - as the report says - "many British companies have given insufficient weight to long-term development". One illustration of this is the fact that business expenditure on research and development is a much lower proportion of GDP in the UK than in Germany, Japan, and the United States.
(Whereas Government spending, even on civil research, is a rather higher percentage of GDP in Britain than it is in either Japan or the United States.)
And the report is clearly right to argue that a longer-term view will be needed, if British firms are to continue to succeed in an increasingly competitive market place.

There are of course no simple - let alone instant - answers.
But one thing that is essential is better communication between management, owners of companies, and the providers of finance.
The Task Force are quite right to press for that.

Better information - and in particular better communication by means of published accounts - has a key part to play in helping share owners understand a company's objectives and the main elements of its long-term strategy.

I particularly welcome the Task Force's support for an accounting standard on disclosure of R&D expenditure, together with some explanation of how R&D spending fits into a firm's overall strategy.

I also endorse the Task Force call for restricting the options currently available in accounting for mergers and acquisitions.
All too often, the real effect of takeovers is inadequately set out and too little information is forthcoming about the true outcome of combining the businesses.

And going beyond what was in the Task Force Report, I believe there is a general need for more relevant and more useful information in Company Reports and Accounts, in a form which can be readily understood by the rapidly increasing number of people who have a right to be interested in it.
This is not just a matter of expressing the accounts in language that can be readily understood - though that is certainly important. They also need to show a true and fair view of the real financial and economic situation of the business - warts and all.
This means - among other things - taking proper account of the effect of off-balance sheet financing and of controlled non-subsidiary companies.

Wider Share Ownership

But there is another, more fundamental way of addressing the perceived problem of short-termism.
And that is wider share ownership.
While the Task Force is right to emphasise the importance of better communications between industry and professional investors, some far-sighted businesses are beginning to look beyond City institutions, and to grasp the value of having their shares held more widely.

The fact is that the small shareholder tends to be more committed to the company in which he invests, provided it treats him well over the years; and, perhaps partly because he is answerable only to himself, the individual investor is more prepared to take a long-term view.

The Stock Exchange as an institution has an honourable record in promoting wider share ownership; and I pay tribute to the personal contribution Nicholas Goodison has made here.
But once the present problems have been overcome, the City - which is hugely successful in so many other ways - must do much more to open its doors to the small investor: to develop dealing and settlement systems that can cope with small transactions; to make it easier for the small investor to buy and sell shares; and generally to develop a much more vigorous retail business than at present exists in this country.

In this context, I warmly welcome schemes that cut down on the paperwork involved in small transactions, like that just launched by Barclays.

If financial firms have been slow to come to terms with wider share ownership, business and industry generally - with a few creditable exceptions - have scarcely begun to think seriously about how to widen their shareholder base.

One problem frequently mentioned is the cost of servicing large share registers.
I accept that some changes may be needed.
It may for example to be possible to reduce the volume of information that now, by law, has to be circulated to every shareholder.
The Department of Trade and Industry have been consulting interested bodies about this issue, though major change in the present requirements would require legislation which would obviously take time.

In the meantime, I have decided to amend the PEP regulations to permit plan managers to distribute full company report and accounts at the shareholder's option only.
And I am taking the opportunity to make a number of minor technical improvements to the PEP scheme, which should be welcome to plan managers.
I trust they will not be slow to pass the benefits on to their customers, in the form of lower charges.

Peroration

This Government has brought about a dramatic improvement in the climate for industry, and industry has excelled itself in exploiting that climate.
Current events in the stock market must not be allowed to obscure this fact.

The next task is no less important: to consolidate these successes by permanently changing attitudes.

That is the challenge for the future.
And it is a challenge for all of us: Government, industry and the City.

But your success in keeping London in the forefront of international financial markets gives me confidence that it is one you will be fully able to rise to.

P7

Financial Situation

3.32 pm

Mr. John Smith (Monklands, East) *(by private notice)* asked the Chancellor of the Exchequer if he will make a statement on the implications of the financial situation for economic policies and the consequences for the sale of BP shares.

The Chancellor of the Exchequer (Mr. Nigel Lawson): I am glad to have the right hon. and learned Gentleman opposite me once again, as he was some years ago when I was Secretary of State for Energy.

Mr. Tony Banks (Newham, North-West): There is not much left now.

Mr. Lawson: You wait and see.

The sharp falls in share prices throughout the world over the past fortnight will tighten monetary conditions somewhat and are likely to have a dampening effect on world demand. It is far too soon to put any figures to this, but I have already responded by reducing interest rates by half a per cent. Interest rates have also come down in the United States.

I will, of course, continue to watch the situation closely, and take whatever steps are required. I am also in regular contact by telephone with my opposite numbers in the other major industrial countries.

Meanwhile, the robust economic health and sound public finances that we have in this country put us in the strongest possible position to weather this storm, just as we successfully coped with the year-long coal strike and the collapse in the world oil price.

As for the implications of the stock market slide for the BP sale, there is provision under clause 8 of the BP fixed price underwriting agreement for the underwriters to seek consultation with the Treasury if a majority of them form the opinion that there has been an adverse change of circumstances, as specified by the agreement, in the light of which they believe that they are no longer assuming a proper underwriting risk. I have been informed by N. M. Rothschild and Sons, on behalf of the United Kingdom underwriters, that a majority of them now take that view. They therefore sent a written representation to the Treasury yesterday afternoon seeking consultation with a view to terminating the offer for sale. I have to say that I was surprised by this. *[Laughter.]* I am now considering the points that they have made, as I am contractually bound to do.

The underwriting agreement sets out a series of steps, which must be followed if the consultation process is triggered. The Treasury considers the representations and consults BP. Rothschild's also seeks BP's views. Rothschild's and the Treasury then consult together. If they are unable to agree, they jointly approach the Bank of England for its assessment. I shall take full account of that assessment before I take a final decision.

I understand that a copy of the agreement has today been deposited in the Library.

It is my intention to proceed as quickly as possible, consistent with the proper observation of the procedures. The House will understand that, now that the underwriters have invoked this consultation process, I cannot say more until the process is concluded, but I will gladly listen to the views of right hon. and hon. Members.

Mr. Smith: Is the Chancellor not ashamed that he had to be dragged reluctantly to the House to answer a private notice question, when he should have volunteered a statement on his own initiative days ago? Does he not think that he should apologise to the House for treating it as being a good deal less important to him than the stock exchange?

Is it not clear that the fundamental reason for the collapse in international markets has been the irresponsibility of Governments, including the British Government, in facing up to the twin problems of the United States' deficit and the Japanese and German surpluses? Instead of taking action to reduce gradually the United States' trade deficit and simultaneously expand the other economies, Governments — who are staffed by people such as the Chancellor of the Exchequer, who are addicted to free market theories—have abandoned their responsibilities to markets that the Chancellor describes as having absurd activities and which, according to the Prime Minister, are involved in 5 per cent. trade and 95 per cent. speculation?

Does the Chancellor understand that the free-market chickens have come home to roost? The markets are desperately seeking responsibility from the Governments that have abandoned them. Is it not now urgent for Her Majesty's Government to co-operate in setting up a new economic summit of the G7 countries with an agenda to concert a plan to tackle the deficit-surplus problem in a way that will avoid recession, reopen opportunities for growth and engage in a fresh and constructive examination of the debt problems of the developing world?

Will the Government accept that, as a result of the events of the past few weeks, free market theories no longer work?

As to BP, will the Government explain why they must take so long to go through the procedures that the Chancellor has outlined? In what he said to the House, he has made it crystal clear that he intends to hold the underwriters to their obligations. Would it not be wiser, given that we are only hours from the closing of this offer, for a little more urgency to be shown in these consultations and for the Chancellor to be more prepared to give a definitive answer to the House today?

Whatever happens with the underwriters or about anything else, will the Chancellor confirm that the Government are obliged to purchase 450 million new shares at the price of 330p and that the difference between the price at which they committed themselves to buy new shares and the present value in the markets is over £300 million?

Will the Chancellor also confirm that whatever happens, £20 million will have been wasted on an extravagant advertising hype? Is it not extraordinary that this colossal waste of money occurs at the same time as the Government are cutting child benefit, apparently on the ground that decent levels of such benefit cannot be afforded in this country?

Is it not clear that, whatever happens to the underwriters, the decision to sell the whole of the Government's stake in BP has been profoundly foolish? The company will suffer, the Government have wasted money and the shares will not be purchased. Repeatedly the Chancellor has claimed that his sole purpose in the BP share sale is wider share ownership. Since the shares will not have been sold to willing purchasers, what will be left of his purpose?

Mr. Lawson: I shall try to deal with the questions in the order in which the right hon. and learned Gentleman asked them. I start with something on which I can agree with him. I agree that the size of the American budget deficit, which is way ahead of its own capacity to finance it, is a major problem in the world economy today. I think, however, that it is a bit of an impertinence for him to blame me or the British Government for that. I vividly recall the time, some three years ago, when I was saying just that and I was being attacked by him and other right hon. and hon. Members who said that we should follow the policies of expanding the budget deficit in this country.

The right hon. and learned Gentleman referred to international co-operation between the members of G7. I agree with him too that that is important. That is in better shape than it has been at any time in the period that I have been Chancellor of the Exchequer, and it has been very successful in the context of stabilising exchange rates, among other things. But I have to say that the sort of workmanlike co-operation that we do have and which I hope can be built upon and improved, is rather more serious than empty waffle about a non-existent plan and some summit.

The right hon. and learned Gentleman then went on to the question of taking so long on the BP front. He obviously failed to listen to what I said. I said that it was not until yesterday afternoon that the BP underwriters made their approach to the Treasury—4.20 yesterday afternoon, to be precise. I have now informed the House and I shall go through the procedures as quickly as can be done, while properly going through those procedures. I would hope to be able to reach a conclusion by Thursday.

The right hon. and learned Gentleman then asked me whether it was true that the Government were obliged to purchase a large number of BP shares at 330p a share. I can tell him, of course, that it is not true. He then said that this episode demonstrated that it was wrong to sell BP shares. But of course, he will recall that the first sale of BP shares was conducted by the Government in which he performed in 1977.

As to the question of wider share ownership, which the right hon. and learned Gentleman seems to be against, I have to tell him that he is in conflict with the views of the hon. Member for Dagenham (Mr. Gould) who is the rising star of the Labour party—or at least he used to be the rising star of the Labour party—when he said:

"Instead of opposing wider share ownership, for example, we should set about making it a reality . . . The idea of owning shares is catching on and as socialists we should support it."

The right hon. and learned Gentleman asks was not wider share ownership the sole purpose of the BP share offer? Obviously, the answer is no, because if that had been the sole purpose we would not have had the issue underwritten in the first place.

Mr. Terence Higgins (Worthing): Does my right hon. Friend agree that it is important that the Treasury and Civil Service Select Committee, which has previously taken evidence on the underwriting of privatisation issues and on wider international matters, should be set up this week so that it has an opportunity of reporting to the House on these important issues?

I welcome the reduction in interest rates. Does my right hon. Friend agree that this must be combined with fiscal balance and that, therefore, it is important that the United States fiscal deficit should be reduced? I congratulate my right hon. Friend on the representations he has already made to the United States Government, but I urge him to redouble them. Does my right hon. Friend agree that many people think that it would be dangerous to put underwriters in a position when they can say, "Heads we win, tails you lose"?

Mr. Lawson: On the question of the BP underwriters, of course I have noted carefully what my right hon. Friend has said. On the question of the Select Committee, I am sure that my right hon. Friend the Leader of the House has heard my right hon. Friend's comments. I personally have always welcomed the constructive discussions that I have had during my period as Chancellor with the Select Committee, which my right hon. Friend heads with such distinction. The sooner it can be reconstituted the better.

As for the wider economic issues, as I said in my opening remarks, I think that it is very important that we continue to keep up the pressure on the United States. The President has made statements showing a lesser degreee of unwillingness to raise taxes than has ever been the case before. I was speaking to Secretary Baker on the telephone this morning.

Mr. A. J. Beith (Berwick-upon-Tweed): Does not the Chancellor think that it is rather perverse for it to be suggested that he could either have caused in some way or prevented the recent upheavals, since they derive mainly from the decision of the President, whom the right hon. Gentleman and Prime Minister so much admire, to cut taxes and increase defence expenditure at the same time? Is it not time to tell the United States that the party's over and that we have to put the main industrial countries together to decide what to do to pay for it?

With regard to the BP share issue, what will the Chancellor do about all those inexperienced small investors who were beguiled by the expensive publicity? What good will it do to the cause of wider share ownership to deliver those people a kick in the teeth?

Mr. Lawson: On the first half of the hon. Gentleman's question, I welcome, just as I did when it came from the right hon. and learned Member for Monklands, East (Mr. Smith), this late conversion to the cause of sound finance, which is something that the Government have been preaching for a very long time, when the only policies advocated by the Opposition were ever bigger budget deficits. I remember the speech I made to the IMF annual meeting in September 1984 when I said that if the United States' budget deficit was not vigorously tackled it would all end in tears. We inherited a huge budget deficit from the Labour party. Even though we were in favour of lower taxes, we initially put up taxes to deal with the deficit first before we could get on with the tax-reducing programme.

As for the question of the small shareholders who may have applied for BP shares, as the hon. Gentleman will understand, like the Treasury, applicants for shares are bound by the terms and conditions of the offer.

Sir William Clark (Croydon, South): Will my right hon. Friend resist the blandishments of the right hon. and learned Member for Monklands, East (Mr. Smith) in favour of abandoning the free market? Does my right hon. Friend agree that the reason why our present economy is so strongly compared with, say, the 1979 economy is that we have allowed the free market to operate within the Treasury's control? It would be folly if we were to change

[Sir William Clark]

course now. Does my right hon. Friend agree that, to get international confidence back into the various money markets throughout the world, the most urgent need is for the American President to make up his mind as quickly as possible to increase American taxes and to reduce public expenditure?

Mr. Lawson: I think there is probably general agreement in the House with what my hon. Friend has said. Of course, to be fair, it is not only on the side of the Americans that action is called for. I believe that in current circumstances there is a danger that monetary policy in the Federal Republic of Germany is really rather too tight, and I hope that some action will be directed on that front as well.

Mr. Peter Shore (Bethnal Green and Stepney): No one can accuse the Chancellor of hyperbole when he says that the events of the past fortnight will have a dampening effect on world demand. The real effects are far more likely to be a serious curtailment of investment, a curtailment of consumer spending and a resulting increase in unemployment. Therefore, will the Chancellor assure the House that he is ready to take counter-recession measures — a package of them, both national and international — to meet the scale of events?

Mr. Lawson: I can assure the right hon. Gentleman that as I said in my opening remarks, I shall take whatever actions I believe to be necessary in the circumstances. It is too soon to say what actions will be necessary, although I have already reduced interest rates. That goes, I think, for all other members of the Group of Seven. The right hon. Gentleman will know, for example, that the President and Congressional leaders have been in active discussions on the subject of getting down the American deficit.

There is no need for the alarmist consequences that the right hon. Gentleman fears if, as I believe will be the case, economic policies in the major nations are conducted in a sensible way.

Sir Peter Hordern (Horsham): Will my right hon. Friend accept that if the BP share issue is withdrawn, it will be widely felt that the underwriters cannot meet their commitments? If that is the case, the damage caused will be much greater than will result if the issue proceeds.

Mr. Lawson: My hon. Friend is very knowledgeable in these matters, and I have carefully noted what he has said.

Mr. Robert Sheldon (Ashton-under-Lyne): Will the Chancellor dismiss the impertinence shown by the underwriters in coming to him to seek to forgo their liabilities and responsibilities? Is he aware that the Public Accounts Committee has condemned the very large fees paid to the underwriters and that, on each occasion we have been informed that this was necessary because of the large risks involved? If we are to remove the risks and give the underwriters a copper-bottomed, gold-plated guarantee, what is the purpose of underwriting at this level?

Mr. Lawson: As Chairman of the Public Accounts Committee, the right hon. Gentleman occupies a very important position in this House, and I have very carefully noted the point that he has made.

Mr. Anthony Nelson (Chichester): Before my right hon. Friend reaches any final decision on this matter, will he bear in mind that he has a responsibility that overrides that of acting as a guardian of underwriting institutions in the City, or even of share applicants? I refer to his responsibility as a trustee of the public purse. Will he bear in mind the fact that the interests of the taxpayer, who will forgo a substantial sum by way of proceeds if the sale is called off should weigh heavily on his mind. After all, does my right hon. Friend really believe that if the market had risen dramatically, rather than slumped, the City institutions would for one minute have considered calling the underwriting arrangements off?

Mr. Lawson: My hon. Friend's point deals with a number of the matters that I have to bear in mind.

Mr. Brian Sedgemore (Hackney, South and Shoreditch): Why has the Chancellor spent a week telling television viewers that it is possible to wipe 25 per cent. or more off the value of stocks and shares all round the world without serious consequences for liquidity, borrowing, trade, output and employment? In the face of impending recession, what does the Chancellor intend to do—other than to lecture foreign Governments?

Mr. Lawson: There is no need to share the apocalyptic visions of the hon. Gentleman provided that the Governments of the major countries pursue the appropriate economic policies. What turned the 1929 crash which I think is in many prople's minds into the slump of the 1930s was not the crash itself but the wholly inappropriate economic and monetary policies that followed it.

Mr. Quentin Davies (Stamford and Spalding): Does my right hon. Friend agree that the present situation is a splendid vindication of the Government's judgment in underwriting this and other privatisation issues and that the Government deserve the wholehearted appreciation both of the House and of the general public in the exercise of that judgment? Does he agree that the main problem with the underwriters is that the foreign underwriters have not underwritten their commitment to BP with investing institutions, and that if they have to sell shares to meet that commitment they will not mainly be British shares that they have to sell?

Mr. Lawson: My hon. Friend—and I am grateful to him for his earlier remarks—is, of course, right to point to a fundamental difference between the underwriting system in this country and the underwriting system on the other side of the Atlantic. In this country it is a feature of our system that we go in for—the underwriters go in for — sub-underwriting on a very substantial scale and therefore the risk is spread very, very widely. In the United States and Canada that practice is not adopted and of course the risk falls entirely with the underwriters.

Mr. Tony Benn (Chesterfield): Has the Chancellor read the speech made in the House in 1914 by Winston Churchill when he acquired a majority holding in the Anglo-Persian Oil Company for £2 million? Does the Chancellor agree that that investment, albeit by the First Lord of the Admiralty in a Liberal Government, was the wisest public investment ever made?

Does the Chancellor agree that the proper course now would be to cancel the privatisation of BP and retain the assets in the public domain?

Mr. Lawson: I have to confess to the right hon. Gentleman that I have not read that speech very recently but I do recall a more recent event—that it was when the right hon. Gentleman was Secretary of State for Energy that the first sale of BP shares was made, at a price of well under 100p per share.

Sir Michael Shaw (Scarborough): Is it not important that the overreactions of the stock exchange should not confuse the public and lead them to believe that the state of British industry and commerce is less strong than it is? At the same time, would it not be very bad for the long-term future of this country if emergency measures were sought to be taken at this time? Does my right hon. Friend agree that we should carry on with the rules as they are and that the undertakers should not be relieved of their responsibilities. [HON. MEMBERS: "Underwriters."]

Mr. Lawson: As far as the undertakers, if I heard my hon. Friends right, are concerned, I have noted carefully what he has said. So far as his earlier points are concerned, yes, I think that if the House looks, for example, at the latest CBI trends survey, it will see an extremely strong and confident performance by British industry and I know that the leaders of British industry do feel that there is absolutely no cause for changing that confidence in the light of recent events on the stock market.

Mr. D. N. Campbell-Savours (Workington): As the flotation was underwritten by four major American institutions, when the Chancellor weighs these matters in the next few days will one of his considerations be the fact that they may be called upon again, to underwrite the flotations with regard to water and electricity?

Mr. Lawson: As I have said to other hon. Members, I shall certainly take very much into account the view expressed by the hon. Member.

Mr. Tim Boswell (Daventry): Will my right hon. Friend confirm that the offer for sale in formal terms remains open, with all its full legal impact? Will he take steps to ensure that when the privatisation programme is resumed, measures are taken to ensure that the undertakers—*[Laughter]*—underwriters—cannot again appeal against the last ball of the over?

Mr. Lawson: I have noted the suggestion which my hon. Friend has made.

Mr. David Blunkett (Sheffield, Brightside): Does the Chancellor accept that in our democracy accountability for the economy and what happens to public assets rests with him, as accountable to this House, and that the so-called capital-owning, share-owning democracy is neither democratic nor effective? As a consequence, does he agree that he should give an assurance to the House that further sales of major public assets will cease and accept that the most widespread form of share ownership is social ownership?

Mr. Lawson: I entirely accept the fact that I do have a heavy responsibility in this job, but I do not accept anything else that the hon. Member said, particularly his belief that share ownership is something which is to be condemned. I welcome the growth of share ownership; it will continue. The privatisation programme will continue and I am delighted that we now have a convert to the cause of share ownership in the person, the important person, of the hon. Member for Dagenham (Mr. Gould).

Mr. John Redwood (Wokingham): Does the Chancellor agree that there are times when concerted foreign exchange intervention can be dangerous before the underlying problem of the deficit has been resolved? Is not that danger especially clear if the German and Japanese authorities put up their interest rates to deal with the monetary consequences of that intervention?

Mr. Lawson: I see no need for German or Japanese interest rates to rise in present circumstances, although that is obviously primarily a matter for those countries. As for intervention in the foreign exchange markets, what my hon. Friend has to recall is that we did not intervene in order to stabilise markets until we had first intervened in a massive way following the Plaza agreement to drive the dollar down, and we only intervened to stabilise it after the deutschmark and the yen had risen by as much as 50 per cent. against the dollar in order to give that massive change in exchange rates time to work through.

Mr. Harry Ewing (Falkirk, East): I represent a constituency where BP is the largest employer, employing more than 2,000 people. Does the Chancellor understand that it is distressing that throughout this fiasco no reference has been made to those who have spent their lives working for BP? Is he aware that I do not hold any strong feelings about what might happen to the directors of BP, and that I care even less about what might happen to the underwriters? However, I care deeply about what will happen to the workers. Will he give an assurance that, whatever decision he reaches, the working people will not be made to pay for the fiasco for which he is now responsible?

Mr. Lawson: I am glad to be able to reassure the hon. Gentleman that there is no danger whatsoever either to BP or those who work for that company, which is indeed one of the finest companies in the world.

Mr. Patrick McNair-Wilson (New Forest): May I congratulate my right hon. Friend both on his sensible answer and, more importantly, on the calmness that he has demonstrated during this most difficult time? Is it not in such stark contrast to the hysterical posturings of the Opposition, who have no credible economic policy?

Reference has been made to the problems in the United States, and there is no doubt about them. However, as there has not yet been any real problem with exchange rates, will my right hon. Friend be most careful to resist any pressures for managed, even fixed, rates, such as were suggested during the Louvre agreement before the crash took place?

Mr. Lawson: My hon. Friend, and I am grateful to him for the remarks he made in the early part of his intervention, is mistaken if he thinks that the Louvre agreement is an agreement to try and create fixed rates à la Bretton Woods. It is nothing of the sort and, indeed, I devoted a considerable part of my speech to the annual meeting of the IMF and World Bank in September of this year to explaining the system of what I called managed floating, which we have arrived at and which I think is beneficial, not least to industry, which finds the wild gyrations in the dollar in recent years extremely disruptive and, indeed, which has had an adverse effect on world trade.

Mr. Eric S. Heffer (Liverpool, Walton): As the casino economy, otherwise named by the Prime Minister as people's capitalism, is now coming apart at the seams, is it not clear that the time has come for a proper recognition

[Mr. Eric S. Heffer]

by the people of this country, especially those in this House, that the capitalist system is falling apart? Is it not time that the Government learnt that lesson and stopped their nonsense with privatisation, which is hurting a great many ordinary working people who have been kidded by the Government?

Mr. Lawson: The hon. Gentleman is really one of the dinosaurs of this House, and as such I have a great affection for him. The workers of this country know a great deal better what is good for them than he does and they have shown this in their response to privatisation issues, in their response to worker share schemes and in their response, indeed, at the last general election.

Sir Peter Emery (Honiton): To help stabilise the position, will my right hon. Friend point out to the public, the Opposition and the press that in today's stock market list in *The Times* hardly one share is not well above the low mark of this year? The concept that there is panic in overall share ownership should be hit hard. The Opposition do nothing to stabilise the position — indeed, they are creating the panic.

Mr. Lawson: I think there is much in what my hon. Friend says, although I do not credit the Opposition with such influence that they were able to start the Wall street slide which began the movement in share prices throughout the world. Nevertheless, if they could have done they would have done.

Mr. Peter Hardy (Wentworth): The right hon. Gentleman suggested that he had been made aware of the view of the majority of the United Kingdom underwriters. Would he care to tell the House whether he has received any communication from the American underwriters, American business or the American Administration? Was the matter a subject of his conversation this morning with Mr. Baker?

Mr. Lawson: I, of course, never reveal private conversations, as I am sure the hon. Gentleman never reveals private conversations, but the provisions in clause 8 of the underwriting agreement concern the fixed price underwriting agreement and they concern the United Kingdom underwriters. There may, of course, have been conversations between the United Kingdom underwriters and the overseas underwriters, but that would not be directly known to me.

Mr. Ian Gow (Eastbourne): Will my right hon. Friend pay a more generous tribute to the right hon. Member for Chesterfield (Mr. Benn)? Was it not he who, under the benign influence of Dr. Johannes Witteveen, came before this House 10 years ago and commended the sale of BP shares? Faced with that precedent, will my right hon. Friend pay a glowing tribute to the right hon. Member for Chesterfield?

Mr. Lawson: I do not think that I could possibly improve on the tribute that my hon. Friend has already paid.

Several Hon. Members *rose*——

Mr. Speaker: Order. We have another important statement this afternoon. I shall take two more questions from either side and then we must move on. However, I say to those hon. Members who will not be called today that there will be another opportunity at Trade and Industry questions tomorrow and also at Treasury questions on Thursday, when I will bear their legitimate interests in mind.

Dr. Jeremy Bray (Motherwell, South): The Chancellor gave the impression at the IMF that there were intervention bands for the dollar in the Louvre accord, but it now appears that that is not the case. Is it his intention that the pound should not stay with the deutschmark, but come somewhere between it and the dollar?

Mr. Lawson: So far as my speech at the IMF is concerned it was an accurate description of the Louvre agreement and anything that the hon. Gentleman may have subsequently read in any newspapers which may conflict with that is therefore incorrect. So far as sterling is concerned, I believe that the maintenance of stability of the sterling exchange rate is in the interests both of British economic policy, including anti-inflationary policy, and the interests of British industry.

Mr. Robert G. Hughes (Harrow, West): In rejecting the Opposition's advice, will my right hon. Friend agree that the nation and the international financial community will conclude that the economy of this country is in far better hands with a Chancellor who sticks to his policies and strategy, rather than with one who follows the Opposition's advice? In the 1960s and 1970s Labour Chancellor after Labour Chancellor gave the impression of running around like a wet hen but did nothing to help the economy.

Mr. Lawson: My hon. Friend is correct.

Mr. Pat Wall (Bradford, North): Last week, did the Chancellor read an edition of *The Wall Street Journal*, which pointed out that the eight occasions since the end of the second world war when shares fell sharply—this is the sharpest fall of all—were followed eight to nine months later by a recession or a severe slowing down of the world economy? That led to increases in poverty, unemployment and economic misery. Will he explain to the people of my constituency what is popular about a people's capitalism which offers them shares at 64p below the market price?

Mr. Lawson: It is indeed fortunate that this Government are in office in this country, as they are the one Government who can steer the country's economy successfully through the stormier period which we may be in. As for share price falls, as my right hon. Friend the Prime Minister pointed out, although there has been a sharp fall in share prices, they are now roughly where they stood at the beginning of this year. That is in sharp contrast to what happened in 1974, when the Labour party came to power, and shares fell during the course of that year by some 50 per cent.

Mr. Keith Mans (Wyre): Will my right hon. Friend the Chancellor explain the position of the small shareholder who has applied for BP shares but does not pay the second instalment?

Mr. Lawson: The rules are very clear in the terms of the offer document. If the second subscription is not paid up the shares are forfeited.

Sir T-Burns 119/2. P7

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4 November 1987

THE CHANCELLOR'S MANSION HOUSE SPEECH

Attached is the text of the speech to be made by the Chancellor of the Exchequer, the Rt Hon Nigel Lawson, MP, at the Lord Mayor's Banquet for Bankers and Merchants of the City of London at the Mansion House tonight.

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71/87

MANSION HOUSE SPEECH: 4 NOVEMBER 1987

On this great annual occasion of the Lord Mayor's dinner for the bankers and merchants of the City of London - and this is now the fifth time I have stood up here as Chancellor - it is customary to say something about the City.

But there are other speeches to come, and I can be brief.
Foremost among those other speeches, of course, will be that of the Governor, who will also be playing his fifth innings here in that capacity.
The excellent working relationship he and I have built up over that period is one that I value very highly indeed, and it clearly assumes a special importance during the difficult time through which we are now passing.
I am immensely grateful to him.

I would also like to salute the City for the way in which it has comported itself throughout almost three weeks of a financial blizzard which blew in from across the Atlantic, with a ferocity few of us have experienced in our lifetime.
Throughout that period, the markets have continued trading without disruption, and without even the curtailment of normal trading hours.
And in the midst of it all, the biggest share issue the world has ever seen was able to go ahead, with the London sub-underwriters ready, willing, and able to absorb the stock with relative ease.

I pay tribute to the Association of British Insurers, who, at the height of the BP controversy, declared

> "ABI members are quite prepared for the issue to go ahead and they will of course meet the obligations they have undertaken. There is no question of the ABI membership seeking to put pressure on Government to have the BP issue postponed."

And I pay tribute, too, to my fellow-guest, the Chairman of the Stock Exchange, Nicholas Goodison, who with characteristic forthrightness made clear that in his opinion, too, the BP share issue should go ahead.

I may be old-fashioned, but in my judgement, had I bowed to the pressure from some quarters to abandon the issue, which had been fully underwritten and - in London, at least, sub-underwritten too - it would have done irreparable harm to the good name and reputation of the City.
That weighed heavily with me in reaching my decision.

As it is, the City can hold up its head with pride.
It has demonstrated to the world, in the clearest possible way, that, so far from being simply a fair weather market, it can handle a storm better than any other financial centre in the world.

That said, let me now move on to discuss the wider question of why the world equity market collapse occurred, what its implications may be, and what needs to be done.

A movement of this magnitude, of this rapidity, requires a threefold explanation.
That is to say, it requires an explanation in financial market terms, in terms of economic fundamentals, and in political terms.
Unless all three elements had been present, I do not believe that the severity of what we have just been through, and the position in which we now find ourselves, could have occurred.

In market terms, it was clear that the longest bull market ever known was bound to come to an end sooner or later.
Over the past five years alone, share prices in both London and New York had trebled <u>in real terms</u>, rising far faster than company profitability and creating a growing gap between the return on equities and the return on bonds.
Though few of us foresaw the speed at which the markets would move when the turn came, this was clearly too good to last.

So far as the economic fundamentals are concerned, many of us had been warning, not for months but for years, of the dangers to the world economy inherent in the massive imbalances afflicting the three largest economies.
At the heart of this problem lay the huge budget and current account deficits of the United States, and the resulting dramatic

shift from a large creditor position built up over decades to a ballooning domestic and external indebtedness.
But there was also the counterpart of this in excessive current account surpluses of Japan and Germany.

It was precisely to deal with these world problems that the Finance Ministers of the major industrial nations have intensified their co-operation over the past two or three years.
A major reduction in the dollar exchange rate, coupled with the promise of action to reduce the US budget deficit, was agreed at the Plaza meeting of the G5 in September 1985.
And both have taken place.
Both the yen and the deutsche mark rose, in pretty short order, by as much as 50 per cent or so against the dollar, and the US federal budget deficit was cut from some $221 billion in 1985-86 to an estimated $148 billion in 1986-87, a fall of about a third - an improvement even greater than the ambitious target the US authorities had originally set themselves.

Hence our decision, at the Louvre meeting in February of this year, to work together to bring about a period of exchange rate stability.
This was both so as to allow time for the massive parity changes that had taken place to work their way through into reduced trade imbalances, and also to bring about a better climate for world economic growth than that provided by the wild gyrations of the dollar in the early 'eighties.

I have no doubt that this was the right course to pursue.
But the correction of imbalances on the scale that had earlier been allowed to arise is bound to take time, and impatience is always liable to set in.
Particularly when political doubts - the third dimension of the stock market slide - began to arise.
Doubts about whether the United States, despite their genuine success in 1986-87, had the political will to reduce still further a budget deficit that was still far too large.
Doubts, too, about whether the United States had the political will to hold interest rates at whatever level was necessary, not merely

to maintain dollar stability, but also to ensure that the deficit, so long as it endured, was soundly financed.
And doubts about whether some other countries would fully accept the implications for their own economies of maintaining currency stability.

It is, indeed, ironic that an apparent unwillingness of the United States to raise interest rates because of an exaggerated fear that this might tip the economy into recession has led to a collapse on Wall Street, whose recessionary threat is very much greater.

Of course, even financial clouds have silver linings.

In the United States, for example, the necessary slowdown in the growth of domestic demand in relation to output - if the trade balance is to improve, as it must - is now likely to be achieved.
And without the higher interest rates which would have added to the burdens of the debtor nations.
At the same time, the sudden loss of wealth suffered by the share-owning people of America is likely to cause them to want to save rather more of their income, thus facilitating the financing of the Budget deficit without so much reliance on sceptical foreigners.
All this is welcome.

But the need for the US Budget deficit to continue to fall significantly remains crucial.
As is now widely recognised, the key is that the current talks between the US Administration and Congress should lead to early agreement on a clear and credible package of measures to continue the reduction achieved in 1986-87.
This should go beyond the $23 billion to which the President is committed under the new Gramm-Rudman Act, and preferably with at least some increase in some form of taxation as part of that package.

This is essential, not simply because reduction of the US Budget deficit is necessary in economic terms, but also because this has now become the touchstone of whether the United States has the political will to make hard choices and to do what needs to be done.

It will be a key element in rebuilding market confidence.

And if such an agreement is soon reached between the Administration and the Congress, then I believe the other major nations of the world would agree to making it part of a wider international accord involving among other things a reduction in interest rates.

I fully understand - and sympathise with - the hesitations of those who are fearful of risks of inflation.
I have many times made it clear in the management of UK monetary policy that I am as conscious as anyone of such risks.
But if interest rates were the right levels three weeks ago, then it is unlikely that those levels are still right after all that has happened since.

I also fully understand - and share - the view that it is for the United States, where the heart of the problem lies, to give assurance of the necessary steps on the fiscal front before others can confidently make a major move on the monetary front.

Moreover, any wider international accord should not, in my judgement, stop there.
We should also take the opportunity to reaffirm the Louvre agreement, making whatever minor - and I stress the word 'minor' - adjustment is necessary in the light of recent events, with the United States in particular committing itself with deeds as well as words to supporting in the market place whatever is agreed, and if necessary visibly equipping itself with the funds to do so.
Others, too, will have to play their part.

By contrast, a so-called free fall of the dollar would solve nothing: it would merely risk a resurgence of US inflation and ensure a further disruption to world trade.
And the idea that somehow exchange rate stability promoted stock market instability, with the corollary that exchange rate instability would promote stock market stability, is manifest poppycock.
Indeed, it was the threat of a breakdown in the Louvre agreement that in part triggered the Wall Street collapse.

I profoundly hope and believe that that threat will not be invoked again.
Nothing could be more counterproductive.

As I made clear in my speech to the Annual Meeting of the IMF in September, the system of managed floating that would best serve the needs of the world economy would have as its objective the need "to maintain the maximum stability of key exchange rates, and to manage any changes that may be necessary in an orderly way".

What is needed in the world today, above all, is the avoidance of any major blow to industrial confidence.
It was not the 1929 crash that caused the depression of the 1930s, but the policy response to it: the failure to provide adequate liquidity to the system, leading to a rash of bank failures, which in turn led to further monetary tightening; and of course the lurch into beggar-my-neighbour trade policies.

I believe we not only must but will avoid both these dangers.
The lessons have been learned.
In the United States, President Reagan has made clear his refusal to follow the protectionist path of Smoot-Hawley, and the Congress must ensure that on this dangerous issue the will of the President prevails.
And on the monetary front, the United States authorities have been quick to ensure that the liquidity of the system will be preserved.

For our part, I moved at an early stage to reverse half of August's rise in interest rates, not simply because some reduction was appropriate in the changed circumstances, though it was.
But I also felt it right, in the light of what was undoubtedly a shock, to signal clearly that the authorities were sensitive to the dangers that some might understandably fear.
Today I decided it was right to act again and reverse the other half.

As for liquidity, the maintenance of a stable exchange rate for sterling, within the framework of the Louvre agreement, to which we remain committed, has meant a higher level of intervention than

used to be the case - most of it, so far, in the direction of increasing the reserves.
You will have seen the exceptionally large increase of getting on for $7 billion in October, published yesterday.
I read in this morning's newspapers that the market is in such a nervous state that it is worried at one and the same time both about the extra liquidity this inflow produces and the funding that would be required to mop it up.
That really is going a little far.
But it is right that I should make my position clear.

To prevent there being excessive liquidity in the economy, our policy is to ensure that, over time, any net intervention is sterilized - in other words, fully funded.
And that will be done, as and when appropriate, although not necessarily entirely within the financial year in which the intervention takes place.
In particular, while the funding programme will continue, it would clearly not be sensible in the present delicate market conditions to extract liquidity on a major scale.

Nor, however, should there be any doubt of our commitment to maintain a stable exchange rate, with the rate against the deutschemark being of particular importance.
It gives industry most of what it wants, and provides a firm anchor against inflation.
And we now have very substantial reserves with which to maintain that stability in the future.

Thus the Government is playing its full part to bring about a smooth adjustment to the shock caused by the fall in the stock market.
There will nonetheless be some very real effects, which it is not within the power of Government to eliminate.
These need not be large, provided business and industry do not lose the confidence that has been built up and that has made such an important contribution to Britain's economic resurgence.

There will be some inevitable effect on demand from the falls in financial wealth: people will see that their financial assets have shrunk and will adjust their spending accordingly.
But, in the UK, the direct effect of that may not be very large, and will reduce any risk of overheating there may have been, with the fire-hoses trained on just that sector where the risk was most evident, thus removing any concern about a resurgence of inflation.

This so-called "wealth effect" will be most evident in the United States, and will inevitably have some dampening effect on world trade.
But there is, again, no reason to expect the effects on the UK to be substantial: UK industry is increasingly well equipped to compete in world markets.
And I have already indicated how, provided the governments of the industrial countries co-operate, and undue monetary tightening is avoided, world recession can, and I believe will, be avoided.

I mentioned a moment ago that one other way in which the UK might be affected would be through a loss of confidence within business and industry.
There is no cause whatever for businessmen to talk themselves into a negative, safety-first mentality, even though I can understand some of their anxieties.
Some, for example, are concerned that their company's market capitalisation has been slashed by up to 30 per cent.
In fact, in most cases, their market capitalisation is now much the same as it was a year ago, when they had few if any worries on this score.
Indeed, the fact that share prices are at about the same level as they were a year ago is something that needs very much to be borne in mind when assessing the likely scale of the economic effects of the stock market falls.

As the Director General of the CBI said yesterday, industry should have no terror of the present squall and "now is the time to look beyond the turbulence of the markets and invest for growth".
I believe that British industry will increasingly recognise this.

For the UK is well placed to cope with the repercussions of the stock market fall, given the general health and enviable soundness of the British economy, and not least the strength of our public finances.

As it happens, I published only yesterday the Autumn Statement which, among other things, contains my latest forecast for the evolution of the British economy in 1988, and this has been widely reported in today's newspapers.

So there is no need to repeat myself this evening.

But the picture is undoubtedly one of an economy that is vigorous, strong and healthy.

A PSBR of only £1 billion: who would have expected that as little as a few years ago?

Growth faster than any other major nation in the world, so that even some slowdown will still leave us expanding at a very respectable rate.

The underlying rate of inflation remaining low.

And our unit labour costs in manufacturing expected in 1988, as in 1987, to rise less than in our major industrial competitors.

The plain fact is that, as a result of sound policies consistently pursued over a number of years, we are now enjoying the benefits of a virtuous circle.

Low inflation, public expenditure under control and sound public finances have led to sustained growth and thus the ability progressively to lower tax rates, which in turn has brought about improved confidence and better business performance.

This is not something that will be blown away by a financial blizzard, however violent it may seem at the time.

Nor, although we are influenced by it, are we in Europe inescapably dependent on the fortunes of the US economy, as recent movements in the London stock market might suggest.

Above all, we are fortunate in this country that the financial storm - if it had to come - has come at a time when the Government has just been granted by the British people - and granted decisively - the strength of a further term of office.

I can assure you, my Lord Mayor, that we shall put that strength to good use.

Sir T Burns
119/2. P7

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4 November 1987

THE CHANCELLOR'S MANSION HOUSE SPEECH

Attached is the text of the speech to be made by the Chancellor of the Exchequer, the Rt Hon Nigel Lawson, MP, at the Lord Mayor's Banquet for Bankers and Merchants of the City of London at the Mansion House tonight.

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71/87

MANSION HOUSE SPEECH: 4 NOVEMBER 1987

On this great annual occasion of the Lord Mayor's dinner for the bankers and merchants of the City of London - and this is now the fifth time I have stood up here as Chancellor - it is customary to say something about the City.

But there are other speeches to come, and I can be brief.
Foremost among those other speeches, of course, will be that of the Governor, who will also be playing his fifth innings here in that capacity.
The excellent working relationship he and I have built up over that period is one that I value very highly indeed, and it clearly assumes a special importance during the difficult time through which we are now passing.
I am immensely grateful to him.

I would also like to salute the City for the way in which it has comported itself throughout almost three weeks of a financial blizzard which blew in from across the Atlantic, with a ferocity few of us have experienced in our lifetime.
Throughout that period, the markets have continued trading without disruption, and without even the curtailment of normal trading hours.
And in the midst of it all, the biggest share issue the world has ever seen was able to go ahead, with the London sub-underwriters ready, willing, and able to absorb the stock with relative ease.

I pay tribute to the Association of British Insurers, who, at the height of the BP controversy, declared

> "ABI members are quite prepared for the issue to go ahead and they will of course meet the obligations they have undertaken. There is no question of the ABI membership seeking to put pressure on Government to have the BP issue postponed."

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I may be old-fashioned, but in my judgement, had I bowed to the pressure from some quarters to abandon the issue, which had been fully underwritten and - in London, at least, sub-underwritten too - it would have done irreparable harm to the good name and reputation of the City.
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It has demonstrated to the world, in the clearest possible way, that, so far from being simply a fair weather market, it can handle a storm better than any other financial centre in the world.

That said, let me now move on to discuss the wider question of why the world equity market collapse occurred, what its implications may be, and what needs to be done.

A movement of this magnitude, of this rapidity, requires a threefold explanation.
That is to say, it requires an explanation in financial market terms, in terms of economic fundamentals, and in political terms.
Unless all three elements had been present, I do not believe that the severity of what we have just been through, and the position in which we now find ourselves, could have occurred.

In market terms, it was clear that the longest bull market ever known was bound to come to an end sooner or later.
Over the past five years alone, share prices in both London and New York had trebled in real terms, rising far faster than company profitability and creating a growing gap between the return on equities and the return on bonds.
Though few of us foresaw the speed at which the markets would move when the turn came, this was clearly too good to last.

So far as the economic fundamentals are concerned, many of us had been warning, not for months but for years, of the dangers to the world economy inherent in the massive imbalances afflicting the three largest economies.
At the heart of this problem lay the huge budget and current account deficits of the United States, and the resulting dramatic

shift from a large creditor position built up over decades to a ballooning domestic and external indebtedness.
But there was also the counterpart of this in excessive current account surpluses of Japan and Germany.

It was precisely to deal with these world problems that the Finance Ministers of the major industrial nations have intensified their co-operation over the past two or three years.
A major reduction in the dollar exchange rate, coupled with the promise of action to reduce the US budget deficit, was agreed at the Plaza meeting of the G5 in September 1985.
And both have taken place.
Both the yen and the deutsche mark rose, in pretty short order, by as much as 50 per cent or so against the dollar, and the US federal budget deficit was cut from some $221 billion in 1985-86 to an estimated $148 billion in 1986-87, a fall of about a third - an improvement even greater than the ambitious target the US authorities had originally set themselves.

Hence our decision, at the Louvre meeting in February of this year, to work together to bring about a period of exchange rate stability.
This was both so as to allow time for the massive parity changes that had taken place to work their way through into reduced trade imbalances, and also to bring about a better climate for world economic growth than that provided by the wild gyrations of the dollar in the early 'eighties.

I have no doubt that this was the right course to pursue.
But the correction of imbalances on the scale that had earlier been allowed to arise is bound to take time, and impatience is always liable to set in.
Particularly when political doubts - the third dimension of the stock market slide - began to arise.
Doubts about whether the United States, despite their genuine success in 1986-87, had the political will to reduce still further a budget deficit that was still far too large.
Doubts, too, about whether the United States had the political will to hold interest rates at whatever level was necessary, not merely

to maintain dollar stability, but also to ensure that the deficit, so long as it endured, was soundly financed.
And doubts about whether some other countries would fully accept the implications for their own economies of maintaining currency stability.

It is, indeed, ironic that an apparent unwillingness of the United States to raise interest rates because of an exaggerated fear that this might tip the economy into recession has led to a collapse on Wall Street, whose recessionary threat is very much greater.

Of course, even financial clouds have silver linings.

In the United States, for example, the necessary slowdown in the growth of domestic demand in relation to output - if the trade balance is to improve, as it must - is now likely to be achieved.
And without the higher interest rates which would have added to the burdens of the debtor nations.
At the same time, the sudden loss of wealth suffered by the share-owning people of America is likely to cause them to want to save rather more of their income, thus facilitating the financing of the Budget deficit without so much reliance on sceptical foreigners.
All this is welcome.

But the need for the US Budget deficit to continue to fall significantly remains crucial.
As is now widely recognised, the key is that the current talks between the US Administration and Congress should lead to early agreement on a clear and credible package of measures to continue the reduction achieved in 1986-87.
This should go beyond the $23 billion to which the President is committed under the new Gramm-Rudman Act, and preferably with at least some increase in some form of taxation as part of that package.

This is essential, not simply because reduction of the US Budget deficit is necessary in economic terms, but also because this has now become the touchstone of whether the United States has the political will to make hard choices and to do what needs to be done.

It will be a key element in rebuilding market confidence.

And if such an agreement is soon reached between the Administration and the Congress, then I believe the other major nations of the world would agree to making it part of a wider international accord involving among other things a reduction in interest rates.

I fully understand - and sympathise with - the hesitations of those who are fearful of risks of inflation.
I have many times made it clear in the management of UK monetary policy that I am as conscious as anyone of such risks.
But if interest rates were the right levels three weeks ago, then it is unlikely that those levels are still right after all that has happened since.

I also fully understand - and share - the view that it is for the United States, where the heart of the problem lies, to give assurance of the necessary steps on the fiscal front before others can confidently make a major move on the monetary front.

Moreover, any wider international accord should not, in my judgement, stop there.
We should also take the opportunity to reaffirm the Louvre agreement, making whatever minor - and I stress the word 'minor' - adjustment is necessary in the light of recent events, with the United States in particular committing itself with deeds as well as words to supporting in the market place whatever is agreed, and if necessary visibly equipping itself with the funds to do so.
Others, too, will have to play their part.

By contrast, a so-called free fall of the dollar would solve nothing: it would merely risk a resurgence of US inflation and ensure a further disruption to world trade.
And the idea that somehow exchange rate stability promoted stock market instability, with the corollary that exchange rate instability would promote stock market stability, is manifest poppycock.
Indeed, it was the threat of a breakdown in the Louvre agreement that in part triggered the Wall Street collapse.

I profoundly hope and believe that that threat will not be invoked again.
Nothing could be more counterproductive.

As I made clear in my speech to the Annual Meeting of the IMF in September, the system of managed floating that would best serve the needs of the world economy would have as its objective the need "to maintain the maximum stability of key exchange rates, and to manage any changes that may be necessary in an orderly way".

What is needed in the world today, above all, is the avoidance of any major blow to industrial confidence.
It was not the 1929 crash that caused the depression of the 1930s, but the policy response to it: the failure to provide adequate liquidity to the system, leading to a rash of bank failures, which in turn led to further monetary tightening; and of course the lurch into beggar-my-neighbour trade policies.

I believe we not only must but will avoid both these dangers.
The lessons have been learned.
In the United States, President Reagan has made clear his refusal to follow the protectionist path of Smoot-Hawley, and the Congress must ensure that on this dangerous issue the will of the President prevails.
And on the monetary front, the United States authorities have been quick to ensure that the liquidity of the system will be preserved.

For our part, I moved at an early stage to reverse half of August's rise in interest rates, not simply because some reduction was appropriate in the changed circumstances, though it was.
But I also felt it right, in the light of what was undoubtedly a shock, to signal clearly that the authorities were sensitive to the dangers that some might understandably fear.
Today I decided it was right to act again and reverse the other half.

As for liquidity, the maintenance of a stable exchange rate for sterling, within the framework of the Louvre agreement, to which we remain committed, has meant a higher level of intervention than used to be the case - most of it, so far, in the direction of increasing the reserves.

You will have seen the exceptionally large increase of getting on for $7 billion in October, published yesterday.

I read in this morning's newspapers that the market is in such a nervous state that it is worried at one and the same time both about the extra liquidity this inflow produces and the funding that would be required to mop it up.

That really is going a little far.

But it is right that I should make my position clear.

To prevent there being excessive liquidity in the economy, our policy is to ensure that, over time, any net intervention is sterilized - in other words, fully funded.

And that will be done, as and when appropriate, although not necessarily entirely within the financial year in which the intervention takes place.

In particular, while the funding programme will continue, it would clearly not be sensible in the present delicate market conditions to extract liquidity on a major scale.

Nor, however, should there be any doubt of our commitment to maintain a stable exchange rate, with the rate against the deutschemark being of particular importance.

It gives industry most of what it wants, and provides a firm anchor against inflation.

And we now have very substantial reserves with which to maintain that stability in the future.

Thus the Government is playing its full part to bring about a smooth adjustment to the shock caused by the fall in the stock market.

There will nonetheless be some very real effects, which it is not within the power of Government to eliminate.

These need not be large, provided business and industry do not lose the confidence that has been built up and that has made such an important contribution to Britain's economic resurgence.

There will be some inevitable effect on demand from the falls in financial wealth: people will see that their financial assets have shrunk and will adjust their spending accordingly.
But, in the UK, the direct effect of that may not be very large, and will reduce any risk of overheating there may have been, with the fire-hoses trained on just that sector where the risk was most evident, thus removing any concern about a resurgence of inflation.

This so-called "wealth effect" will be most evident in the United States, and will inevitably have some dampening effect on world trade.
But there is, again, no reason to expect the effects on the UK to be substantial: UK industry is increasingly well equipped to compete in world markets.
And I have already indicated how, provided the governments of the industrial countries co-operate, and undue monetary tightening is avoided, world recession can, and I believe will, be avoided.

I mentioned a moment ago that one other way in which the UK might be affected would be through a loss of confidence within business and industry.
There is no cause whatever for businessmen to talk themselves into a negative, safety-first mentality, even though I can understand some of their anxieties.
Some, for example, are concerned that their company's market capitalisation has been slashed by up to 30 per cent.
In fact, in most cases, their market capitalisation is now much the same as it was a year ago, when they had few if any worries on this score.
Indeed, the fact that share prices are at about the same level as they were a year ago is something that needs very much to be borne in mind when assessing the likely scale of the economic effects of the stock market falls.

As the Director General of the CBI said yesterday, industry should have no terror of the present squall and "now is the time to look beyond the turbulence of the markets and invest for growth".
I believe that British industry will increasingly recognise this.

For the UK is well placed to cope with the repercussions of the stock market fall, given the general health and enviable soundness of the British economy, and not least the strength of our public finances.

As it happens, I published only yesterday the Autumn Statement which, among other things, contains my latest forecast for the evolution of the British economy in 1988, and this has been widely reported in today's newspapers.
So there is no need to repeat myself this evening.
But the picture is undoubtedly one of an economy that is vigorous, strong and healthy.
A PSBR of only £1 billion: who would have expected that as little as a few years ago?
Growth faster than any other major nation in the world, so that even some slowdown will still leave us expanding at a very respectable rate.
The underlying rate of inflation remaining low.
And our unit labour costs in manufacturing expected in 1988, as in 1987, to rise less than in our major industrial competitors.

The plain fact is that, as a result of sound policies consistently pursued over a number of years, we are now enjoying the benefits of a virtuous circle.
Low inflation, public expenditure under control and sound public finances have led to sustained growth and thus the ability progressively to lower tax rates, which in turn has brought about improved confidence and better business performance.

This is not something that will be blown away by a financial blizzard, however violent it may seem at the time.
Nor, although we are influenced by it, are we in Europe inescapably dependent on the fortunes of the US economy, as recent movements in the London stock market might suggest.

Above all, we are fortunate in this country that the financial storm - if it had to come - has come at a time when the Government has just been granted by the British people - and granted decisively - the strength of a further term of office.
I can assure you, my Lord Mayor, that we shall put that strength to good use.

(P7)

Mr. Speaker: I do not think that it will help me.

BILLS PRESENTED

IMMIGRATION

Mr. Secretary Hurd, supported by the Prime Minister, Secretary Sir Geoffrey Howe, Mr. Secretary Walker, Mr. Secretary King, Mr. Secretary Moore, Mr. Secretary Rifkind and Mr. Tim Renton, presented a Bill to make further provision for the regulation of immigration into the United Kingdom; and for connected purposes: And the same was read the First time; and ordered to be read a Second time tomorrow and to be printed. [Bill 49.]

MISUSE OF DRUGS

Mr. Menzies Campbell presented a Bill to extend the coverage of the Misuse of Drugs Act 1971 to include certain drugs which have been misused for the purposes of improving performance in sport: And the same was read the First time; and ordered to be read a Second time on Friday 22 January and to be printed. [Bill 46.]

Opposition Day

[2ND ALLOTTED DAY]

Financial Markets

Mr. Speaker: I have selected the amendment in the name of the Prime Minister.

4.17 pm

Mr. John Smith (Monklands, East): I beg to move,

That this House, recognising that the stock market collapse results from failures in international economic co-operation and the excessive priority given to finance at the expense of the real economy, and that the collapse has serious implications for the level of economic activity in the United States and for investment and employment at home, notes that the United Kingdom still has close to three million unemployed, that manufacturing output has only just returned to the levels of 1979, and that Her Majesty's Government admits that there will be a downturn in the growth rate, an increase in inflation and a record deficit of £9 billion on manufactured trade in 1988; and urges the Government to initiate action among the leading industrial countries in order to concert adjustment of economic imbalances on a planned basis including expansion in the economies of Western Europe, to significantly cut interest rates, to target increases in public expenditure in order to prevent an economic downturn, and to adopt an industrial stategy aimed at systematically developing the strength of industry, technology and skills throughout the whole of the nation.

This is a timely debate. Following the crash in the financial markets, and with the threat of an economic crisis looming, the House should concentrate its mind on the lessons to be learnt from the turbulent events of recent weeks with one overriding objective—the urgent steps that need to be taken to ward off the threat of economic downturn, with the painful consequences for jobs, the standard of living and the national economic strength that would come in train of that.

We know from the Chancellor's Autumn Statement that there are difficulties ahead. The statement was portrayed in euphoric terms by parts of the British press, with its close identity with the interests of the Conservative party. However, it is sometimes useful to see what the foreign press says. *The Wall Street Journal* reported the Chancellor's Autumn Statement. Its headline read:

"Lawson Warns of Hurdles Facing Britain's Economy."

It continued:

"Chancellor of the Exchequer Nigel Lawson painted a picture of Britain's economy next year, warning that the nation faces slower growth, higher inflation and a mounting balance-of-payments deficit."

Let us be in no doubt that we face difficult times. Major change has occurred and markets have collapsed all over the world, particularly in London. Many people sense that we are at the crossroads in the economic development of the country and that if the wrong decisions are taken now they will have consequences for many years ahead. There is a tendency to blame all that on the markets. It is said that they had over-valued and were correcting. The Chancellor offered that as one of the explanations in his Mansion House speech last night.

The Chancellor's initial reaction in the early days of the crash was more outspoken. He said that it was a grotesque aberration and a grotesque over-reaction. He talked about the markets behaving with a herd instinct. The epithets

[Mr. John Smith]

came cascading from the Chancellor as he laid about the markets, which in other times he had revered, or possibly worshipped. Last night, the tone at the Mansion House changed. As the right hon. Gentleman stood in his white tie and tails, the principal guest at the Lord Mayor's banquet for bankers and merchants of the City of London, he obviously thought that he should put his thoughts rather differently. He said:

"I would like to salute the City for the way in which it has comported itself throughout almost three weeks of a financial blizzard which blew in across the Atlantic."

There were no crude references to grotesque over-reaction, the herd instinct or absurdity. If nothing else, it shows how singing for one's supper can modify one's approach to events.

The Chancellor's case on the cause of the collapse of the market was simple. He said that it was all down to the Americans. The billing and cooing of the Thatcher Government towards the United States' Administration has apparently been replaced by tones of harsh and unforgiving rebuke. That is the line from the Chancellor. However, as we know, a message has gone from the Prime Minister to the President of the United States, the contents of which have not been revealed. It may say, "Do not take this chap Lawson too seriously. He is rude by nature and he cannot help it. I am still your friend. Maggie."

The Chancellor's main point was that it all happened because of a lack of political will in the United States; a lack of will to tackle the budget deficit. When things go wrong, the Chancellor and the Government, notably the Head of the Government, always find someone else to blame. This time it is the naughty Americans. Basically, the Chancellor said that they should be put in the dunce's corner until they had sorted out their problems and that no international action should be taken to deal with an international crisis until the Americans had sorted themselves out.

The Americans have a responsibility for the events that have occurred. They were running twin deficits — the budget and the balance of payments—which could not be sustained. The budget deficit is not the only factor. After all, the Japanese have a large budget deficit, which is not a cause for concern. The reason is that the Japanese, by their own savings, can fund the deficit. Apart from anything else, they tend to buy Japanese and they save. The United States was, and is, relying on the rest of the world to finance its deficit.

I believe that the Chancellor and others may have concentrated excessively on the budget deficit. It is the trade deficit that affects the nation more directly. Both deficits may have to be reduced, but it is crucial that we appreciate that it should be done on a gradual basis that will not cause a major distrubance to world trade and throw us into recession. It is a one-eyed view of the world simply to blame the Americans. The imbalance is at the heart of the matter. The United States has a large deficit, while others, notably Germany and Japan, are in surplus.

I fear that the truth is that for many years the major industrial countries have put the tackling of the imbalance well down their order of priority. Perhaps that was nowhere more compellingly illustrated than at the Venice summit held earlier this year during the general election. I hope that those, including our Government who took part in that self-congratulatory and vacuous occasion now feel ashamed at the irresponsibility that they showed in not tackling the issue then. We recollect that the United States Secretary for the Treasury asked the Organisation for Economic Co-operation and Development countries to set targets for expansion so that they could help the United States in the gradual reduction of its deficit. However, he got not assistance from the other countries.

Why was there a failure of international economic co-ordination? Why was there a failure to act in a situation that all the countries must have known would end in tears? Far too many of them believed that just as in their own countries free markets were the regulators of the economy, so international economic relations could be left to the free forces of the market. They could not have been more wrong.

In 1985 some effort started to be made to deal with the dollar and exchange rate instability, through the Plaza agreement of 1985 and the Louvre accord of 1987. In his speech to the International Monetary Fund the Chancellor advocated a new move away from total reliance on market forces and floating exchange rates with his hybrid concept of managed floating. Those faltering attempts at international co-ordination are to be welcomed. It is particularly beneficial for politicians such as the Chancellor to have to realise that their free market nostrums do not work in the real world in which they operate.

There are some differences in attitude displayed by the Chancellor between 1980 and 1987. On 3 July 1980 the Chancellor answered a written question. He was asked:

"what mechanisms exist for medium or long term alteration of the exchange rate."

The hon. Member who asked the question was given a short and snappy answer. The Chancellor said:

"Market forces."—[*Official Report,* 3 July 1980; Vol. 987, c. *677.*]

The Chancellor reinforced that in a written answer on 3 November 1980, when he said:

"The exchange rate is determined by market forces, not by the Government."—[*Official Report,* 3 November 1980; Vol. 991, c. *458.*]

In a written answer on the following day he said:

"The effect on the exchange rate of a reduction of United Kingdom interest rates relative to the United States rates, if any, would depend upon the circumstances of the time."

This is the important part—

"There is no stable or reliable relationship between interest rates and the exchange rate." — [*Official Report,* 4 November 1980; Vol. 991, c. *537.*]

On 7 October 1987 the Chancellor was quoted in *The Guardian* as saying:

"I believe . . . that we can and should use the experience we have gained to build a more permanent regime of managed floating. I do not see the past two years simply as a temporary phase. Our objectives should be clear: to maintain the maximum stability of key exchange rates and to manage any changes that may be necessary in an orderly way."

The *Sunday Times* on 11 October 1987 said:

"Elaborating on these proposals, Lawson explained that 'monetary policy—the determination of short-term interest rates — should be pursued in a way consistent with exchange rate stability'. In other words, interest rates would be adjusted to keep the exchange rate stable."

So much for there being no stable or reliable relationship between interest rates and exchange rates. Of course, we welcome the progress of the Chancellor's education, but it has been an expensive education for Britain, just as the experiments in monetarism have been disastrous for British industry.

Mr. John Redwood (Wokingham): Will the right hon. and learned Gentleman confirm that the national executive committee under his chairmanship is looking into an extensive way of intervening in people's savings and wants to go back to the idea that savings should be confiscated and directed at the behest of Labour politicians? Does he seriously believe that that would solve the problems for which we have a perfect answer but about which he does not have a clue?

Mr. Smith: I thought that the hon. Gentleman, as a director of Rothschild, was going to ask me about something else. I gave way believing that his remarks might be relevant. In fact, his intervention had nothing to do with the debate. However, now that he has intervened, let me remind him that he, too, has been going through an education process. He seems to have changed his views a little since his time in the No. 10 policy unit. In a television programme last Sunday he was advocating the borrowing of £5 billion, £6 billion or £7 billion.

Mr. Redwood: The question asked on the television programme was very specific. When asked what I would recommend in the likely circumstances of slower growth, I said that there should be no increase in borrowing and that we should keep a tight ship, which is what my right hon. Friend the Chancellor has been doing. When asked what I would recommend if world GNP fell by five percentage points in a single year, I said that £5 billion or £6 billion of borrowing would be appropriate and, indeed, unavoidable. Is the right hon. and learned Gentleman really suggesting that the world GNP will fall 5 per cent. next year? If he is, I do not believe him.

Mr. Smith: It was generous of me to allow the hon. Gentleman to give his fallback explanation. He will recall——

Mrs. Elaine Kellett-Bowman (Lancaster) *rose*——

Mr. Smith: It would help us all if the hon. Lady would allow me to answer the point on which I have been invited to comment.

The hon. Member for Wokingham (Mr. Redwood) will recall that one of the possibilities considered in the television programme was a British growth rate of 1·5 per cent. It is in that context that he gave the answer to which I referred.

Mr. Redwood *indicated dissent.*

Mr. Smith: The hon. Gentleman may shake his head, but it is not fair of him to do so. In any case, there are more important matters in this debate than the views of the hon. Gentleman, and I must move on.

Opposition Members welcome the progress in the Chancellor's education. It is now vital that there should be an international response involving Governments. The fact is that the shattered markets are looking to Governments to play their indispensable role in the regulation of world economies. A gradual but steady reduction in the United States deficits—particularly the trade deficit—must take place in concert with expansion in Western Europe and Japan. It is not good enough to wait until the Americans do something, hint at action on interest rates and seek to reinstate the Louvre accord. That response by the British Government does not rise remotely to the level of events. The British Government——

Mr. Redwood *rose*——

Mr. Smith: The hon. Gentleman does not want to listen, but perhaps he might do so for the next minute or so.

The British Government should now take the lead in urging a meeting of the G7 countries with the purpose of working out a new international accord, not just to put the United States in the dock, but to engineer—I suppose that the Chancellor would say "manage"—joint action to save us all from disaster. A successful accord would do more than anything else to restore confidence. It would chart a way through the difficult years ahead.

Several Hon. Members *rose*——

Mr. Smith: Hon. Members can hardly ask me questions before I have explained my point.

The accord should concern itself with interest rates and managing exchange rates, but it should also contain agreement on one crucial factor: if United States deficits are to decline, Western Europe and Japan must expand to meet the situation. We need an accord related to economic policies as well as financial matters. That is at the heart of the matter. Although the Chancellor has spoken at length about the arrangements since 1985, the fact is that they have broken down. We need a new approach, a sense of urgency and a recognition that internationally interconnected economies cannot be dealt with by policies followed by countries with regard only to their own interests.

That is the response that I would have hoped for from the Chancellor. However, instead of urging a statesmanlike initiative the Chancellor gave only a frenetic lecture to the United States and, what is more, a calculated insult to the president of the Bundesbank. The truth is that the British Government have no policy response to make at international level.

The Chancellor of the Exchequer (Mr. Nigel Lawson): I was very concerned when I heard the right hon. and learned Gentleman say that I gave a calculated insult to the president of the Budesbank. I happen to know Herr Karl Otto Pöhl very well. I have worked with him in international affairs for the past four and a half years. I have given no insult to him. Will the right hon. and learned Gentleman quote the so-called insult that I gave, or withdraw his remarks?

Mr. Smith: The passage in the Chancellor's speech to which I referred states:

> "By contrast, a so-called free-fall of the dollar would solve nothing. It would merely risk the resurgence of US inflation and ensure further disruption to world trade, and the idea that somehow exchange rate stability promoted stock market instability, with the corollary that exchange rate stability would promote stock market stability, is manifest poppycock."

misprint here

The right hon. Gentleman knew that that was the view expressed by the president of the Bundesbank.

Mr. Lawson: I am quite sure that that is not the view of the president of the Bundesbank. Will the right hon. and learned Gentleman kindly give us the evidence suggesting that that is the view of the Bundesbank president?

Mr. Smith: It was certainly the view of some leading commentators in the British Press.

Mr. Lawson *rose*——

Mr. Smith: Let me answer. The Chancellor knows that he was attacking that view. He knows where it came from, and he knows the message that he intended to convey.

Mr. Lawson: I am afraid that the right hon. and learned Gentleman must withdraw. That is not the view of the president of the Bundesbank, and the right hon. and learned Gentleman has produced not a shred of evidence to suggest that it is. Will he kindly withdraw?

Mr. Smith: I had no idea that I would touch such a sensitive spot. I have no intention of withdrawing my remarks, which were perfectly within the rules of the House.

Mr. Lawson: It is untrue.

Mr. Smith: I do not believe that to be the case. What should happen—*[Interruption.]* If hon. Gentlemans will let me get a word in, I will finish. What should happen is that the Prime Minister should send a letter to the president of the Bundesbank, just as she sent a letter to the President of the United States.

Mr. Lawson: The right hon. and learned Gentleman made a serious allegation. Like me, the president of the Bundesbank is a member of the G 7 group. Will the right hon. and learned Gentleman give the quotation from a speech of the president of the Bundesbank in which he has expressed that view? That is not his view and he has never expressed it?

Mr. Smith: I shall be pleased if the Chancellor will tell me whom he was attacking in his speech.

Mr. Lawson: I was attacking some of the economists employed by City stockbroking firms who have been putting that view forward. Now that the right hon. and learned Gentleman knows that, will he withdraw what he said?

Mr. Smith: It appears that the Chancellor was attacking some of those whom he congratulated last night at the Mansion House for comporting themselves so well during the crisis.

Mr. Lawson *rose*——

Mr. Smith: I have given way five times.

Mr. Lawson: The right hon. and learned Gentleman has now admitted that what he said about the president of the Bundesbank was totally false, fictitious and, to coin a phrase, poppycock.

Mr. Smith: It is clear that there is a difference of opinion between the Chancellor and myself. I have reason to believe that what I said is correct, and I stick to it. I wish to get on——

Sir William Clark (Croydon, South) *rose*——

Mr. Smith: No. I want to move to the serious matter of the economy, which we should be discussing in this debate.

The truth is that the Government——

Sir William Clark *rose*——

Mr. Smith: I am not giving way. I have given way five times and I am not giving way again.

The truth is that the British Government have no policy response at international level. We are constantly told that Britain has achieved a new and semi-miraculous status in the world, that some new respect has been acquired, so why is that not used to give a lead towards a new international accord?

Several Hon. Members *rose*——

Mr. Smith: I have said that I am not giving way. I do not know whether——

Mr. Tim Smith (Beaconsfield): There is no evidence for what the right hon. Gentleman has claimed.

Mr. Smith: As I said, I do not know whether the Government's inaction is due to a lack of appreciation of the danger of——

Mr. Tim Smith: No evidence whatsoever.

Mr. Deputy Speaker (Sir Paul Dean): Order. Sedentary interruptions take up a great deal of time. Many hon. Members wish to speak in this debate, and I hope that it can now proceed quietly.

Sir William Clark: On a point of order, Mr. Deputy Speaker. With the world economy in its current state, is it not incumbent upon a spokesman for the Opposition to behave responsibly? The right hon. and learned Member for Monklands, East (Mr. Smith) made an accusation that could sour relationships between this country and West Germany, and he refuses to withdraw it. Is that not disgraceful?

Mr. Deputy Speaker: That is a point of argument, not a point of order for me.

Mr. Stuart Bell (Middlesbrough): Further to that point of order, Mr. Deputy Speaker. Is it not a fact that no statement made in this House could possibly affect the world economy if that statement were wrong? The statement by my right hon. and learned Friend the Member for Monklands, East (Mr. Smith) is clearly correct.

Mr. Deputy Speaker: Let us get on with the debate.

Mr. Smith: I am not surprised by all this, because it is the usual practice of Tory Members, when they hear something that they do not want to hear, to resort to procedural disruption to prevent us from having a proper debate.

I do not know whether the Government's inaction is due to a lack of appreciation of the dangers that we face, or to an incapacity to respond. Increasingly, the Chancellor reminds me——

Mr. Quentin Davies (Stamford and Spalding) *rose*——

Mr. Smith: No, I am not giving way.

Increasingly, the Chancellor——

Mr. Quentin Davies *rose*——

Mr. Allan Rogers (Rhondda): On a point of order, Mr. Deputy Speaker. When a Labour Front-Bench spokesman is making a valid point, is it in order for the Tory party to use the tactic of wheeling in its second-hand car salesmen to disrupt the proceedings?

Several Hon. Members *rose*——

Mr. Deputy Speaker: Order. I appeal to the House to get on with the debate.

Mr. Smith: As I was attempting to say, I do not know whether the Government's inaction is due to a lack of appreciation of the dangers or to an incapacity to respond. Increasingly, the Chancellor reminds me of the Emperor Nero, to whom he bears a passing facial resemblance. The difference is that Nero knew when Rome was burning.

The link between the international scene and the British economy is direct, so there is a threat of recession in Britain regardless of what happens in the United States.

If America succeeds in reducing both its deficits, but especially its trade deficit, there will be less room for British exports in American markets. If it fails to reduce the deficits and interest rates have to rise, that will push the American economy into recession and there will be consequences for Britain. Therefore, it is vital that we do not wait for the Americans to find a solution before we adopt a strategy for our country.

The Opposition advocate a targeted increase in public investment — *[Interruption.]* The hon. Member for Wokingham wanted to borrow £5 billion, £6 billion or £7 billion for that purpose. We need to improve the infrastructure, and if we have a programme of public investment——

Mr. Quentin Davies *rose*——

Mr. Smith: No. If we have a programme of public investment——

Mr. Quentin Davies *rose*——

Mr. Smith: The hon. Gentleman keeps rising, but I shall not give way to him. I hope that he accepts that.

We need a programme of public investment to provide better facilities, better communications, progress in our inner cities and some hope to our declining regions. That would be worth while in itself, but with the possibility of a recession it becomes economically imperative. After all, the Government tell us that our finances are sound. What better base from which to start a new public investment programme? Other countries are doing that. It may not have escaped the notice of those who follow these matters that a fiscal package introduced by the Government of Japan earlier this year amounting to 6 trillion yen—about £25 billion—included a public works component of £11 billion. If it makes sense for the Japanese to invest in their infrastructure, why does it not make sense for Britain to do the same? Doing so would provide new jobs, improve the functioning of the economy and help us to avoid recession.

There may be a reason why the Government do not want to embark on that—perhaps because they are saving that money for tax cuts in the next Budget. In Britain's current economic position, nothing would be more irresponsible than to embark on a programme of tax cuts that would inevitably suck in imports and add to a balance of trade deficit in manufactured goods that is heading towards £8 billion. If the public expenditure programmes were planned with care, concentrating on the regions and the inner cities—where people are out of work, where there is slack in the economy and where, goodness knows, so much desperately needs to be done—we could achieve social and economic results with a low risk of any inflationary consequence. That would be an effective short-term strategy, leading to real benefits in the medium and long terms.

However, we need to do more. We need to improve the long-term competitiveness and strength of the British economy, especially British industry. We are, perhaps, approaching the end of the period during which North sea oil has been a major prop to the British economy. Time after time the Government have been rescued from the consequences of their folly by the reservoir of North sea oil and the huge funds that it has made available to them. It has given them protection against balance of trade and balance of payments problems. Yet this still-oil-rich country is heading towards a balance of payments deficit of £3·5 billion.

We know that investment in industry is still 7 per cent. below its level in 1979—far lower than that of our competitors. We know also that since 1980 Britain has been the only country of the five major Western industrialised nations to reduce spending on research and development as a proportion of gross domestic product. There is a complete failure to realise that technology is the driving force of the modern economy. We need a new approach to education and training so that our people can acquire the skills necessary to become the best educated and trained work force in Western Europe.

The Chancellor used to say that there was no need for the Government to spend money on research and development, and on education and training, because the Government would make industry profitable, and industry would then spend money on research and development and on education and training. Industry has become more profitable, but I am sorry to say that there has not been the promised increase in spending on research and development, and on education and training.

We argue the need for an international response. We also argue for a national strategy as well as an international accord. There should be a reduction in interest rates throughout the countries in Western Europe with which we are closely associated. We need a fiscal response and the public investment programme that I have advocated. We need to build long-term strengths so that this country will have an industry that can sustain us in the 1990s——

Mr. Tim Yeo (Suffolk, South) *rose*——

Mr. Smith: I am not giving way. The trouble is that we have a Chancellor who is compromised by having to get out of the monetrist position that he adopted previously. His policies and recommendations do not fit the time in which we live. Unless the Government alter their course in the way recommended in the motion, not only will they fail, but this country will suffer.

The Chancellor of the Exchequer (Mr. Nigel Lawson): I beg to move, to leave out from "House" to the end of the Question and to add, instead thereof:

"congratulates Her Majesty's Government on restoring the public finances to such strength and soundness that the British economy is growing faster and unemployment falling more rapidly than in any other major industrialised country while inflation remains low, thus enabling the United Kingdom once again to play a major role in international financial discussions and providing sufficient resources, despite the halving of the nation's oil revenues, to enable them to increase spending on the National Health Service, education, law and order, and other priority programmes above previous plans, while ensuring that public spending as a whole continues to grow more slowly than national income and while public borrowing, even without any benefit from privatisation proceeds, has been reduced to its lowest level for 17 years".

As far as I can make out a continuing thread in his speech, the right hon. and learned Member for Monklands, East (Mr. Smith) accused me of having learned something. That is not an accusation I can throw at him. He has learned nothing, but merely repeated the policies which led to disaster when his party was last in office.

[Mr. Nigel Lawson]

Before I deal with the problems of the world economy—and as I have said on many occasions, we are going through a difficult time — perhaps I might make an announcement in which the House may be interested.

Mr. Tom Clarke (Monklands, West): The Chancellor, when referring to my right hon. and learned Friend the Member for Monklands, East (Mr Smith), said that we would face disaster. I remind the Chancellor that my right hon. and learned Friend and I represent Monklands constituencies and our majorities rose by nearly 30 per cent. in the last election. Does that represent disaster?

Mr. Lawson: I am sorry that I gave way to the hon. Gentleman. I wish to say something about the BP share support scheme.

As I told the House a week ago today, I have made arrangements with the Bank of England to ensure that there are orderly after-markets in BP shares. Formal notice of these arrangements, under which the Bank will offer to purchase partly-paid BP shares at a price of 70p each, will be published in the national press tomorrow and Saturday.

In my statement I told the House that the offer would remain open for at least one month, and not more than two. I can now be more precise. The offer will close at the earliest on 11 December, and at the latest on 6 January. Five working days' notice will be given before the closure.

The offer will be open to all holders of partly-paid BP shares and—a point which is of considerable importance for the small investor — the issue department of the Bank will make no handling charges whatever, so the investor will receive the full 70p a share. At 3pm today the price stood at 78p a share.

Mr. Rogers: If the Bank is to charge nothing, who will pay the handling charges?

Mr. Lawson: Taking the whole thing together, it is clear that the taxpayer has a very good deal indeed from the BP share sale, whatever happens. My right hon. Friend the Financial Secretary will be pleased to answer detailed questions on this matter.

Mr. John Smith: Who will pay?

Mr. Lawson: If the right hon. and learned Member from Monklands, East wishes to pursue the matter from a sedentary position, I hope that he will tell the House what is his present view on the issue. The House will recall that on 27 October the right hon. and learned Member was asked by an interviewer for the BBC Radio 4 programme "The World Tonight",

"What view do you take of the underwriters' request for a postponement?"

The right hon. and learned Gentleman answered:

"I think it is hard to justify".

But two days later he was urging precisely that course.

Mr. John Smith: I am grateful to the Chancellor for giving way, although he has a certain obligation to give way to me.

On BP, why will the Chancellor not give a straight answer to my hon. Friend the Member for Rhondda (Mr. Rogers)? The Chancellor knows perfectly well that the taxpayer is paying so why does he not say so? He knows perfectly well that from the beginning of the BP share issue we said that the Government should not be party to it. The Chancellor has known that for a long time. When, as in this instance, the Government give a floor of 70p for a share, is that not a speculators' charter? Are they not saying, "Buy a share for 78p, but risk only 8p"?

Mr. Lawson: It is astonishing that last Thursday, a week ago today, the right hon. and learned Member was greatly concerned about the effect of the share sale on BP following the collapse of the stock market. Putting that floor under the price for this period has saved the disorderly after-markets that would otherwise have caused difficulties for BP. That is what I have done. If the right hon. and learned Gentleman thinks that that should not have been done, let him say so. I shall gladly give way——

Mr. John Smith: The Government should not have sold the shares.

Mr. Lawson: The right hon. and learned Gentleman now says that we should not have sold the shares. The Government of the party that he supported in 1977 made the first share sale of BP at a price for fully-paid shares that was equivalent to under 70p.

Mr. John Smith: Does the Chancellor not understand that we have made it clear throughout that the Government should not have parted with the shares? Taxpayers may have got some money back but they have lost an important and valuable asset. The Chancellor says that he rescued BP, but was it not he who put it in danger in the first place?

Mr. Lawson: Even the right hon. and learned Gentleman will admit that I was not responsible for the fall on the world stock markets, which started in Wall street. The right hon. and learned Gentleman says that his party was against the share sale. I shall read again what happened on the radio programme in which he took part. The interviewer said:

"What view do you take of the underwriters' request for postponement?"

The right hon. and learned Gentleman replied:

"I think that it is hard to justify."

That is what he said, but two days later he said that the sale should have been postponed. That deals with the right hon. and learned Gentleman's point on BP. — *[Interruption.]* I shall come to the international situation in a moment. The right hon. and learned Gentleman has commended the view that I hold, and have held for many years, that the United States needs to reduce its budget deficit. I am glad that there is that agreement between us. But of course, that is precisely the opposite view to that which he and his right hon. and hon. Friends have consistently held.

Mr. Nicholas Budgen (Wolverhampton, South-West): Does my right hon. Friend think that it will be politically easier for the President and those who support him in America to cut the deficit if he is seen to be receiving raucous advice from the rest of the world?

Mr. Lawson: I shall come to the world situation in a moment. However, it would be strange if, having urged the Americans to cut their budget deficit for the four and half years that I have been Chancellor and having warned consistently of the damage that would occur if they did not, I suddenly changed my tune. We have remained the staunchest ally of the United States throughout that period. The views that we express, and that we have a right to express, are listened to and taken seriously because the Americans know that we are their staunchest ally.

Mr. Rhodri Morgan (Cardiff, West): In the light of the answer that the Chancellor has just given about impending disaster, why did he decide to float the BP share sale and then engage in a £20 million advertising programme to try to persuade many unsophisticated small investors to take part in it?

Mr. Lawson: I am not in possession of such prescience that I can forecast what is going to happen to the stock market. However, if we are to talk about predictions, I notice that different predictions are now being made by the right hon. and learned Member for Monklands, East than were made by his right hon. Friend the Member for Birmingham, Sparkbrook (Mr. Hattersley) who predicted time and again that soon after the election we would raise taxes. However, his right hon. and learned Friend the Member for Monklands, East now says that we are going to cut taxes, and that he does not want us to do that. I hope that they will make their minds. Are we going to raise taxes or cut them?

Mr. Rogers *rose*——

Mr. Lawson: I shall give way in a moment.

The plain fact is—and this is an important point—that those right hon. Gentlemen consistently commended the Americans for running that large budget deficit which, as the——

Mr. Neil Kinnock (Islwyn) *indicated dissent.*

Mr. Lawson: I shall quote the Leader of the Opposition who is interrupting from a sedentary position. In a speech on 19 October 1984, at the presentation of the Welsh marketing awards in Cardiff, the right hon. Gentleman said:

"There is a vitality in the US economy and no one doubts that it was initiated by Government spending."

— *[Interruption.]* Let me continue. The right hon. Gentleman went on:

"The indelible fact remains that the climate for growth, for work, for investment and enterprise was created by the stimulus of public expenditure and borrowing policy. If we are to renovate our economy, if we are to stimulate activity and sponsor enterprise, we have to generate expansion in much the same way, by much the same means."

Mr. Kinnock: The Chancellor should quote also the many other instances when I, together with my right hon. and hon. Friends, said that we would not for one second advocate the scale or purpose to which that has been put, but that it was necessary for the Government to act in a similar way for exactly that purpose of stimulation. The consequence of the Government not doing so is a massive manufactured trade deficit and an increasing balance of trade deficit in an oil-rich country that still has nearly 3 million people unemployed. Is the right hon. Gentleman proud of that?

Mr. Lawson: The right hon. Gentleman is wriggling and making things up as he goes along. He knows perfectly well that he commended the American budget deficit, the ballooning deficit, and urged this country to emulate it. The consequence of that deficit is that the Americans have got into a difficult position. They have a huge current account deficit which is far greater than ours and a big budget deficit. It is this country which has the fastest rate of growth of all the major nations and this country which is in a strong positon. It is sterling which is strong today and the dollar which is weak. There is no doubt about that. That is not something that I say with any pleasure. I do not think that the weakness of the dollar is of any assistance to either the United States or the world economy. The policies that the Americans themselves now agree are mistaken, and that they are seeking to reverse, are the policies that the right hon. Gentleman has advocated for this country and that he is still advocating today.

Mr. Rogers: The Chancellor criticised my right hon. Friend the Leader of the Opposition for proposing minimal increases in income tax. Does he agree that, since 1979, as a result of indirect taxation the burden of taxation has increased?

Mr. Lawson: Tax rates have steadily gone down. The overall tax rate——

Mr. Rogers: What about increased charges for gas, electricity and water?

Mr. Lawson: They are not taxes. The hon. Gentleman seems to be totally unaware of the difference between a tax and a price.

I shall now turn to the problems of the world economy, which the debate purports to be about. We are indeed passing through a difficult time in the world economy. I have made that absolutely clear. In my judgment, it is also clear that the financial collapse that we have seen in equity markets throughout the world has really had three main causes. There has been the reaction of the financial markets which, earlier, had gone far too high in relation to the underlying profitability of companies in which shares were traded. There are also the economic imbalances, to which the right hon. and learned Member for Monklands, East referred, above all in the United States, with a massive budget deficit and, of course, the accompanying massive current account deficit. It is precisely because I and my fellow Ministers of the Group of Seven have been aware of the need to correct the imbalances that, for some years now, we have been seeking to get harmonisation and uniformity of policies, to put the imbalances right. The right hon. and learned Gentleman referred to the Plaza agreement of September 1985, in which I participated, and which successfully set out to achieve two things; first, a sharp reduction in the value of the dollar, which had become heavily overvalued; and, secondly, a reduction in the American budget deficit which, by that time, was identified by the United States as well as by myself and others in positions of responsibility in the industrialised world, as being a major problem. That succeeded. The budget deficit of the United States was reduced—although it still needs to be reduced a great deal further—and, indeed, the value of the dollar came down substantially.

Again co-operating in February of this year, we decided in the Louvre agreement to pursue a policy of exchange rate stability. But there was a great deal more to it than that. The right hon. and learned Gentleman clearly has no understanding whatever of the contents of the Louvre agreement. He spoke as though the Louvre agreement were merely an attempt to manage exchange rates to secure stability.

Certainly, securing stability of exchange rates was an important purpose. But he should read the communique

[Mr. Lawson]

that I have in front of me. I shall certainly read it to him. He will take my word for it. That communique contained 10 paragraphs, of which nine were concerned with the uniformity of economic policies, and the 10th was concerned with the stabilisation of exchange rates.

As for why it is possible to stabilise exchange rates now, whereas it was not possible to stabilise exchange rates at an earlier date—I shall explain it for the benefit of the right hon. and learned Gentleman — I made that abundantly clear in my speech to the IMF in September before the storm broke. In the 1970s and early 1980s, when inflation was so high, it was impossible to achieve any stability of exchange rates. A precondition of having any degree of exchange rate stability has to be getting inflation down and a convergence of inflation rates at a low level. That came first and it will be maintained. It is on the basis of that that we have been able to achieve exchange rate stability.

That was the problem on the economic front, which we have been addressing. Of course, that problem remains. There has now been added a political problem, as I said at the Mansion House last night, of a doubt throughout the world and, indeed, in the United States, about whether they have the political will to deal with the problem which faces them.

The importance of the negotiations that are now going on between the United States Administration and Congressional leaders is great. I have been in continual contact during this period with my opposite numbers in the other major nations, and particularly in the United States and Germany, which are the key countries in this issue. As the right hon. and learned Gentleman pointed out, my right hon. Friend the Prime Minister has sent a personal message to the President of the United States in the same sense. We all wish to see——

Mr. Kinnock: Since the Prime Minister has been reluctant to publish the message which she sent to the President at around the same time as the right hon. Gentleman was speaking in the Mansion House last night, may we have his assurance that it was not just the same sense but the same words, and that it was not an attempt to put balm on what he was saying?

Mr. Lawson: I assure the Leader of the Opposition that, although the words were inevitably different, the message was the same.

Mr. Kinnock: May we have the Chancellor's view on why it was necessary, when his message was so public and so clear, for the Prime Minister to take it upon herself to send another message—a private one—saying only the same thing? Why was that necessary? Was it a lack of confidence in the Chancellor or in his manner?

Mr. Lawson: It seems quite extraordinary, when Opposition Members have been urging us all the time to do everything that we can internationally to secure agreement to deal with the problem, that the right hon. Gentleman apparently criticises the Prime Minister for having participated and sent a message to the President of the United States.

Mr. Kinnock: It is the Chancellor's assumption that I criticise the Prime Minister. The real question is this: was the Prime Minister in any way critical of the way in which the Chancellor was expressing himself or what he was saying?

Mr. Lawson: I assure the Leader of the Opposition that the Prime Minister was not in any way being critical of the remarks that I made. I am not surprised that the Leader of the Opposition jumps up and down all the time. He is trying to protect the right hon. and learned Member for Monklands, East (Mr. Smith) from exposing his views any further.

The right hon. Gentleman is urging us to get an international agreement. Of course we want to see an international agreement, but the first step in any international agreement has to be the securing of agreement within the United States on a package of measures — and a credible and sufficient package of measures—to attack its budget deficit and bring it down and thereby recreate market confidence. Because of the American system, where there is a Republican Administration and a Democrat-controlled Congress, and where the steps that are agreed have to pass through Congress — there has to be the necessary legislation — there has to be agreement between the Administration and Congress.

I urge both of them to make every effort to reach an agreement as soon as possible. It is essential that that is done. I believe that they recognise that fact, although, obviously, it will be much more satisfactory when the agreement is finally concluded. Then, certainly once that keystone is placed in the arch, we can have a meeting.

I believe that we shall have a meeting of the Group of Seven to build an international agreement on the basis of the United States' measures to reduce the budget deficit. That will include, I am sure, measures on the monetary front and structural measures to improve the performance of the economies of the various countries, as, indeed, we have pledged in the Louvre agreement. But we shall take that further, with more reductions in interest rates as a distinct possibility.

The international package must be based on the Americans taking steps to put their house in order. They know that, and to have a meeting now, when that is not in place, would have a devastatingly counter-productive effect on world markets. Therefore, it is necessary to proceed with a proper step-by-step approach with the Americans reaching their agreement first. Under the Gramm-Rudman legislation, they have a deadline of 20 November by which they must reach an agreement. I hope that they will succeed in beating that deadline by a significant amount, but we shall have to wait and see.

Miss Marjorie Mowlam (Redcar): Will the Chancellor tell us how much it has cost the Government this year to support the dollar?

Mr. Lawson: It is a curious thing that, when we were selling dollars just over a year ago, the Opposition were asking how much that cost. Now that we have been buying dollars, deutschmarks and yen, we are asked how much that costs. There is no cost. All that is happening is the exchange of one currency for another. All that I shall reveal is that the foreign exchange reserves of this country have pretty well doubled since the Government came into office. We also have net overseas assets larger than any other country in the world, with the exception of Japan, so our overseas financial position is stronger than it has ever been before. That puts into perspective the remarks made earlier by the right hon. and learned Member for Monklands, East about the very small current account deficit.

Mr. Budgen: My right hon. Friend says there is no cost, but if many dollars are bought and then go down in value, surely a loss is sustained?

Mr. Lawson: No loss is necessarily sustained. It depends what happens over the long period through which the reserves are held. My hon. Friend has always been strongly opposed to any intervention in the foreign exchange market, but I believe that intervention over the past nine or 10 months since the Louvre agreement has been highly beneficial. That is widely understood, not merely by all those countries who have participated in the Louvre agreement and who have reaffirmed that agreement, but by traders, industrialists and business men generally. It is right that we should stick with that.

Mr. Kinnock: The Chancellor said, quite accurately, that his hon. Friend has always opposed Government intervention, but was not that basic to the very strategy of which the right hon. Gentlman was proud to be the author — the medium-term financial strategy — under which everything should find its own level and in which the Government should not intervene?

Mr. Lawson: The right hon. Gentleman is totally unable to see the difference between intervention in every nook and cranny of the economy and intervention in the foreign exchange market.

Mr. Alistair Darling (Edinburgh, Central): The Chancellor has talked about intervention. Can he say whether he will intervene in any future sales of public assets? Will he also let us know whether he will intervene to provide a floor to prop up industries in parts of the country where they have been collapsing precisely because of the lack of confidence that was exhibited when the BP sale took place a week ago?

Mr. Lawson: Like my hon. Friends who I heard muttering behind me, even though perhaps they should not have been, I do not think that that question is worth answering.

What we are talking about is international co-operation to deal with the very difficult situation that the world economy is passing through today, and in which this country's economy is among the strongest in the world, and is widely recognised as such. That co-operation has been demonstrated as recently as the past few days. The right hon. and learned Member for Monklands, East failed to mention that, yesterday, I reduced interest rates again by ½ per cent. and that, today, the German authorities have followed by reducing their interest rates. I welcome that.

Mr. John Smith: Before the right hon. Gentleman leaves this matter can we get it clear that, if the United States succeeds in reducing its deficit, the Chancellor and other Western European countries will expand their economies to deal with the deflationary problem that may arise as a result of the unilateral reduction of the United States deficit? Secondly, in 1980 when the right hon. Gentleman answered a question about what mechanisms existed for the alteration of the exchange rate he said that there were market forces and that alone. Is that still his view?

Mr. Lawson: On the right hon. and learned Gentleman's second point I do not believe that he listened to my earlier remarks. At the time when inflation throughout the world was very high it was impossible to manage the evolution of exchange rates—market forces were all that could do the trick. I explained in considerable detail in my speech to the IMF annual meeting in September — long before this financial storm broke — that a pre-condition of being able to create exchange rate stability was that, first of all, we got world inflation down, and inflation down in all the major nations. That is what we have done. Now it is possible to intervene successfully to manage exchange rates. I explained that very clearly and that is accepted by the other countries which have taken part in the Louvre agreement.

As to the first part of the right hon. and learned Gentleman's question, it is a fallacy to assume that expansion is only secured or can be secured in any significant way by expanding budget deficits. That is precisely the point that I have tried to explain to the right hon. and learned Gentleman. That is the problem that the United States has. It expanded its budget deficit considerably, but then found itself saddled with a collapse of confidence and a massive burden of debt interest. By contrast, what we have done is steadily to reduce our budget deficit, as a result of which we are in an unparalleled position of strength, and we have the fastest rate of economic growth in the world today.

If the Americans were to reduce their budget deficit still further, the confidence that that would bring would be beneficial for growth in the United States, and for world growth.

Mr. Rogers *rose*——

Mr. Lawson: I shall give way for the last time.

Mr. Rogers: The Chancellor has criticised the Americans for having a budget deficit, but is it not a fact that we have had a budget deficit in this country, but that it has been hidden by North sea oil revenues? That has meant that the Chancellor can come forward successfully with the charade that taxation has not gone up. We have had a deficit, but it has been fattened by North sea oil and the sell offs.

Mr. Lawson: The hon. Gentleman is — [HON. MEMBERS: "Right"]—no he is not right.

Following the collapse of the oil price, which is referred to in the amendment, the proportion of our total tax revenues that come from North sea oil is now extremely small. The yield has gone down from about £12 billion to £4 billion. Despite that, we have got our deficit down because we have been pursuing sound policies. So the way to deal with the problem is to continue with the co-operation that we have had among the major nations.

That co-operation is real and was seen only this week with the reduction yesterday of interest rates in this country, followed by the reduction of interest rates in the Federal Republic of Germany today. We must continue with that co-operation. The United States Administration and Congress must continue their negotiations to get a proper package that will secure a reduction not merely in the budget deficit for fiscal year 1988, but for fiscal year 1989. The composition of that package must carry credibility in the world markets. Then, when that has been secured there should certainly be a meeting of the Group

[Mr. Lawson]

of Seven — and I shall certainly participate in that meeting on behalf of the United Kingdom—to build up that package into a wider international package of co-operation.

This debate has taken place after three weeks of turmoil in the stock markets. It is not clear yet when that turmoil will come to an end, or precisely what effects it will have. What is clear is that the United Kingdom economy is incomparably better placed to cope than it would have been had I accepted any of the advice proferred by the Labour party, including most of all, the consistent advice to expand our budget deficit. The Labour party is giving us that advice again today. I have no doubt that I shall receive more advice from it and indeed, from other quarters in the weeks to come.

I shall, of course, continue to keep interest rates carefully under review as I always do. When I decide the fiscal stance in my next Budget—and I do not propose to make that judgment until then—I shall, of course, take fully into account the likely effects of the recent stock market collapse and any subsequent events. One thing that I am not going to do is to follow the primrose path advocated by the Labour party.

The House and, indeed, the country should bear in mind that the reason why we have coped successfully with earlier shocks and why we are so well placed to cope with this one is that, for more than eight years, the Government have pursued firm policies designed to put the economy on a sound footing and keep it there. The benefits of those policies are clear and by sticking to them we shall ensure that the British economy remains among the strongest and soundest in the world.

5.28 pm

Mr. Robert Maclennan (Caithness and Sutherland): Throughout the difficult period of the past three weeks the Chancellor has been endeavouring to paint a rosy picture of the British economy; and, to some extent, in so doing he has betrayed a certain insularity of approach. He is entitled to take credit for the facts that he outlined in his Autumn Statement—the improved rate of growth, the lowered inflation and the falling unemployment. We, however, are equally entitled to point out that that statement foreshadowed changes—all for the worse—in the year ahead.

The Chancellor is right to take some credit for pointing to the relative strength of this country to stand up to the storm that has been blowing through the markets in the past three weeks. However, he cannot be complacent about the risks that this country faces, flowing principally from a probable United States recession if and when measures are taken to curb the twin deficits. The loss of confidence in the United States that will follow the introduction of the measures that the right hon. Gentleman is advocating is likely to hit investment. The widespread share ownership in the United States means that many people there will reduce their consumption. There is a severe risk—indeed, a virtual certainty—of a downturn in demand, which is bound to affect exports from this country and other developed industrial nations. There is a serious risk that that danger will be deepened and extended if the United States Administration and Congress do not come together to reach an agreement that results in genuine reductions in the fiscal deficit.

It is right to mention that the risks are not peculiarly confined to the United States. The financial markets in Japan have fallen somewhat less than those in the United States and Europe. Many thought that that relative strength rested on a somewhat insecure base; not on real corporate earnings, but on inflated asset values and short-term capital gains. That house of cards could easily gradually crumble, although I believe that Japan incorporated could probably prevent a sudden crash. However, the result could be damage to investment and growth in Japan, too.

I have given the Chancellor what credit I think he is due, but I do not think that he can altogether escape some share of the blame for the suddenness of the turn-round in the financial markets. After all, the right hon. Gentleman was party to the Washington meeting of the Group of Seven when the Louvre bands on exchange rates were reiterated, and the market has simply given its thumbs down. It has recognised that the assertions were unbelievable. The IMF projections at that time showed that at current exchange rates the United States would still have a current account deficit of $150 billion in 1991. There was no way in which the United States could be allowed to build up international indebtedness at that rate. The markets did not believe it, and it is perfectly obvious that they were right not to. Poor United States trade figures for August confirmed that scepticism, convinced United States investors that adjustments would have to be made involving the recession, and undermined the profits that had already been forecast, and also equity values.

The Chancellor's remarks on this subject in his speech on 30 September at the IMF in Washington were certainly not of a kind to suggest that he expected what has happened in the past three weeks. There was a lack of urgency in his remarks, and a lack of appreciation of the risks that we were running.

I do not deny that he has, from time to time, drawn attention to the risks. He has done so, but there was a distinct lack of emphasis on the problem in his speech at that time. When the Chancellor was working with his colleagues in the Group of Seven at the time of the Louvre agreement—with the grain of the markets—he carried more conviction than at the IMF meeting, when he seemed to be running very much against the market forces to which he has usually paid so much more attention.

What must be done now? Of course, the right hon. Gentleman must recognise that his influence in international matters is, to some extent, limited, and the Opposition cannot pin the blame for the turbulence, which is external in origin, on him. Nevertheless, the Chancellor can do several things that would be of assistance in protecting, or assisting the protection of, the world economy. He has not shown any sign of being willing to do several things that he could do to protect the British economy as far as possible from the storms that are beginning to blow. Of course, the United States must reduce its fiscal and current account deficits, as the Chancellor has said. It is easy for us to advocate the fiscal balance measures that he has advocated, but there is no point in our whingeing about the consequences of the steps that will have to be taken, and which will have serious consequences for imports into the United States subsequently, including imports from this country. They are bound to occur, however the United States cuts its deficit.

We must recognise, too, the crucial importance of preserving open markets. There are real threats of recurrent, resurgent protectionism in the United States. It is extremely important that we in Europe do nothing in the European context that promotes or encourages protectionist measures. That places a special importance on the GATT discussions on agriculture. Faced with a weak private sector demand and a cut in the fiscal deficit, the United States must improve its international trading position quickly. That must involve letting the dollar rate fall below the Louvre bands. The Opposition motion today has got it a little wrong. The Chancellor is right to suggest that we should avoid rapid, disruptive exchange rate movements. I do not know precisely what the right hon. and learned Member for Monklands, East (Mr. Smith) had in mind, because it did not become clear in his speech, although the motion speaks of something dramatic on this front. That would be damaging to confidence, and hence to economic activity in other countries. Some fall, however, must be permitted. The alternative is for our exports to be hit by the United States recession, or by United States protectionism.

I also accept the Chancellor's view that the position would be greatly assisted by more expansionary policies, particularly in the Federal Republic of Germany. I welcome the announcement of the cut in interest rate there today. I do not altogether find the Chancellor's earlier public criticisms of the Federal Republic attractive. He sometimes seems a little like a child who is not prepared to play the game himself but criticises other players. That is not wholly edifying. His advice to the Europeans would carry greater weight if he entered more fully into the European exchange rate mechanism, which would give him additional leverage with the colleagues with whom he has to deal, and with whom he should be concerting his voice to bring about the changes to which I know he attaches importance.

Mr. Redwood *rose*——

Mr. Maclennan: I shall not give way to the hon. Gentleman.

The surplus countries do not really want to reduce their surpluses, and it is as well to face that reality. The United States must cut its deficit. How is a balance to be struck? The answer, or part of the answer, which neither the right hon. and learned Member for Monklands, East nor the Chancellor addressed in their speeches, lies in the Third world and its need to be able to import more. We must not shut our eyes to the close link between the structural problems of the Organisation for Economic Co-operation and and Development and the debt crisis in the less-developed countries. I had hoped that the Chancellor would say something about that. What is happening to the developed countries is nothing compared with what will happen to the countries whose commodity prices will be struck by the downturn in demand. Those countries will, therefore, be much less well placed to contribute any purchasing power to the economy of international trade.

There is an urgent need to restore capital flows to the less-developed countries and to recognise that at such a time as this, when investment in those countries is risky, it cannot be assumed that the banks will in the near future voluntarily increase lending. Therefore, there is a considerable need for equity capital or guaranteed debt. In his Autumn Statement the Chancellor recognised the importance of an increase in World Bank capital. That is welcome, but it is not enough. The OECD Governments must do more, and Britain should be much more generous about export credit cover. It would be of considerable help to United Kingdom industry if we were to do so, especially if other OECD countries were in decline.

I was disappointed to see in the Autumn Statement the prediction for next year of a 22·5 per cent. fall in Export Credits Guarantee Department cover. The Chancellor would do well to look at that again. No doubt we will be told that this is asking the taxpayer to take the risk of providing such cover, but the taxpayer is already doing so. I call in evidence the tax relief on the banks' provisions against the debts of less-developed countries.

Unless the Government take action to help the less-developed countries to import more, there will be more write-offs and no more tax relief to follow. Therefore, it is in the interest of taxpayers to help to solve this problem. Some of what I say may not seem directly connected with the perceived problems of the domestic economy that will flow from this. While the Chancellor may be right to predict that the United Kingdom's economy will remain reasonably buoyant in 1988, even if the world economy retracts, by 1989 it is certainly likely to be caught in the wake of these damaging consequences. It is important that Britain takes such action as it can to offset that.

If the economy is slowing down, there cannot be any case for the Chancellor focusing further upon the reduction of the public sector borrowing requirement, which is at an extraordinarily low level. It is practically negative, and in the Budget he must recognise that it is time to put more resources into those sectors that will increase Britain's prosperity. Obviously one has to be selective, and if I were to single out one area I would say that the right hon. Gentleman should look at education. It is quite extraordinary that the prediction for next year of the increase in expnditure by the Department of Education is 0·1 per cent. In the first leader of today's *Financial Times* there is a comment on the desirability of the Chancellor looking favourably on such expenditure on education, possibly in the form of tax relief that the Chancellor m:y have in mind to encourage people to choose education rather than holiday villas in Marbella. There is also a strong case for increasing expenditure on health and social services.

The Government must allow interest rates to come down gradually and should encourage them to do so. There cannot now be much doubt that there is little risk of overheating in the economy, certainly not in the City or in the south-east. Generally, all countries need lower interest rates in a recession, and with inflation no longer likely to rise again significantly, Britain is no exception. The Chancellor must be certain that the pound does not become overvalued in this situation. It is inevitable that there will be some strengthening againt the dollar, but that must be accepted as part and parcel of the reduction in the US deficit.

We must not get involved in a beggar-my-neighbour policy of competitive devaluation. The pound must remain competitive in Europe. Sticking to the deutschmark now is all right, but if there is a realignment in the next few months we should behave like a good member of the European monetary system and negotiate an appropriate level. The pound might not need to fall as far as the French franc, but it does not need to be pegged to the deutschmark.

[Mr. Maclennan]

The Chancellor has no grounds for any self-satisfaction. He has been part of the Group of Seven and party to policies that have led to this crisis. However, he has some opportunity to limit the damage, and to do so he must play a full part in the international discussions. I fully take the point that the Chancellor made in answer to the right hon. and learned member for Monlands, East, that a premature conference with the ground inadequately prepared, and the necessary steps not taken in Washington, would most likely be disastrous. There must be international consultation, so that the response to what is happening is absolutely clear. The right hon. Gentleman would be greatly strengthened in the role that he could play if he operated more fully in the monetary system of the European Community.

As I say, the Chancellor could give a lead, by example in dealing with export credit, and not give just good advice. Above all, he must recognise that his role in this matter is bigger than he has sometimes suggested. That is because of the very strength about which he spoke. He can legitimately claim some credit for that strength. The Chancellor boasted about our present growth rate, but he must recognise that as a whole international growth rates are dangerously low and falling. If we continue in this manner, we shall not be isolated from the consequences of a deep recession, possibly plummeting to a slump.

5.47 pm

Mr. Leon Brittan (Richmond, Yorks): Nothing that has been said by the Opposition since the fall in the stock market, since the publication of the Autumn Statement and certainly in the course of this debate, has begun to dent the Government's proud but fully justified claim to have put the British economy in a quite exceptionally strong and soundly based position to weather the economic storms emanating from other parts of the globe.

The right hon. and learned Member for Monklands, East (Mr. Smith) began by making allegations, for which he was totally incapable of providing the faintest scintilla of evidence, about the views of Dr. Pöhl. The right hon. and learned Gentleman suggested that there should be international co-operation in the from of a conference before the principal cause of the problems about which the international conference was supposed to confer—the United States deficit—is dealt with. Such a course of action would at best be a charade, and at worst a disaster. The right hon. Gentleman then regaled us with a sad catalogue of tired old policies that have failed in the past and would fail today. It is not surprising that he resumed his seat with evident relief.

I welcome the opportunity to congratulate the Chancellor of the Exchequer on pursuing policies that have brought steady growth, falling unemployment and low inflation.

Ms. Hilary Armstrong (Durham, North-West): Does the right hon. and learned Gentleman agree that, despite all the euphoria that he has expressed, in the north, which we both represent, although there has been a drop in unemployment, unemployment there is still far too high? Does he also agree that we need more serious intervention by the Government to build a solid and sound regional economy?

Mr. Brittan: I certainly agree with the hon. Lady that unemployment in the north, and in other parts, is too high, but I draw to her attention the latest evidence from a part of the country with which she will be familiar — Teesside. Growth is no longer just taking place in the south-east or in the traditionally more prosperous part of the country. Teesside as much as any other part of the country, has suffered from the decline in traditional industries, and sadly it has been an unemployment blackspot. Business and industry have not been slow to point that out. Therefore, it is significant that the 30 October 1987 press release of the Teesside and District chamber of commerce and industry records that the prosperity of local manufacturing business continues to increase, according to its end-September quarter economic survey.

Comparing the results of the survey of local manufacturing businesses for the third quarter of 1987 with the results for the third quarter of 1986, the press release concludes that 58 per cent. report increased sales, compared with 40 per cent. last year; that 53 per cent. report that their work forces have increased over the past three months, compared with 27 per cent. last year; that there is more optimism when it comes to expectations about the future size of the work force, because 28 per cent. expect to be employing more people in three months' time, whereas last year the figure was 20 per cent.; and that investment plans for plant and machinery are being revised upwards by 28 per cent. of the sample, compared with only 18 per cent. last year. When it comes to business confidence, 75 per cent. expect turnover to increase over the next 12 months, compared with only 47 per cent. last year, and 65 per cent. expect profitability to increase over the next 12 months, compared with 36 per cent. last year. I am glad that the hon. Lady gave me the opportunity to draw out those figures.

Dr. John Reid (Motherwell, North) *rose*——

Mr. Brittan: I am afraid that there are too many hon. Members who wish to speak for me to give way any further. The policies outlined in the Autumn Statement are likely to sustain the confidence shown by that survey only last month in one of the worst hit parts of the country.

Last year, I frankly had some anxiety about the change in the Government's aims for public expenditure—the change from keeping it roughly level in real terms to reducing it as a percentage of the gross domestic product. It seemed to me that there was a real risk of that change being regarded as a dangerous weakening of the Government's determination to curb public spending. With a growth rate of 4 per cent. this year, it is clear that the increase in spending of £2·6 billion for 1988-89 is perfectly compatible with financial prudence. With such a large increase in the national income, it is entirely reasonable that that should be reflected in a modest increase in public spending, provided that the increase is sufficiently modest for the proportion of national income taken by public expenditure to continue to fall. That condition is clearly met in the Government's spending plans, which I therefore fully support.

The risks to the economy, therefore, emanate from overseas. Absolutely nothing that has been said in the House or outside it has achieved the remotest success in establishing or proving that the policies or actions of the Government have played any part in the current turmoil.

Last night and today the Chancellor gave a short, sharp prod to the United States. He stressed the urgency of action to deal with the budget deficit if the fall in world stock markets is not to gather further momentum and lead to a world recession. He was right to do so, but it is important to point out that he added two further matters. He pointed out that he was saying nothing new, and that the problem is one of political leadership.

Earlier in the year I expressed concern about the quality of United States' leadership as reflected in its handling of the situation in the Gulf. That was regarded by some hon. Members as mildly heretical at the time. The concern expressed by the Chancellor has shifted to the economic leadership of the United States, and it is just as justified. That concern, although expressed more openly, frankly and sharply in recent days than in the past, has been felt and stated for many years. I think that the Chancellor referred to a period of four and a half years. When I was Chief Secretary to the Treasury in 1982, I had a meeting with somebody who was then, and still is, a senior figure in the United States Administration, when I urged on him the necessity to deal with the budget deficit of the United States. That was not some eccentric frolic of mine. I was saying what everybody in the Government then felt and was saying on similar occasions.

We did not, however, get all that much support from the rest of the country. Some people at that time were urging us to increase the public sector borrowing requirement by massive sums. We were asked, not only by Opposition Members, "What is so magical about the public sector borrowing requirement? Is it not just a figure, just a lot of mumbo jumbo, a few billions here and a few billions there? Surely it cannot make any difference." There were many who added, "Look, the United States is borrowing massively. It is not doing any harm to that country. It is allowing an expanding economy." Frankly, faced with that chorus, it was difficult to keep saying that what was happening in the United States was unsustainable and that the chickens would surely come home to roost. It was impossible to predict precisely, when that was going to happen, but it was clear beyond the slightest doubt that happen it would, and happen it has. We cannot expect to be unaffected.

If we had followed the advice of the Labour party and weakened ourselves by massive increases in the public sector borrowing requirement, what has happened in the world markets would already have sent our economy into a tailspin. However, there is only limited comfort in that reflection. While world economic problems remain, it is right to urge the United States to curb its deficit and to urge the Germans and the Japanese to expand. It is not our business to tell the United States precisely how to deal with its deficit, or what combination of spending cuts or tax increases should be brought to bear, although *The Daily Telegraph* was right to point out this morning that the United States could raise $50 billion through a gasolene tax and still leave petrol at prices not seen in Europe for the better part of a decade. I only hope that there is enough of a crisis atmosphere in the United States to provide the political impetus to force the President and Congress to reach a resolution of these matters.

It is important that the cuts in the deficit should be substantial and credible. They have to be more than the $23 billion provided by the Gramm-Rudman Act anyway. Although they must be substantial, they must not be so great or so fast as to create recessionary pressures, unlikely though it is that that would happen. World markets are much more concerned that the announced cuts, if agreement is reached, should be effected within a clear and defined timescale. It is because of the need to have confidence that we are not just seeing another set of words and promises, such as those that we have seen so often from the Japanese, that there should be a tax component in the package. Anyone who has been Chief Secretary to the Treasury in this country, or the equivalent in the United States, is well aware that theoretically agreed cuts in spending can all too soon melt away, and the markets appreciate that.

If such an agreement could be attained there would be scope for concerted world action, with reduced interest rates. However, that alone would not be sufficient. The risk of protectionism in the United States is at least as great a threat to the world economy as the budget deficit. If that is to be withstood—and here I agree with the hon. Member for Caithness and Sutherland (Mr. Maclennan)—there must be a fall in the value of the dollar. The Louvre agreement will have to be modified, certainly with regard to the principles of managed floating favoured by my right hon. Friend the Chancellor. It will have to be modified to allow for a fall in the dollar, although not too great a fall, and certainly not a free fall or anything of that kind. However, it will have to fall a certain amount to offset protectionist pressures.

All that has consequences for us, but we cannot be sure precisely what the consequences will be. If international agreement can be secured in response to what has already happend, and in relation to the corrective measures that must be taken, that is likely to lead to only a modest reduction in the rate of growth in this country from the 3 per cent. mentioned by the Chancellor at the IMF meeting in September to the 2·5 per cent. figure that features in the Autumn Statement. However, we will have to consider future interest rate reductions and our own fiscal policy.

The Chancellor was correct to stress that there is a special uncertainty about forecasting at the moment. It is fortunate that decisions about the size of the public sector borrowing requirement and tax cuts do not have to be taken today. All that can and should be done at this stage is to put down a marker or two. With an assumed PSBR for 1988-89 of £1 billion, there would clearly be scope for tax cuts of about £3 billion.

There is a lot of scope for argument about the way in which those tax cuts should be used and I would favour using as much of the scope as possible to take people out of paying tax altogether, one way or another. However, if the international prospects look gloomy, and if the risk of recession increases when the time comes to determine the PSBR for 1988, the Chancellor might well think it appropriate and necessary to accompany lower interest rates with a slightly higher level of borrowing. To do that in such circumstances would not in any way be contrary to our economic strategy. It would make it possible to accommodate more tax cuts than would otherwise be possible. The purpose of that would be economic and not political. In such unhappy circumstances, we would be playing our part to keep the world out of recession.

It would be wrong to increase borrowing substantially or to increase it from a starting point, such as we had a few years ago, of a very large deficit. If we were really facing world recession with a very nearly balanced budget, there would be a powerful case for a modest degree of fiscal relaxation.

[Mr. Brittan]

I very much hope that it does not come to that. I hope that sanity prevails in the councils of the nations and that we will be able to reach the kind of agreement that will ensure that economic growth can continue on the scale envisaged in the Autumn Statement next year and in the years beyond. I have no doubt that the policies followed by the Government give us the best chance of doing that.

6.3 pm

Mr. Brian Sedgemore (Hackney, South and Shoreditch): I had been led to believe that I would have the delightful pleasure of following a Conservative Member making his maiden speech. I think that the right hon. and learned Member for Richmond, Yorks (Mr. Brittan) did very well and I hope that hon. Members on both sides of the House will agree with me. As some editors used to say,

"There must be some mistake here, surely".

The crash on the stock exchanges around the world strikes at the heart of the Chancellor's belief that markets act wisely and rationally. When the crash started, the Chancellor began appearing on television stations bitterly criticising the market players. However, at least he looked perky and bright. By the time that he eventually appeared in the House and realised that he had a BP flop on his hands, he had turned a bilious green and that colour seems to have remained with him right up to today.

I was very worried for the Chancellor and for the nation today. The Chancellor's speech was so bad that, had the markets been listening to him, I fear that they might have followed the course of the St. Petersburg market in 1917 when the index fell to zero and the Russian revolution followed.

The Financial Secretary to the Treasury (Mr. Norman Lamont): That was a golden age.

Mr. Sedgemore: The Financial Secretary to the Treasury calls it a golden age. I do not accept that view. I am not one of those old time Stalinists.

On Tuesday the Chancellor delivered his Autumn Statement. I found myself agreeing with the market that it was frighteningly irrelevant to the needs of the nation at this time. On the very day that the Chancellor announced his statement, the markets which, given what had happened over the past three weeks, could only be described as being in ebullient mood, plummeted by 70 points. Yesterday, after the markets had had time for calm and mature reflection on the value of the Autumn Statement, they plummeted a further 45 points.

Who on earth wrote the Autumn Statement? The only name that I have been able to come up with so far is that of John Banham, the ludicrous director general of the CBI, who earlier this week gave us this year's immortal quote:

"Crash? What crash? I can't remember any crash."

The problem is that there is a complete disconnection between the contents of the Autumn Statement and what is happening in the real world. Most bizarre of all—and nearly all hon. Members have referred to this today—the figure for the PSBR is set at 0·25 per cent. Getting rid of the PSBR seems to have become an icon in the Chancellor's pagan theology. However, why should we get rid of it? What is the reason behind that?

As the PSBR has been reduced, real interest rates have risen. Real interest rates are now twice what they were in 1979. If there is some empirical evidence to show a relationship between reducing PSBR and reducing inflation, I hope that some Conservative Members will produce it tonight. As a member of the Treasury and Civil Service Select Committee I and Conservative Members have looked hard, but none of us has been able to find that evidence.

What should the PSBR be? I watched the famous television programme "This Sunday" when the hon. Member for Wokingham (Mr. Redwood) was asked what he thought the PSBR would be if the dollar had a hard landing. He replied that he thought it should be between £5 billion and £7 billion. That is roughly 1·5 per cent. of GDP. I asked myself what I would have replied if I had been asked the same question at the same time with the same premises. I would have combined prudence with the knowledge that there are many unused resources in our economy and that 2,900,000 people are out of work. It was within the premises of the question that a severe recession was about to follow. In those circumstances, I would have picked a slightly higher PSBR at between 2·5 per cent. and 3 per cent. of GDP. In my view, historically that would not have been out of balance, given the problems that we would have been facing.

The crash on Wall street started on Monday 19 October. Perhaps it was ironic that I first discussed with a journalist the political and economic consequences of a crash in a coffee shop in Brighton three weeks earlier on Wednesday 20 September. Given the time and the place and the fact that I am only an obscure Back-Bench Member in the British Parliament, no one took any notice of the imminent collapse that I was telling people about. That is life, I suppose, but ultimately the academics and the historians will want to know what I was saying at the time. There is also a 20-page speech setting it out for the same party conference, so it is on the record.

It is clear that there is going to be a recession. The only question worth asking is, "How big will it be?" It is sometimes possible for Governments to mitigate the consequences of what happens, but such awesome economic events have the habit of brushing aside the puny efforts of statesmen. We cannot pretend that they have not occurred. The Government have had a lot of luck in their economic management—perhaps more than most other Governments—and it is sad to see that luck running out through the irrational antics of the Chancellor's erstwhile friends who play the markets around the world. The nation should realise that the thundering herd of Thatcher rhinos which stampeded to sell on the London stock exchange are all either friends of the Prime Minister or friends of the Chancellor, or both.

In America, Reagan's buffaloes caused the damage; in Britain, Thatcher rhinos created mayhem. But it will not be only them who pay the price. I remember, when the Labour Government faced a crisis in 1976, Tony Crosland said that the party was over. In 1987, I must say, on behalf of the Conservative party, that the ball is over. No one is fooled by the Autumn Statement.

"Never glad confident morning again", Nigel!

These have been three terrible weeks for those who believe that the markets know best. We have a Chancellor who, as I have told the House before, could not float one of the richest, most powerful and most profitable companies that the world has ever known without intervention because the markets could not cope. What kind of Chancellor is this who said to the world, "BP—don't be part of it, whatever you do"?

This Chancellor used to tell us that the only determinants of the economy were the various measures of money supply — Mo, M1, M2, M3, PSL1, PSL2, broad money and narrow money. He used to say that, because the markets were both the medium and the message, he could abolish the minimum lending rate. Yet, in the middle of a crisis, this free-market, non-interventionist Chancellor, brass-necked, poker-faced and without a hint of shame, told an astonished world that he was about to reduce interest rates by a half of 1 per cent., in what has subsequently been described as the most ludicrous piece of fine tuning that the British economy has experienced since the war.

Are we really to believe that this free-market, non-interventionist Chancellor now has a nightmare every night, in which he goes through the agony of wondering whether to tell the House or the Bank of England next day that he is going to change interest rates by a fraction of a percentage point? Interventionists, fine tuners and keynesians the world over simply do not know how to respond.

This Chancellor used to appear in the House and tell us that the foreign exchanges knew best. Now the exchange rates are fixed by the Louvre accord, and are basically determined by central banks and central Government. How extraordinary it is to see the great god and lord protector of markets turn turtle in such a ridiculous fashion. Now his only market principle, his only monetary principle and his only economic principle is lack of a principle.

I do not know, Mr. Speaker, whether you remember James Russell Lowell. He once said

"I *don't* believe in princerple, But O, I *du* in interest."

Is that not a definition of the modern Conservative Chancellor? Utterly without principles, but believing in interest—the interest of underwriters and market players whom he must save from themselves, and of fat cats in the City who have ruined it for us all because they operate on a casino called the London stock exchange?

Talking of the word "casino", perhaps I could make a sad — or perhaps joyous — announcement. I am reliably informed that John Maynard Keynes, the famous economist who dubbed the stock exchange a casino 50 years ago, today turned over in his grave, smiled knowingly and went back to sleep for the rest of eternity, because he had realised that the genesis of his ideas would prevail. The hon. Member for Wokingham is right: Keynesian ideas will prevail over those of the Chancellor. I wish the hon. Gentleman well in his argument with the Chancellor, who told the House today that, whatever happened to the world economy, be it a soft or a hard landing, he would not go into deficit financing. In two years' time, the hon. Member for Wokingham will have it right and the Chancellor will have it wrong: there will be deficit financing.

The question that we must ask ourselves is, "How serious will the crisis be?". When I asked the Chancellor a question last week, he replied that it was not the crash but the actions of Government that had created the crisis in the 1930s. I consider that a dangerous half truth. I do not believe that it is possible to wipe out $1,000 billion off the value of stock all round the world without severe damage, whatever the response of Governments.

Mr. William Cash (Stafford): Does the hon. Gentleman accept that in 1929 the stock market rose significantly before the recession, and it was the imposition of protectionism in the United States that set the recession going? No doubt the Chancellor rightly had that point in mind.

Mr. Sedgemore: First — and I shall say more about this—I do not believe that if the stock markets suddenly bounced up tomorrow the problems would be solved. Secondly, I disagree fundamentally with what the hon. Gentleman has said about protectionism. Perhaps he should realise that protectionism came in in Britain in 1932, and the British economy, which had been growing at 2 per cent. per annum, suddenly grew by 4 per cent. per annum at almost exactly the same time. I know the argument, but I think that there is wide disagreement about the role played by protectionism in that crash. I do not wish to go into the matter in detail, but I am not on the side of the hon. Member's interpretation.

I believe that the real problem lies in the loss of confidence and the creation of uncertainty. Even if the markets bounced back next week, that loss of confidence and uncertainty would still be there, because we would not know where the markets would go in the following week. The interaction between uncertainty and loss of confidence, and liquidity and the ability to borrow, produce, and trade, creates a problem that cannot be wiped out by a series of Government macroeconomic measures.

Sir Ian Lloyd (Havant): I have listened to the hon. Gentleman with considerable interest. There seems to be a certain inconsistency in his attribution of the cause of the present position in the first place to the inefficiency of markets, and in the second place to a lack of confidence and uncertainty. If the market for assets—which is what the stock exchange is—has operated efficiently, should it or should it not have reflected uncertainty or a decline in confidence? Was it operating efficiently, or was it not?

Mr. Sedgemore: I am told that that is a question that the hon. Gentleman must answer because he knows more about the markets than I do.

In the interaction between loss of confidence, uncertainty and liquidity — the ability to borrow, produce and trade — there is a series of timescales and many institutions and individuals are involved. It is naive for the Chancellor to believe that for the British, American, Japanese or German Governments to take one or two macroeconomic measures will suddenly right everything. That is not a credible scenario. The event has happened and some of the damaging consequences will be there whatever happens.

We have been told—again it has been the subject of the debate — that the Americans caused the problem with their budget deficit. There is no doubt that the budget deficit has created many difficulties for America, but we are not concerned with deficit budgeting per se. America decided to finance its budget in order to keep inflation down by borrowing foreign money. They also have to finance a trade deficit at the same time. The cumulative amounts, taking into account interest on foreign debts, built up by its trade deficit and budget deficit, will, it is threatened, be measured not in billions of dollars but trillions of dollars. When that happened, it was clear that

[Mr. Sedgemore]

the American economy was in an arithmetic hole from which it would not get out without causing a lot of damage.

We have now seen the first part of that damage. There will be second and third instalments. They will hurt America and the United Kingdom. But to seek to argue, as the Chancellor apparently did, that therefore there was no case for deficit financing in any other country—none of the others faced the same kind of problems that the Americans faced as a result of financing theirs through foreign debt—is a patent absurdity. If Japan, Germany, France, Italy and Britain were all to stop their deficit financing, we would see a slump which would make the current situation seem almost like a vicarage tea party on a Sunday afternoon. It is plainly not credible to put forward that argument. The hon. Member for Wokingham has got it right, and the Chancellor of the Exchequer has got it wrong.

I agree with the hon. Member for Wolverhampton, South-West (Mr. Budgen) when he finds it faintly ridiculous that the Chancellor should go along to the City of London and wag his finger and butt his stomach out in the direction of the Americans, almost in complete incomprehension of the kind of problems faced by that political system in this kind of crisis. It is almost impossible to believe that that kind of approach by a British Chancellor, which totally ignores the realpolitik of the United States, can do Britain, the United States or the world any good at this time.

Whether or not the Chancellor has abused Mr. Pohl the member of the Deutsch Bundesbank, it is no good us giving the Germans a lecture. Their interest rates are considerably lower than ours in actual and in real terms and they have limited room to manoeuvre. Even if we lecture the Japanese, I am sure that they will not wipe out all their surpluses just because it might suit us.

Although, like everbody else, I can be in favour of international accords, meetings and some attempt to find some new structure for the way in which the world deals with its financial crises, for the moment the British Government should be changing their monetary and fiscal stance in order to do their bit to help the world. The motion recognises that, and so I shall support it.

6.24 pm

Mr. David Davis (Boothferry): I am grateful to you, Mr. Speaker, for calling me to make my maiden speech so early in the debate. I am also grateful for the compliments on my speech, however premature.

I pray the indulgence of the House to speak briefly about my constituency and to pay proper tribute to my predecessor in Boothferry. The constituency of Boothferry encompasses the Yorkshire wolds and extends down to the vale of York, across the Ouse and Humber to include the Isle of Axholme. It is a beautiful rural area and can claim to be one of the cradles of English individualism. Many of its people fought for their beliefs and for other people's rights. Some died. Robert Aske, who led the pilgrimage of Grace, was hanged in chains in York castle. Others, such as William Wilberforce and John Wesley have, by the force of their character, and their commitment to their ideas, changed the world in such a way that history will never forget them.

Today, individualism takes the form of enterprise and initiative on the part of the people I represent. That is why Yorkshire and Humberside has many more small businesses, private enterprise and self-employed people than most other areas of Britain.

My predecessor in Boothferry was Sir Paul Bryan. When Sir Paul entered the House as the Member for Howden 32 years ago, he was already distinguished by his war record. He was a holder of the Military Cross and Distinguished Service Order. I think that he was the last Member of the House to hold both those decorations. He was clearly a man of considerable courage and leadership. Courage has been described as the quality of exhibiting grace under pressure. Sir Paul had the quality of exhibiting grace in all circumstances. He was greatly loved in my constituency for his dignified leadership, quiet compassion and calm wisdom. If I can do as much for my constituency and the House as Sir Paul did, I shall be justifiably proud.

Sir Paul had one other characteristic when he came to the House which helped him to stand out from the crowd. He had an entry in the "Guinness Book of Records". He was and is a keen golfer and he achieved the feat of getting two holes in one, as some hon. Members will know. He tells the story of returning from that round, buying the traditional round of drinks in the club house and telling the barmaid about the fact that he had scored two holes in one. She asked him which holes he had scored them on and he said that it was the ninth and twelfth. "But, Mr. Bryan," she said, "those are the two shortest holes in the club." Such wry scepticism is often seen on the Opposition Benches today.

My right hon. Friend the Chancellor of the Exchequer has scored hat trick after hat trick — in the Autumn Statement last year, the Budget this year and the Autumn Statement this year — when we had a higher growth record than any other Western nation, a faster fall in unemployment than any other country, and many other characteristics in our financial situation which stood out as being models for the rest of the world. However, the comments of the right hon. and learned Member for Monklands, East (Mr. Smith) will not be the real test of the Government policy. The real test of the Government's policy and our economy will be how it withstands the global adversity that we are seeing today.

I want to explore how that test will come about. I am not just talking about a slump or a potential slump. If we have a slump, everybody understands what that means as a test for our economy. If we avoid a slump, that, too, will be a test for our economy.

Let us examine what has been said about what is needed to avoid a slump. My right hon. and learned Friend the Member for Richmond, Yorks (Mr. Brittan) basically described five different points. Two of them are American. There is obviously the need to cut the budget deficit and the Americans must abandon protectionism. Three other things have to be done. First, we must maintain the liquidity of the financial markets, and that has already been done. Secondly, we probably have to see some fiscal relaxation in Germany and Japan. Thirdly, we must see a modification of the Louvre accord to allow the dollar to devalue to a proper level against the deutschmark. If that goes ahead and is successful in preventing a global slump, there will be a continuation of growth in global demand — it will not be as high as in recent years but it will continue. However, the structure of that global demand will change.

Labour Members like to talk about the real economy, but what will happen in real terms? The American market will suffer deflationary effects. The policy change and the consumption effects of the Wall street crash will have deflationary effects. American industry and employment will be protected from that, to some extent, by the dollar-deutschmark parity change. British industry will not be protected. Some £12 billion worth of exports will be going into the dollar area markets. We will have a smaller, more difficult market for our high-tech and high-value items —typically the items that we sell to the United States— and we will face tougher competition from American producers with that dollar advantage.

We will have to look elsewhere for outlets. If the global economy is growing, by definition there will be expansion elsewhere. When we look elsewhere we will run head on into Japanese competition and Japanese products that have been displaced from the United Kingdom market. We will also face German and American competition, which will be tougher because of that dollar parity change. We will have to battle hard for our market share. That market will not necessarily be in the same products—it certainly will not be in the same place—and we will have to fight for every percentage point of share.

How will Britain's industry cope? The transformation of British industry in the past eight years will ensure that we will win enough battles to maintain our growth rate. How would we have done eight or ten years ago if we had taken on the Japanese or tried to sell Jaguars to Germany? That is the acid test of Government policy. That is the test that will apply if the global market does not crash. The previous Labour Government would have failed that test. Their policies would not have coped because of the lack of competitiveness that they brought about in British industry.

That is the successful scenario, but in the unsuccessful scenario the other side of the Government's balance sheet takes effect. Clearly competition and competitiveness still matter. However, the Government's ability to inject more demand into the economy—this is a common sense approach, not a Keynesian one—is a function of its creditworthiness. Any company chairman will know that creditworthiness dictates how one copes. The United States' problem is that it has run out of creditworthiness.

The Government's balance sheet is as good as it has ever been, but it is not the only important balance sheet. Over the past few years it has become fashionable to criticise the bull market. However, one of its side effects is that British industry has been able to obtain lower borrowing levels, better equity funding and a lower risk base than ever before. Thus, it is better equipped to deal with higher competition and higher margins.

Our policies stand up, on any scenario, in comparison with anybody else's. We have the flexibility to move with the world markets. We have the capacity to cope with a drop in world demand. In the final analysis, whatever the outcome, the British economy has the equipment to harness the wind or weather the storm.

6.33 pm

Mr. Peter Shore (Bethnal Green and Stepney): It falls to me to be the first speaker to be called after the hon. Member for Boothferry (Mr. Davis). I add my congratulations to those of Members who are sitting immediately around him on a distinguished maiden speech. It combined matters that we like to hear in a maiden speech. The hon. Genleman talked about his constituency, which has obviously produced men of great character for many hundreds of years, and he paid tribute to his predecessor, Sir Paul Bryan, who many years ago won the affection of hon. Members. The hon. Gentleman made a valuable contribution to the debate. He warned that we will face tougher competition in world markets, which is indisputably true, as a consequence of the past three weeks. We shall look forward to future contributions from the hon. Gentleman.

I should like to say equally pleasant things about the Chancellor of the Exchequer, but they would not be true. He did not do himself any good in his speech, nor during his exchanges with my right hon. and learned Friend the Member for Monklands, East (Mr. Smith). The right hon. Gentleman displayed a degree of oversensitiveness and irritability. For the first time, it made me wonder whether we are wise to press for the presence of television cameras in the Chamber. If world markets had be able to see the look on the Chancellor's face—the clear state of anxiety and agitation—panic would have been conveyed to markets here and abroad.

It was not only the manner of the Chancellor's speech that was worrying. My hon. Friend the Member for Hackney, South and Shoreditch (Mr. Sedgemore) and others put their fingers on a central and worrying point in the right hon. Gentleman's analysis. The Chancellor was challenged by my right hon. and learned Friend the Member for Monklands, East as to what he would do if the United States Government followed his advice and cut their budget deficit, with the subsequent contraction of world demand, and what he and his colleagues in the G7 countries would do to expand demand to offset the deflationary influences of the American economy. His answer was one of the most negative and worrying statements that I have heard. He dismissed out of hand the possibility of using public expenditure and the public sector borrowing requirement or a range of direct measures that are available to the Government to compensate for a massive loss of demand elsewhere.

As we approach the end of the third week of disorder in the stock and currency markets, none of us can doubt the considerable dangers that face the western world. Thousands of millions of pounds of capital values have been wiped out, with all the effects that that will have on consumer demand, capital investment and commodity prices. I am grateful to the hon. Member for Caithness and Sutherland (Mr. Maclennan) for bringing the consequences for the Third world into the debate. It is difficult to quantify these matters, but the effects will be severe. The central task of the British Government and the other leading industrial nations is to prevent the current disorders in the money markets leading to a serious recession in the real economy. I hope that hon. Members can agree on that point.

The Chancellor has done all that he can by verbal reassurance to stabilise the market. Yet successive statements in the House over the past fortnight—following two successive 0·5 per cent. interest rate cuts—have been followed by further declines in the *Financial Times* index.

As to the current state of the British economy, I agree with the Chancellor that the stock exchange has overreacted to a ludicrous degree. Now that our own market, with the Government's enthusiastic encouragement, has simply become a component in a global stock

[Mr. Peter Shore]

market, it is hardly surprising that our stock exchange is just as much, if not more, influenced by events in the world economy as it is by the fortunes of the British economy alone.

My right hon. and learned Friend the Member for Monklands, East was right to stress the fact that the basic imbalance between the current account deficits of the United States and the current account surpluses of Japan and Germany are a major source of instability. It is a mistake to have a one-sided view. The United States had a deficit of $140 billion in 1986, but Germany and Japan had a combined surplus of no less than $122 billion in the same year. This year the United States deficit will be $147 billion and the German and Japanese surplus will be no less than $132 billion. Next year, although the United States deficit is forecast to fall to $126 billion, the surplus of Germany and Japan is still estimated to be no less than $116 billion.

In my view, the failure of Germany and Japan to expand their internal demand is just as culpable as that of the United States in failing to bring its external account closer to balance. Indeed, I would say that it is more culpable. The United States deficits have been the only real engine of world economic growth in the past five years. If the United States market had failed to grow, and if exports from other countries, including the Third world debtor countries of Latin America, had been choked off by American deflationary measures, the world economy could just as easily have been plunged into recession and the world money markets disrupted by successive debtor defaults among the main debtor nations. By 1988 the United States is scheduled to have halved the deficit levels incurred in 1985. More rapid progress would give some benefit but, if it is not carefully judged, the American economy could easily tip over into recession. It is for that reason, and because I cannot believe that megaphone financial diplomacy makes sense, that I regret the over-emphasis placed by the Chancellor in his Mansion house speech on the correction of the American budget deficit alone.

Two things are needed. First, we need steady opinion and clear evidence that the United Kingdom Government have recognised the threat to the British economy and are ready to take effective measures to counter the onset of recession. Secondly, we need support for essential international co-operation to bring some balance and stability back into world trade and exchange rates and to foster economic growth.

On United Kingdom internal action, I very much regret the fact that the Chancellor did not take the occasion of the Autumn Statement to announce substantial increases in public expenditure. If only a year ago, when presenting the 1986 Autumn Statement, the Chancellor was able to congratulate himself on his prudent management of the economy with a £7 billion PSBR—equivalent to 1·75 per cent. of GDP — surely a year later, and in the aftermath of the London stock exchange collapse, he could have announced measures to strengthen the British economy well within last year's prudent PSBR target of £7 billion. That would not only have been extremely welcome to those who have pressed for so long for improvements in infrastructure and for better public services; it would have ensured an additional increase in GDP next year of about 1·5 per cent. I heard somebody say that that would be inflationary. Why should it be more inflationary this year than the £7 billion PSBR was last year when we were managing our affairs with prudence?

By limiting the increase to a mere 1·75 per cent. in real terms, the Chancellor has failed to use the main instruments of counter recession policy. He still has the fiscal judgment to make at Budget time, and I have no doubt that he will be looking for a cut in income and other taxes. There is no certainty that such increased purchasing power will lead to increased expenditure or that if such expenditure did take place it would not take the form of increasing imports rather than a stimulus to the British economy.

We must look to international co-operative action for the crucial decisions in the period ahead. The Louvre accord and the Plaza agreement have had great success in achieving a managed re-alignment of currencies and a successful and major devaluation of the dollar against the deutshmark and the yen. I am sure that the Chancellor will wish to sustain and reinforce those beneficial agreements. I hope that we shall hear confirmation of that from the Minister in his reply to the debate.

Exchange rate and interest rate policies, although extremely helpful, are not enough in themselves. It is essential that the economies of the Western world should better co-ordinate their policies of economic growth than they have in recent years. World economic expansion cannot now be left to the United States alone. The burden has to be taken up by other major industrial countries such as Britain and France, but most notably by Japan and Germany. I hope that the Government will put their full weight behind that essential aim.

6.46 pm

Mr. David Howell (Guildford): I warmly congratulate my hon. Friend the Member for Boothferry (Mr. Davis) on his excellent and extremely interesting maiden speech. He spoke not only with great gusto but with considerable authority. We are not just mouthing words when we say that we look forward to hearing similar contributions with similar authority in the coming weeks and months. He did extremely well.

The difficulty that has faced the Labour party was well described in an article about 10 days ago in the *Financial Times*. That newspaper is not always a paid-up supporter of the Government. However, a political correspondent pointed out that the Labour party would be unable to say anything intelligent or sensible about the economy as long as it was unable to recognise what had happened in the economy. If it persists in asserting, against all the evidence, that everything is hopeless and that difficulties are worse than ever, and if it is unable to see that there have been fundamental improvements in the structure of the economy, such as those mentioned by my hon. Friend the Member for Boothferry, it will continue to make banal and unconvincing contributions to the debate. I am afraid that that is the problem that the right hon. and learned Member for Monklands, East (Mr Smith) was caught up in today, and it almost sunk him completely when he tried to put forward his ambiguous position.

Whatever the dangers in the world — they are considerable—the reality is that this vessel, the British economy, is extremely seaworthy and in much better shape than it has been in the past. That does not mean that we will not be rocked about, but it is in good condition, and credit for that goes to my right hon. and hon. Friends, especially to my right hon. Friend the Chancellor of the Exchequer. He has supervised the recreation and rebuilding of a more seaworthy British economy than in the past. The London stock market took an enormous buffeting. It was greater than many people expected, but it was paying the price of being a truly global stock market. When it was the one market in which people all over the world could sell their shares rapidly, they naturally chose London. That does not mean that the United Kingdom economy is not extremely sound and in excellent shape. There should be no ambiguity about that. If Labour Members want to join in the debate on how to handle the difficult world conditions, they should get away from their blind dogma that everything is disastrous, recognise the achievements that have been made and learn how to build upon them.

During the past two years my right hon. Friend the Chancellor has led the way in international co-operation. He has taken a substantial lead. He has been able to do that because the British economy is sound and is no longer weak and in debt as it was under the Labour Government. That has helped greatly to steady the international situation. I am predisposed against currency intervention. It is very difficult, it works only if it moves with the market, it can cost a great deal and it can be highly ineffective. However, we must face the fact that with vast capital movements around the world that have nothing to do with currency requirements for trade a degree of cushioning and moderating of currency volatility is desirable. My right hon. Friend the Chancellor has recognised that and, with his international colleagues, has moved urgently and constructively to meet the need.

Having said that, I suggest to my right hon. Friend that there could be a limit to the usefulness of what might be called America-bashing. The United States deficits are very swollen. However, the plain fact is that even if it is wrong that they should be so large — and there are reasons for that which have not yet been mentioned — there will be no change overnight. If the world's policy-makers wait for miracles to happen in Washington, and for major cuts in the budget deficit to be achieved by big tax increases or expenditure cuts, there is a danger that they will be disappointed. As the hon. Member for Hackney, South and Shoreditch (Mr. Sedgemore) said, the American constitution, from its inception was constructed and designed to prevent rapid Executive action. It is certainly not designed to overcome the gigantically powerful spending lobbies in the United States. Therefore, while I hope that we shall hear credible statements from Washington, it is unwise to depend solely on some magic being worked overnight in Washington to correct the fundamental difficulties and imbalances in the American economy. They will take a long time to put right.

It is important that while we wait for that to happen we consider urgently the two immediately identifiable areas in which policy went somewhat awry in Western economies in recent months. We should see whether, by repairs in those areas, we can achieve an early restoration of confidence in the world economy.

Of those two aspects of policy, the first is the Louvre accord, which hon. Members have mentioned. The Louvre accord was the second agreement in which my right hon. Friend the Chancellor took a leading part. Earlier he was one of the architects of the Plaza agreement, which was extremely skilfully timed and which was able to influence, stabilise and handle the dollar decline very successfully. The Louvre agreement was reached with rather different ambitions in mind, and we need to consider whether those ambitions should now be modified substantially.

The apparent stability of currencies within pre-set ranges that existed in the summer months of this year covered up the pressure that was building up for the dollar to decline further. People say that the dollar should decline further, but it has already declined. Now the Louvre agreement has momentarily broken down — unfortunately amid open abuse on either side of the Atlantic. Mr. James Baker and Mr. Stoltenberg, for example, have said some unnervingly robust things about each other. When that happened, the seeds were sown for the very substantial dollar decline that has taken place in recent days.

It is essential that my right hon. Friend the Chancellor, who has taken the lead as an architect of international co-operation, should come to the fore and apply his enormous talents to building a better system that can deal with crises such as that which developed when Japanese and German interest rates momentarily rose and caused the Americans to grow angry. That is precisely the sort of crisis that should have been handled by a sensitive and flexible Louvre accord, based on discreet and close understanding between finance Ministers and central banks. Many people thought that we had such arrangements in place, but it turned out that we did not. I believe and hope that my right hon. Friend the Chancellor is now putting his talents to rebuilding such arrangements, because that is the first requirement if we are to begin to see confidence restored. It is no use waiting for the miracles in Washington, which will take much longer. We must move on that front now, and I think that my right hon. Friend pointed in that direction in his speech in the City last night.

The second change that is immediately required, and immediately possible — in contrast to our longer-term hopes — becomes clear when we turn our eyes to Japan. Like the American deficit, the Japanese surplus will take a long time to go. There is no more chance of turning the Japanese into a high-consumption, low-saving society overnight than there is of curing the United States budget deficit overnight. In the mean time, the Japanese have a duty similar to the duty that fell to this country in the 19th century when we dominated the world with our exports. That duty is to maintain massive capital outflows from the economy to finance and stabilise the rest of the world. That is what has happened in the past two years, with the Japanese financing the United States deficit. One could argue that there was some justice in that because the United States deficit was driven, at least in part, by defence expenditures incurred to assist Japanese interests. That uneasy settlement seemed to work for a time.

When the Japanese withdrew from the United States bond market and ceased to finance the United States deficit some spotted the danger signal and others did not. The Japanese withdrawal in April led to the gradual unfolding of the crisis. At this stage, pressure should be exerted, not so much on the United States, but on Japan, which should be urged to fulfil its role of maintaining its capital exports. I do not much care how the Japanese go about that. Perhaps they should go back to the United States bond market. Perhaps they should massively increase their grants to developing countries. Perhaps they should make a more direct contribution to the world security system. There are many ways in which they can

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maintain a massive capital outflow. Unless the Japanese do that, the lack of confidence and misery of recent days will continue.

The right hon. Member for Bethnal Green and Stepney (Mr. Shore) is very experienced and has lived through, and served in Governments through many crises. However, I do not share his view that we should all deliver good lectures to the Germans and Japanese on how to expand their economies. For one thing, I do not think that would have very much effect, and for another, careful examination of the evidence shows that the Germans and Japanese have done a considerable amount. One does not get a clear impression of that because German official rhetoric is designed to disguise the fact that the German economy has expanded or has been accommodating in any way, but today, with the cut in the Lombard rate, that has become very evident. The Japanese, too, have increased their imports vastly in recent years. Japan is a conservative society, but it has moved to meet the situation, not only by its standards, but by anyone's. We should not be bashing Germany and Japan. Instead, we should move forward with a new and modified Louvre agreement.

Opposition Members will not share my view that by far the wisest course for any one country to follow is to do what we are trying to do against the coming storm—batten down, maintain sound public sector finance as far as possible, and concentrate in every way on improving the flexibility and the supply side of the economy. My hon. Friend the Member for Boothferry suggested that we should expand Jaguar and other volume car sales into other markets and that is how we shall achieve that aim. We shall do so, not by throwing higher public spending at problems, but by improving the capacity of our economy to operate in the new and much bumpier conditions ahead.

Perhaps we should relax a little on monetary and fiscal matters, given that the world inflation risk is now very low and that the price of oil will fall in the new year, albeit not dramatically. There is no world danger of inflation. However, the idea that we should answer the problems of the coming storm by piling on more sail in every direction and waiting to be blown over—or urging the Germans and the Japanese to do so—is absurd, dangerous and irresponsible.

I must tell my right hon. Friends something that I suspect they know already — that another financial earthquake could happen again if we simply sit around waiting for something to happen in Washington that will not happen in the short term. In dealing with past policy mistakes that must be put right it is far better to concentrate on what is within the Government's capacity to achieve than to wait for developments in either Washington or Japan that are concerned with the fundamental imbalance of the world economy. That imbalance has developed over many years and will take many years to put right. Let us instead concentrate on a modified Louvre agreement, with the Japanese resuming their capital support and capital exports, thereby giving the world at least a breathing space to restore world stability and growth, and then build on that.

7 pm

Mr. Rhodri Morgan (Cardiff, West): As one of the 1987 intake, I add my congratulations to those already expressed to the hon. Member for Boothferry (Mr. Davis) on an exceptionally coherent maiden speech. I think that Opposition Members would be about 80 per cent. in agreement with him. The hon. Gentleman represents a constituency just north of the great dividing line—often described as running from the Severn to the Humber—as I do in representing Cardiff, West. It is a part of the country that is familiar with adversity, so we can speak with a great deal of sense about the real world in which we live and the problems that the country faces in trying to adjust to the events of the past eight years.

in that spirit of inter-party co-operation, I think that we all agree that tonight we are discussing the death of Reaganomics. As we know, that comprises seven or eight elements—the obsession with tax cuts, depressing levels of berefits in the welfare state and the attempt in initial years to raise the currency to artificial levels— which were intended to apply a cold shower to manufacturing industry that was thought to have outdated practices, strong trade unions and dependence on smoke-stack industries, creating what, in the north eastern part of the United States, became known as the Rust Bowl—union bashing, popular capitalism, supply-side economics, enterprise culture, deregulation, particularly of airlines and financial markets—which led to takeover mania—and a huge expansion of credit. Of course, the Opposition accept that, happily, none of those factors applies in this country—they play no part in this Government's policy; they are purely American phenomena. Therefore, we are glad that the Government are trying to dissociate themselves from Reaganomics. They are ditching President Reagan in his final year of office, and they claim that the problems in America are not ones that this country could ever face.

Mr. Ian Taylor (Esher): Does the hon. Gentleman accept that the problem in America does not revolve around the items that he listed — some of which are admirable—but has happened because America tried to apply those policies before it had brought its deficit under control, unlike this Government? That is what has given our Government so much flexibility but has caused the problem in America.

Mr. Morgan: I could add further items, such as military spending. Indeed, the way in which the British economy has developed shows remarkable similarities to the American economy. An example of that is the level of manufacturing investment. It is one area on which I disagreed with the hon. Member for Boothferry. He claimed that the British economy was now more efficient than it was in 1979 and, therefore, was far better placed to weather the storm.

However, we know that manufacturing investment, even at the height of what the Chancellor likes to call the great boom economy, is 7 per cent. below its 1979 level. That poses certain problems in weathering the storm. Indeed, at the gathering last night the Governor of the Bank of England—and I am sure that the Chancellor heard him — said that he was worried that the crash would affect the recovery of industrial investment that is essential to sustain non-inflationary growth. The recovery of industrial investment has not yet returned to its 1979 levels, and the crash may depress its current level that is already 7 per cent. below that of 1979.

I think it fair to say that we are currently somewhere near the top of the trade cycle, but with a downturn very likely, what will next year's industrial investment be compared with 1979? It makes us wonder how we can have that boom economy when industrial investment is so low. It is a distorted economy because it has been run on similar lines to the American economy. There has been far too much union bashing, caning of the traditional smoke-stack industries, deregulation and takeover mania. Financial investment has become more important than capital investment. The Government have deliberately encouraged the enterprise culture and popular capitalism, which have taken precedence over the encouragement of industrial investment, infrastructure, education, research and development and all the other matters on which the Government should be concentrating.

We do not have a more efficient economy, only a smaller and more distorted economy — not a healthy position with a likely downturn next year. The Opposition are not alone in predicting that downturn—it is widely predicted in the London Business School forecast published this week. Indeed, most commentators agree that it will be extremely difficult to maintain our levels of exports, especially to the dollar areas, during the recession that is bound to happen as America does exactly what the Chancellor told it to do through his megaphone of international co-operation last night.

What have been the effects of the distortion caused by encouraging deregulation in the financial markets and the "anything goes" atmosphere that has applied equally to both the City and to Wall street? We have closely intertwined financial markets—indeed, they are almost as intertwined as our stocks of Trident missiles, as was announced two weeks ago, much to the amazement of the Opposition. Furthermore, so intertwined are they that the flurry of arrests and the attempts to correct the excesses of the City following the Guinness takeover of Distillers would not have happened but for American corrective action of its takeover mania on Wall street.

If I understand it correctly, District Attorney Giuliani of the New York district court became bored with Mafia bashing and turned his attention to the revelations of insider traders Dennis Levine and Ivan Boesky about City misdoings. The Opposition heard the evidence of that with a feeling of great alarm. It is the product of the attempt to inculcate an "anything goes" atmosphere and takeover mania, which themselves were brought about by excessive concentration on deregulating financial markets and the neglect of industrial investment. That had distorting effects on the real economy and has created the inability to weather the storm next year. It leaves the United States of America and the United Kingdom with far too little manufacturing industry and Germany and Japan with perhaps far too much for their own health. It certainly leaves Britain with too little to solve the problems of 2·75 million or more unemployed and the prospects of a recession next year.

The attempts to inculcate popular culture reached a further ludicrous level one week ago today, with the decision to proceed with the BP share sale. Such sales have become an important part of the Government's philosophy. They maintain that we must get more like America, that we must spread share ownership among the people, and that we must—in this case—pour troubled oil on the troubled waters of world financial markets. A top American stockbroker — not Goldman Sachs — referred to it as the charge of the Light Brigade. Opposition Members watched with great alarm the Government's extraordinary decision to proceed. Obviously, they suffered from indecision about it as they decided to suspend the advertising campaign.

How narrowly was disaster averted? If the BP share sale had been one week earlier, or the crash had been one week later, how many small shareholders would have been dragged into a stock market which they did not understand but had entered because they believed every word of the £20 million advertising programme. Conservative Members have to concede that that have been the end of popular capitalism in the stock markets in this country, and of any prospect of wider share ownership for at least a decade. All hon. Members would concede that that would have happened if the timing of either the crash or the BP share issue had been altered by one week. I think that I am being fair to the calendar and to the sequence of events last week.

When the Chancellor decided to proceed with the share sale one week ago, there was a wonderful explosion of enthusiasm from Conservative Members. Coming from the Principality, I was reminded of those odd occasions at Twickenham when England scores a try early in the game, and takes an early lead, and a section of the crowd who bear more than a passing resemblance to Conservative Members realised that it may be their only opportunity to let some air out of their lungs. Knowing that the final score will be pretty dire, they decide to take a little comfort.

In the few moments before the Chancellor said, "However, in order to avoid unstable markets", Conservative Members availed themselves of the opportunity to cheer. We have seen the extraordinary debacle, the real BP share price continuing to drop and the buy-back option being extended by a further two weeks, if I understood correctly the Chancellor's statement. The stock markets have failed to respond to the buy-back option and to yesterday's half point cut in interest rates. Share prices continue to slide.

I do not know where the Chancellor will attempt to put his sticking plaster next. He has been rushing around blaming the Americans, cutting interest rates and providing a buy-back option to prevent BP and other share prices from falling. I am not sure what other options he may have in mind, but if people believe that such tinkerings will solve the problem of the world economy they probably believe that bicycle clips are an effective cure for diarrhoea.

The problems are deep-seated. Conservative Governments are in charge of seven of the major countries of the Western world and their tendency to blame each other increases daily. The problems in our economy which has been distorted by borrowing ideas, though not money, from Reaganomic America is becoming more serious as we go over the top of the trade cycle and down into the recession that all independent commentators are expecting next year.

Far be it from me after the events earlier today to suggest that in the remainder of his political career the Chancellor may be thinking of taking up non-executive directorships with BP, N. M. Rothschild or anybody else. I am sure that he will be far too busy with his new post as chairman of "The Narrower Share-Ownership Council".

My hon. Friends and I want a less distorted economy, more industrial investment, more infrastructure investment more research and development and more education

[Mr. Morgan]

and training because, above all, instead of selling our future as the Chancellor keeps doing, we should use the strength that we have to buy our future.

7.14 pm

Sir Peter Hordern (Horsham): I shall not follow too closely the speech of the hon. Member for Cardiff, West (Mr. Morgan) because he went rather wider than I intend to. However, some of my remarks will follow the course of his, and I hope that my speech will not be altogether out of the context of his contribution.

I congratulate my hon. Friend the Member for Boothferry (Mr. Davis), in his absence, on an admirable maiden speech. He spoke, not only with great clarity and style, but positively. I am glad that he paid such a graceful tribute to Sir Paul Bryan who was a special friend of all Conservative Members. However, I advise my hon. Friend that when he recounts a funny story he should at least acknowledge the author. I hope that on another occasion he will do so.

I pay credit to my right hon. Friend the Chancellor of the Exchequer for his achievements, which many commentators have put down to luck.

Mr. Austin Mitchell (Great Grimsby) *indicated assent.*

Sir Peter Hordern: I notice that the hon. Member for Great Grimsby (Mr. Mitchell) is one such person.

There is no luck in consistently reducing the public sector borrowing requirement and removing many of the restraints that have handicapped our economy for many years and, at the same time, increasing public expenditure where it matters most. It is not a lucky chance that productivity is at its highest level for many years. At any time my right hon. Friend might have fallen victim to the siren voices of some of my hon. Friends or to the foghorn voices of Opposition Members, who still continue to urge him to spend more money and indulge in deficit financing. My right hon. Friend has resisted them all and has never fallen victim. Therefore, he has every right to claim that he has followed a most prudent and direct course in keeping public expenditure under control, although sometimes expenditure has gone a little further than was orginally intended.

I think I am right in saying that when my right hon. Friend was Secretary of State for Energy, the National Coal Board amassed substantial reserves of coal under his guidance before the strike and today we are in the strongest possible position to withstand a buffeting in the world financial markets. My right hon. Friend will know, because he is a complete realist in such matters, that there is certain to be a buffeting. Through no fault of our own, the outlook for the world economy is distinctly rocky at the moment. Stock markets everywhere reflect that. It is absolutely right to criticise the febrile nature of stock markets and the fact that they have fallen so far. However, on all past criteria they were far too high before the crash and it is by no means certain that the fall has finished. There is no just price for equities, only a relationship with bonds and the outlook for growth. That outlook is now in doubt because of the internal and external deficit of the United States.

We have all derived much benefit from the expanding market in the United States of America of the past five years. That applies not least to Japan, which until now has been quite happy to finance such expansion. Let us suppose that the United States acts to correct its deficit. What would we think if it withdrew some of its large strategic investments abroad, such as its 300,000 armed forces in western Europe? Only yesterday we had an assurance from the President that no such thing would occur. However, it would be tempting, to say the least, for Congress to look for means by which it could reduce its overseas deficit.

Mr. Budgen: I ask my hon. Friend to make a leap of the imagination. If he were, for example, a farmer in the mid-west who had been brought up with isolationist tendencies, and if, by chance, he happened on one occasion to listen to some of the advice that has been showered on America recently, might he not feel rather offended by that advice and even come to the conclusion that it would be a good thing to withdraw American forces from Europe?

Sir Peter Hordern: That is a risk that we should all be aware of. What would happen if Congress and the President enforced an Act to restrain foreign trade? I read Samuel Brittan's article in the *Financial Times* today, which stated that there was an agreement among senators to block any such move. It could well be a close-run thing, and pressures for trade restrictions are bound to grow. We should be willing to heed the concern of the United States about the effect of the common agricultural policy and the European Airbus, about which it feels strongly.

Let us suppose that the United States reduces its internal deficit by applying a petrol consumption tax. That would reduce internal demand and ultimately the demand for our exports and those of western Europe and Japan. However, let us suppose that the United States does none of those things. We have been urging the United States to reduce its internal and external deficit for a long time, but let us suppose that it follows a policy of masterly inaction. That is at least as likely as that it will follow the harsh regime that is proposed for it, not only by hon. Members here, but by many other countries. The United States might simply muddle on. What price the Louvre accord then? Keeping the dollar at more or less current rates is proving an extremely expensive business. The Germans are fed up with propping up the dollar, because of the effect on their money supply and, ultimately, on inflation. It is no use Mr. James Baker sounding off against Herr Stoltenberg. I have long admired West German monetary policy, and Germany cannot be blamed for not being prepared to import or risk inflation.

My right hon. Friend the Chancellor says that there has been a substantial inflow into reserves, amounting to about $16 billion. That figure is recorded in the Grey Book. We have been supporting the dollar at great cost. As the House knows, to nullify that expansion at the cost of supporting the dollar, if we are not to have any monetary consequences, we will have to sell the exact equivalent amount of gilt-edged securities to the non-bank public, and that sum would have to be added to the public sector borrowing requirement. I have no idea what that would mean. It could amount to £5 billion or £6 billion. Therefore, although the PSBR is low, I do not think that it is quite what it seems.

I did not hear exactly what my right hon. Friend said, but he may decide that he need not fund that extra amount and the cost of intervention in various foreign exchange markets because the monetary policy could accommodate it. It is no longer any use trying to follow the formerly magic figures of M0 and M3. I like to think that there is no greater devotee of these matters than myself. Indeed, I often think that I am the last remaining monetarist. I have done my best to follow those figures, but it is no longer any use. If any hon. Member wants to know what monetary policy is, it is whatever my right hon. Friend says it is.

It is perfectly true that expectations about spending may have changed. I believe that that is the case. However, just a few months ago, at the beginning of August, so far as monetary aggregates were concerned, my right hon. Friend thought it right to put up interest rates. Of course, it is the shock from the stock markets that has now induced him to reduce, or cause to be reduced, those interest rates, not once, but on two occasions. Add to that the increase in the money supply that is likely to come about by continued intervention in the foreign exchange markets, and I believe that there will be a substantial increase in monetary aggregates.

We should not spend too much time trying to support the dollar while the United States prevaricates. That is likely to be an expensive course. If there is a fundamental imbalance, there is nothing to be gained by such a game.

I recall the words of Sir James Callaghan when he was Prime Minister. He mentioned a convoy of countries, setting off, not only in perfect harmony, but with engines going rather faster than they were designed to go, steaming to the promised land of eternal growth.

I recognise that the comprehensive discussions with other countries are necessary. No doubt they will proceed. I hope that no one thinks that the result of the discussions will lead to a massive growth that will be able to recover the American deficit. I do not believe that. There is no future in such an arrangement. Perhaps that is not what my right hon. Friend has in mind. It will not work. We must take account of matters as they are. It will not be easy. It is better to allow the dollar to fall to the level at which its payments may balance—whatever that may be —than to prop up a system with increasingly reluctant allies to support a rate for the dollar that cannot be justified.

We can do something about the situation. It does not consist solely of lecturing Japan and West Germany about expanding their economies against their will. Ages ago we should have reduced the tariffs that we mounted against United States exports. Of course, it can rightly be said that the United States has a most protectionist regime, but we cannot claim that Western Europe is blameless in that respect. We have only to look at the operation of the CAP and is consequence. It has raised food prices and costs generally for our own people. I have no doubt that that could happen in many other countries. It is all very well to tell the Americans what their duty is, but we have a plain duty to make United States trade exports substantially easier than they are at present. That is something practical that we can do. We should talk to our trading partners about how we can reduce existing tariff barriers. That would do more good than any amount of confabulation about the pace at which we should advance and how much money we should pump into our respective systems.

I do not know whether any hon. Member has woken up in Kansas City on a bright sunny morning. *[Interruption.]* Knowingly, that is. If, by chance, they have done so, they would have been offered some of those delicious American pancakes with maple syrup and a copy of the *Kansas City Star*. If they had looked at the *Kansas City Star*—there are about 32 pages of it—they would not have found a single word about any event outside the United States, and precious few about events outside Kansas. The idea that Americans will be lectured by us or other responsible countries in western Europe demonstrates an active imagination. They will not listen.

What is the real state of the United States economy? What will happen? Suppose the dollar were to fall. Why should it not be a benign economic influence in the United States? There would be a reduction in the inflow of Japanese imports and, I regret to say, from us. The United State economy would be boosted, at least temporarily, until it could become competitive again. That is certainly an attractive course for America. I hope that nobody thinks that America may not favour a marked decline in the dollar rather than adopt policies, even if they are practical and we urge them upon it, which it does not like.

I urge my right hon. Friend, however desirable it may be, not to think that the Americans will take early notice of lectures and rhetoric telling them what to do. They will not listen. We are in a relatively strong position, and we shall need to be during the weeks and months ahead. Above all, I hope that, in concert with our partners, we shall try to take the opportunity to remove the trade barriers that have existed for far too long. We can make a good start with the common agricultural policy.

7.29 pm

Mr. Pat Wall (Bradford, North): Black Monday 19 October 1987 may well mark a watershed in post-war history; a watershed in the trading relationship between advanced western industrial nations, a watershed in industrial relations between Britain and other countries, and a watershed in relationships between different groups and classes within our society.

One thing is certain; the events of the past three weeks cannot be passed off as some form of temporary aberration, as an absurd reaction or an example of late autumnal madness. The Chancellor may refer to events in Wall street as the big dipper effect and to subsequent City of London collapse as a grotesque reaction, but some hon. Members might be forgiven for believing that such events are a reflection of the real state of the world economy and markets.

Let us examine the figures. There has been a fall of a trillion dollars in the value of world shares. On Black Monday 1987 there was a fall of almost 23 per cent. on the Wall street stock exchange, compared with a fall of only 13 per cent. on Black Tuesday in 1929. There has been a £146 billion cut in the value of shares on the London stock exchange. Such startling events cannot be dismissed as lightly as the Chancellor would suggest.

Last week, I directed a question to the Chancellor and referred him to remarks in *The Wall Street Journal* and the report from the National Bureau of Economic Research in America which showed that each of the post-war occasions when shares fell sharply, had been followed eight or nine months' later either by a recession or at least by a severe slowing down in world economic growth. The nub of the question which faces the House, all Western nations, all political parties and the lives and realities of millions of ordinary people throughout the world is this; why should the latest stock exchange collapse be any different from the eight previous post-war collapses? This

[Mr. Pat Wall]

is by far the most severe. This is the first post-war stock exchange fall to be compared with the events of 1929. It is true that the 1929 collapse was preceded by a drop in investment and production, and the recent collapse occurred during a relative boom—a boom which has been labelled by some economists in their peculiar jargon as a growth recession. Perhaps Chancellors of the Exhequer, economists and I might find that term better explained by Tommy Docherty. When he was manager of Manchester City he was asked to explain his feelings after five successive defeats. Bold Tommy said, "We are rolling along on the crest of a slump." They were brave words from Mr. Docherty. He did not keep his job. The Chancellor's brave words to various stock exchanges and business organisations during the past fortnight will not alter the course of developments that are taking place throughout the world.

It is also true that, compared with the situation in 1929, banks, especially those in America, are not as directly involved with stock exchanges. The collapse of the banks led to the major recession and associated problems in America. Nevertheless, there is a new problem facing the banking world: the Third world debts which will not be recovered over the next few years.

On the other hand, the growing development of the world as a single market, the growing division of labour on a world scale, the scouring of the remotest corners of the world market by investment managers in search of successful investment and the computerisation of stock exchange equipment have led to a much more generalised fall than was experienced on a world scale in 1929. Perhaps we should recall the graphic words of John Foster Dulles who coined the phrase, the "domino effect", in respect of the political situation in south-east Asia. Today, the fall of one stock exchange rapidly leads to the fall of others.

I wish to deal with the development of the capitalist economy in the post-war period. Between 1949 and 1973, national output grew by 9 per cent. per annum in Japan, 4·5 per cent. in Europe and 3·7 per cent. in the United States. That post war boom led to rising profits, reaching a peak in the 1950s and still at about 17 per cent. during the 1960s. It then began to fall, culminating in the first post war world recession of 1974-75. That recession was followed by a short boom from 1976 to 1979 and by an even deeper recession between 1979 and 1981.

Growth rates between 1982 and 1987 have been significantly lower than those of the 1960s. Japan achieved a growth rate of 3·8 per cent. compared with its earlier rate of 9 per cent., the EC a rate of 2 per cent. compared with 4·5 per cent. and the United States a rate of about 2 per cent. Profits, which fell to as low as 3 per cent. in 1981, have recovered slowly to about 9 or 10 per cent. This is not particularly attractive for investment in the private sector, when investors can receive similar rates of interest from the banks.

The growth rate between 1924 and 1929 was higher in percentage terms than it has been during the five or six years of the present so called boom. The world came out of the last recession in 1981 on the basis of the demand for goods and labour created in the American economy. That demand was led by the tremendous expansion in American arms expenditure, which is a colossal $300 billion dollars per year, compared with Britain's £18 billion, which is the highest figure of any nation in the EC and far higher than that of Japan. There were false hopes in the United States that an arms drive would lead to increased manufacturing production and success in that country. Without that arms drive, there would not have been even the modest improvements which the Chancellor has attempted to claim over the last few years. Without the American boom and the American arms drive, there would have been no progress and even greater unemployment for the people of Britain and western Europe.

That arms drive, which has led to a deficit in the American economy of between $160 billion and $170 billion, was financed by attracting investment in the American economy from Germany, Japan and other nations, on the basis of interest rates which at one time reached a staggering 19 per cent. That enormous rate of interest explains the present crisis and led to the overpricing of the dollar, the lack of competiveness of American industry and to the twin dilemmas of a budget deficit of about $170 billion and a similar trade deficit, as imports poured into America from Japan, West Germany, the EC and, to a limited extent, from Britain.

Two years ago, faced with the collapse of non-armaments manufacturing in America and with the growing tide of demands from those manufacturers for tariffs and restrictions on foreign trade, American policy was reversed. There was a rapid cut in interest rates to the present level of a little under 9 per cent.

Although that reversal did little to stimulate general manufacturing in the American economy, it led to a dramatic fall in the price of the American dollar—an overall fall against other leading currencies of 40 per cent. and a fall of between 48 and 50 per cent. against the deutschemark. Faced with dwindling returns on their investments in American industry, West Germany and Japan moved their investments from dollars into other currencies. That increased America's problems.

It is all very well to talk of world economic co-operation, but in spite of both the Plaza and the Louvre agreements, the decision of the West German authorities —later withdrawn, it is true—to increase interest rates was the single item which represented the final straw that led to the Wall street crash of 19 October.

The problem in the United States is not as simple as the Chancellor and Prime Minister would have us believe. It is very easy to deliver pious lectures to the American Government about cutting their budget deficit, but how will that be achieved? Will wages be cut or will social wages —welfare payments to the American population—be cut? Such cuts would restrict the ability of the American working people to buy back the goods that they produce. It would lead to a downturn in the American economy and the rapid onset of recession. The Chancellor has called for higher taxes in America, but that would mean a cut in business profits. In America, as in Britain, the vast majority of investment in industry comes from banks rather than the stock exchange or from the profits taken from the labour of working people. An increase in taxes would lead to a fall in investment in American industry and to recession. Of course it may be true that tax increases would mean that the onset of the recession would be slower.

I do not believe that people appreciate the magnitude of the problem. A trade war could develop. I believe that it is ironic that, once again, the Chancellor has poked fun at the Labour Front Bench today. He said that the Labour party has changed its position and is now calling for

America to cut its deficit. In anything there must be a sense of proportion. I am sure that most people would realise that there is a difference between a lake and an ocean, even if both are manifestly composed of water. It is ironic that the Chancellor who, par excellence, has been the Chancellor of "solve-all" by cutting taxes is now lecturing the American Administration on the need to increase taxes to solve its deficit problem. Indeed, he is also a recent convert to the cutting of interest rates.

A world trade war, sparked off by a recession in America, would have enormous repercussions for other countries. At the moment America takes up 25 per cent. of total world imports and exports only 6 per cent. of its production. Britain exports 33 per cent. of its gross national product, as does West Germany. Holland, Sweden and Belgium export 50 per cent. of their produce. In a trade war, the American economy, because of its continental nature and, even today, its enormous strength, would certainly suffer, but Britain, West Germany, Europe and Japan would face a more devastated future. The Americans demand from the Japanese a 20 per cent. share of the Japanese market. In fact, at present, the Japanese have a 13 per cent. share of the American market. Japan imports only 5 per cent. of its total needs. It is ludicrous to expect the Japanese Government and Japanese big business to quadruple their imports from America. If they did so, a similar demand would be made by other nations of the EEC.

By definition, politicians have a certain amount of ego. There is a certain amount of satisfaction for anyone to go before any body and say, "I told you so. I told you what would happen." Some of us have, for some time, predicted a further world recession in the lifetime of the Government. We feel ourselves vindicated by the collapse that has taken place in the past three weeks on the stock exchange. Indeed, it is a forerunner of the events that are about to take place. However, we witness these events with no pleasure.

Recession means increased unemployment, increased economic misery and increased turmoil among the various populations of the world. There is no joy in poverty and there is nothing noble about it. Many Labour Members and I suspect, even a few Conservative Members, have known what poverty and unemployment mean. They may know that through personal experience, or through their families, friends, neighbours or their communities. Poverty is a narrowing, restricting process. It drives people to despair and causes enormous problems.

The folklore of the American 1929 crash — the popular picture — is that of millionaires, jobbers, brokers, company presidents and ex-rich investors throwing themselves from the windows of the stock exchange. Now they have built that building so that that is impossible. Those deaths represented a tiny handful of people, but many more people died as a result of the 1929 crash. In the years of depression that followed 1929 and the massive unemployment that occurred in Germany, in Britain and throughout the world, many people in ordinary families committed suicide. Many people died prematurely because of inadequate diet. Many people died prematurely because of diseases that could have been cured if they had had the money to seek treatment at that time. Many infants died in the first weeks and months of life because they lived in the appalling slums that existed in the cities of the world at that time. Therefore, nobody on the Labour Benches and no Socialist makes the prediction of the coming recession with pleasure.

In recent weeks the Conservative party, officially through the Prime Minister, has said that Socialism is dead. It has been claimed that Socialism is an outmoded philosophy and that its support among the people of Britain will soon die. However, with the pressure of the stock exchange collapse, part of the Socialist ideals have been accepted by the Conservative Government. It may be argued that the stock exchange is of no relevance to the real economy and that is true. More than 90 per cent. of the transactions that take place on the world stock exchanges have absolutely nothing to do with commerce and industry. They are concerned with gambling and speculation in shares, futures and currencies. They have nothing to do with the creation of wealth on a world scale. Wealth is created by the labour of working people in productive industries.

It is on the basis of the wealth created in the productive sectors of the economy—as the Tory amendment partly recognises—that we can pay for the civilising parts of our life: health, education, sport, culture, the arts and all the things that make life richer and more noble. The belief that that is the role of the stock exchange shows that it is not Socialism that is old fashioned, but capitalism, which has gone back to the same old process of the inter-war years.

There have been two old-style recessions since 1975, with two weak booms in between them. We now stand on the eve of an even more devastating recession in the world economy. As we have already seen with the BP farce, much of the gloss has been taken off so-called people's capitalism. Socialism stands for collective decisions and ownership of wealth, and the direction of industrial production to the needs of people and not to a handful of stock exchange speculators who benefit the most; such Socialism is needed. It is a system of society which will become more attractive.

We are moving into an era of people's Socialism, not people's capitalism. It is necessary, and although we have perhaps not said it very well in recent years, what we are trying to do is to build a plateau — not for the underwriters of the BP claim, but for millions of ordinary people. I refer to a plateau of decency and reasonable living standards, on which people can develop their personal talents, personalities and more satisfactory lives.

Today is 5 November. On this day throughout the world millions of women will spend four hours collecting water and fuel — an economic activity that is not recorded anywhere in world statistics. How ironic that people are forced to that back-breaking labour in a world of yuppies, sunrise industries, space travel and enormous technological development. What sort of system are Conservative hon. Members defending when, in times of recession, only 70 per cent. or less of human productive resources are in use and, in boom times, it is only 80 per cent.? 19 October marked the end of people's capitalism and the beginning of a popular people's Socialism.

7.52 pm

Mr. Terence Higgins (Worthing): The House should be grateful to the Opposition for promoting today's debate because Opposition speeches, the Opposition motion and an article in *The Sunday Times* last Sunday, written by the hon. Member for Dagenham (Mr. Gould)—I believe

[Mr. Terence Higgins]

that he is to reply to the debate—all show how badly the Opposition have misunderstood the present economic problems. I shall quote one sentence from the article I have mentioned:

"The casualties of the crash have been spectacular. The first has been confidence in the soundness of the government's economic strategy."

If one thing has emerged clearly, it is that the House is not really concerned today with the soundness of the Government's economic strategy, or the British economy.

We confront some extremely difficult financial problems, and it is certainly right to ensure as much international co-operation as soon as possible. The hon. Member for Bradford, North (Mr. Wall) said that this was a time in which the speculators on the stock exchange were making large profits. I doubt whether that is the case. The hon. Gentleman also referred to the crash of 1929, but it is important to remember that the Wall street stock market crash did not cause the recession of the 1930s, which was the result of the mistaken reactions of Governments around the world to that event. That is why I believe there are big differences between the two crashes, and it is important to analyse what needs to be done in the present circumstances.

The Opposition motion, and the speech of the right hon. and learned Member for Monklands, East (Mr. Smith), laid particular stress on saying that excessive priority had been given to finance at the expense of the real economy. It is strange that Opposition Members should draw that dichotomy. The reality is that the way in which the Government can influence the real economy is largely by financial means. Of course, they are not the only means, and the Government cannot themselves create wealth. That is done outside the House. But to say that one should concentrate on finance or wealth creation is to create a dichotomy that suggests that one must distinguish between the two. There are intimately related. If one analyses the one wrongly, there will probably be disastrous effects on the other.

The right hon. and learned Member for Monklands, East seemed to concentrate on the problem of the United States' external deficit, and suggested that that was a problem for us. However, the fact that the United States is exporting too little and importing too much—much of it from this country—is not the immediate problem. We must spell out the relationship between the fiscal deficit and the external deficit of the United States. Recently the reality has been that the growth of the American fiscal deficit has resulted in higher interest rates, which were necessary to fund it. That, in turn, has resulted in an inflow of funds from abroad, because savings in the United States were not enough to fund the deficit, even at those high interest rates. The effect of that has been to raise the dollar exchange rate, which has made American exports less competitive and imports to the United State more competitive, with a resulting balance of payments problem.

So the crux of the matter must be the United States deficit. That is the root of the problem — not the external deficit, on which the right hon. and learned Member for Monklands, East concentrated.

It is important to be as symmetrical as possible about this issue. Much of the problem arises from the position of Japan and Germany, to which many hon. Members have referred. That is a real problem. For decades, we have found that it is much more difficult to get countries with strong currencies to take corrective measures than countries with weak currencies. That applies all the way from the scarce currency clause of the Bretton Woods agreement. Even so, we must seek to persuade the United States to take effective action, especially on the fiscal deficit. We must also recognise that it is much more difficult for the United States to take that type of action than it is for the British Government. We have a marvellous invention — I am always surprised that no one else has copied it — the Provisional Collection of Taxes Act 1968. It is possible for the Chancellor of the Exchequer to have a discussion in Cabinet one morning, to come to the House in the afternoon and to announce that taxes will change in a matter of hours. It is vastly more difficult for the United States to do that.

Also, the division of powers in the United States between President, Congress and the Federal Reserve creates real problems. Nevertheless, it is urgent that action be taken on the deficit but, for the reasons that I have mentioned, that will mean, in the first instance, a clear statement of intent by the United States. We all know that it is never popular to say that taxes must go up. I do not believe that any declaration of intent on reducing public expenditure in the United States will carry sufficient conviction to restore confidence, which is badly needed in the international community. However, a pronouncement about taxation would have an immediate effect.

We must recognise that there is still a real danger of what the Treasury Committee said in its report as long ago as September 1985. That report spelt out the danger of a hard landing for the dollar if something was not done. A sudden downward slide in the dollar exchange rate would have obvious inflationary implications and would create other problems about the confidence of people from abroad who have invested money in the United States. That could result in a considerable rise in interest rates to offset that fall. As the Treasury Committee said, that would create a serious situation. That is one of the main reasons why it is important that action should be taken on the fiscal deficit in the United States.

It is also important for us to take effective action. The response of the Chancellor in reducing interest rates following recent events was the right one. We must certainly welcome the fact that there has been a similar move in the United States in contrast to what happened after the 1929 Wall street crash. However, there is still further scope for us to reduce interest rates against the background of a situation that is not the same as it was a month ago.

The original medium-term financial strategy set out very clearly why it was intended to reduce the public sector borrowing requirement. It was said that that was to be done in order to lead to a reduction in interest rates. My right hon. Friend the Chancellor has been extremely successful in reducing the PSBR—even if one allows for the fact that to some extent the reduction is due to the proceeds of asset sales. Therefore, we ought to be getting the benefit of that success. We were subsequently told that it was necessary to keep interest rates up because that would have a favourable effect on the United Kingdom's exchange rate. However, we all know that our exchange rate is now very healthy. If anything, from the exporters' point of view, it is rising to levels that are disadvantageous rather than advantageous. That restraint has gone.

The third reason which might justify high interest rates is that the economy might have been overheating. It is extraordinary that the Opposition motion complains that there will be a downturn in the economic growth rate. Of course there is a downturn from the unexpectedly high growth rate of 4 per cent. last year that was set out in the Autumn Statement. Allowing for the fact that the growth rate forecast in the Autumn Statement includes oil, the growth rate in the non-oil part of the economy should still be 3 per cent. The Opposition cannot reasonably complain about that. It is now at a level which, given the events of the last few days and their depressing effect, has taken some of the dangerous froth off the top of the economy which might otherwise have inhibited the Chancellor from taking a more relaxed attitude to interest rates.

As some hon. Members have said, we owe a great deal to the United States for the growth that the world has enjoyed in recent years. I hope that in a spirit of friendly persuasion we can get the United States to do something positive on the lines that I have suggested. In turn, we can respond with a further change in interest rates. That still leaves a problem in terms of the Germans and the Japanese, and we must hope that that problem can be solved by negotiation.

The suggestion by the Opposition that we should have a G7 meeting to sort out the problems is not the right answer. It would be extremely dangerous to have a meeting at this stage unless we were absolutely clear that it would produce positive results. Nothing could do more damage than a G7 meeting that broke down and was seen to have broken down. It is right that my right hon. Friends the Chancellor and the Prime Minister should continue to seek to persuade our international trading partners to learn the lessons of the 1930s. I think that they have learned those lessons, and if that is so then not only our strong economy but the other economies of the world will manage to weather this financial storm and go on to an improving rate of rapid economic growth.

8.4 pm

Dr. John Reid (Motherwell, North): I echo the congratulations offered by my hon. Friends to the hon. Member for Boothferry (Mr. Davis) on his maiden speech. I am sure that he will deliver many more interesting speeches. I would be less than truthful to the House if I did not say that my admiration for that speech was enhanced because, due to Committee work, I heard only one other speech in the debate—the speech by the Chancellor. After that speech it was almost inevitable that the maiden speech by the hon. Member for Boothferry should be received in glowing terms.

I listened to the Chancellor in amusement and amazement. It put me in mind of the famous last words of Douglas Fairbanks senior. Before he died he said, "I never felt better in my life." The whole of the Chancellors' speech was complacent, and either he does not or he will not understand the threat of the crisis in the City. I agree with the right hon. Member for Guildford (Mr. Howell) who said that the financial catastrophe might hit us again and that we could not just sit around and wait. The problem facing the right hon. Member for Guildford is that that is exactly the Chancellor's policy. Is it any wonder that Sir Nicholas Goodison, the chairman of the stock exchange, said last night at a dinner which the Chancellor attended:

"the fall in share prices over the last three weeks demonstrated a massive loss of confidence in the judgment of the world's political leaders."

To whom do the Treasury Ministers think Sir Nicholas Goodison was speaking? Was he speaking about the leadership in the Soviet Union, or China or Taiwan or was he—as he must have been—speaking about the Tory leadership of the seven major industrial powers of the Western world?

I suppose that we should be thankful for small mercies, because the Chancellor has moved somewhat in the last week. When the crisis started a week ago, the Chancellor argued that the stock exchange was acting in "an absurb way" and that it would not affect the real economy. He has now had to admit that the collapse in share prices and the events in America are likely to have a recessionary impact on the economy. It is all the more puzzling that even though he has moved that distance, he still retains a policy of doing absolutely nothing.

We know that the Government have a 4 per cent. growth rate this year and they say that next year it will be only 2·5 per cent. We know that the inflation rate this year is 4 per cent. Next year it will go up to 4·5 per cent. For nationalised industries, it will probably be 6·5 per cent. and in the housing sector it will be 7 per cent. The Government admit that the trading deficit will be worse next year—up to £9 billion for manufactred trade goods.

There is fear of a fall in growth and an increase in recession, the threat of an American spin-off in the recession and fear of increased unemployment. In that situation is it not amazing that the Chancellor is without policies? I was tempted to use the simile, "the king with no clothes" but I thought that the image might horrify the House. The Chancellor has no international policy because he will not take a lead in calling a meeting of the major industrialised countries. He has no national policy because he will not take the precautionary or preventive measures that are necessary to protect and to raise public investment.

My right hon. and learned Friend the Member for Monklands, East (Mr. Smith) and my other hon. Friends have outlined an alternative. We have called for regulation of the financial markets and for international action. We have also called for a further fall in interest rates and for an injection of public investment into the British economy to prevent a downturn and further unemployment. That is the way to match economic sense and social conscience. I shall dwell on that for a moment, because under the Government those things have been separated and remain poles apart. In one compartment there are the economics of the madhouse as they are so often called, and the other compartment contains the philosophy of the poorhouse which governs the social reality and the social policies of the Government.

Conservative Members have confined the debate to the City of London as though it sits in a little crystal glass unrelated to the outside world. The right hon. Member for Worthing (Mr. Higgins) asked that we link the financial and industrial sectors and that we link the debate to the realities of the real economy. We should also link the debate to the realities of the real world, not only the economic realities but the social realities. If we do that, we shall find that the contrast between the Government's treatment of certain sectors becomes all the more stark.

I am not surprised that the Government want to keep their colleagues in the City isolated from any outside

[Dr. John Reid]

reality, because the Government are the party of the City, are paid by the City and are driven by the City, for the City. The past week has illustrated just how far that bias has gone. We have seen the Government running around trying to stop City investors losing their proverbial shirts. The BP share issue proved that, despite all the proclamations of adherence to free market economics, the Government are prepared to intervene in the economy. They are prepared to intervene to avoid hardship and poverty, but tragically only when it is hardship and poverty affecting their friends in the City.

When was the panic when those on the poverty line increased to 18 million? When was the House greeted with hushed statements when the number of people on supplementary benefit increased by 119 per cent. under the Government? When was the midnight oil last burnt by civil servants in Whitehall or the Treasury poring over a solution to the 3·5 million unemployed? When were civil servants paid overtime to work through the night to find a solution to the 1,200 Caterpillar workers in my constituency who tomorrow will probably lose their jobs?

There was no panicht, no statements and no burning of the midnight oil over those issues. For eight years the Government have shown an indifference to growing impoverishment and increasing deprivation among millions. However, they went scuttling back to their drawing board when their City friends faced the grim prospect of having to sell one of their Picassos, while the really deserving people do not have Picassos to sell. They do not have millions to shuffle between frontiers. They do not take their savings bank deposits and deposit them in South Africa because it will earn an extra 0·5 per cent. interest there since that country is guarded by guard dogs and barbed wire. That is the real scandal of the financial crisis.

There used to be a saying that God helps those who help themselves. We should rephrase that. This Government help those who help themselves. They help those who help themselves to the rich pickings of privatisation at the taxpayers' expense. Having helped themselves, those poor Oliver Twists of the City time after time come running back with their big begging bowls demanding ever more. The big, bumbling beadle of a Chancellor is ready to dollop out ever more of the taxpayers' money to bale out those poor Oliver Twists.

That philosophy has never been better illustrated than by the conflicting actions of Government Departments last week. While officers in the Treasury were working their shirts off to save the investments of the rich, the Government were presiding over more than half a million householders who pay tax on incomes below the poverty line. There are three times more on the poverty line than when the Government took office. While the Treasury mandarins worked late into the night to hatch a cunning, expensive plan to bale out the Government's city friends, just down the road their colleagues in the Department of Health and Social Security were beavering away just as hard in an attempt to freeze and eventually to abolish child benefits, despite the fact that 4 million children are now in poverty. While those Treasury mandarins did their utmost to protect the institutions that underwrote the privatisations, they could not find it in their hearts or in their heads to devise a scheme to help those 4 million children in poverty.

When it comes down to it, the City is the friend of the Chancellor. The Chancellor, in an astonishing statement today, said that when he used the word "poppycock" last week he was referring to some of the brokers in the City, yet last night he sang their praises. The peddlers of poppycock of last week have become the cockleshell heroes of last night. For the Tory Government, I suppose that that is how it should be.

The basis of a strong economy is not how loud the Chancellor can shout about cuts in public spending or how often he can lecture the United States on economics; it is the sensitivity of the Government's fiscal policy. By that standard, their record has been one of unmitigated failure. They have shown no sense in their approach to our national assets. They have undervalued them by £2·6 billion so that they could be sold off painlessly to the lucky few. They have shown no sensitivity because, at the same time as they helped investors and their friends in the City, they have abolished the maternity grant and the death grant, income support for young people is being cut by about £6 per week and those who look after elderly or sick relatives will lose their long-term rate of benefit, and will not receive a premium to compensate.

It is difficult to believe that the Chancellor could come to the House full to the brim with self-satisfaction and smug to the point of overflowing when so many people lack the ability to feed their families, to care for their elderly dependants and to educate their children to a standard that one would expect in a civilised country.

Regardless of what the Chancellor claimed this week, the economy is not strong because no country is strong unless it can protect its weak and its most vulnerable. The Government have deliberately followed policies that have hurt individuals but helped big City institutions. They have made millions suffer while a prosperous few have made millions. Now that the Government Benches have some knowledge of the poverty and hardship faced by those outside the City of London in my constituency and the constituencies of other hon. Members, we demand that the Chancellor withdraw the absurd comments he made on Tuesday about the unsoundness of the policies that the Government have been following. He ought to have the guts and the sense to admit the nonsense that he has been speaking and the insensitivity of those policies, and support the Opposition motion.

8.16 pm

Sir Anthony Grant (Cambridgeshire, South-West): This evening the hon. Member for Motherwell, North (Dr. Reid) has spread gloom and prejudice with much greater cheerfulness than did his hon. Friend the Member for Bradford, North (Mr. Wall). The whole theme of the Opposition's argument has been one of rejoicing in gloom. I think that it was the hon. Member for Cardiff, West (Mr. Morgan) who used a rugby analogy that reminded me of the key match at Twickenham where the England wing three-quarter was carried off on a stretcher. Dai turned to Taffy and said, "Oh, Taffy, I do hope it is nothing trivial." The Opposition really have enjoyed wallowing in gloom. The right hon. and learnd Member for Monklands, East (Mr. Smith) got so intoxicated with the exuberance of his own verbosity that he was caught out in a misquotation. That is something that we shall remember for quite a long time.

We all know that what markets dislike above all is uncertainty, and the uncertainty is over what will happen about the United States deficit. I am certainly not going to offer any advice to the Americans. They are overwhelmed with advice and are unlikely to take the smallest notice of me or of any other hon. Member.

Mr. Bryan Gould (Dagenham): Including the Chancellor.

Sir Anthony Grant: Indeed, including the Chancellor. I do not think that they take much notice of him. It is for them to sort out. In seeking to resolve their problems, I pray that they will not resort to an increase in protectionism. I absolutely agree with my hon. Friend the Member for Horsham (Sir P. Hordern) in his condemnation of protectionism, and the protectionism that we indulge in. As he implied, it is often the case of the kettle calling the pot black when we pontificate on the issue. Protectionism is very tempting to politicians, especially when one is coming up to an election. It is very attractive, but it must be resisted. I hope and pray that the United States will resist it as a means of resolving its difficulties.

I shall confine my remarks at this hour to one aspect that has not been debated. Nothing that has happened in recent weeks in the upheavals that we have seen in world markets should halt the move towards wider share ownership in our society. I believe that in recent weeks we have had a salutory lesson that wider share ownership is not short-term stagging. If people want that, they had better go to Newmarket or Epsom and gamble. Share ownership means long-term investment. People have learnt that there is no such thing as on and on and up and up. That view has rather dominated thinking in recent years. One of the best things that the Government have done is to encourage the spread of ownership of all kinds, including property, and more recently of shares in British industry.

More than 25 years ago I was a founder member of the wider share ownership movement. I rejoice in the fact that wider share ownership has become fashionable. We have been through some bleak periods. We used to be an all-party movement and great contributions were made by Lord Lever and Lord Houghton, who are both now in another place. That period was followed by the rise of the hard Left and a lack of encouragement from both Labour and Conservative Governments. The concept of wider share ownership fell into disfavour. I am now happy to say that wider share ownership is fashionable again. Indeed, it has even been espoused by the hon. Member for Dagenham (Mr. Gould) and one cannot be more fashionable than that. I believe in the spread of ownership.

Mr. Gould: I concede that I shall speak later in the debate, but as the hon. Gentleman has mentioned me now perhaps I should make it clear that I have always said that the form of share ownership that I advocate is the employee share ownership scheme where shares are held collectively and not traded on the stock exchange. That would constitute a form of popular socialism rather than popular capitalism. However, I am delighted to hear that the hon. Gentleman is so much in favour of my views on that subject.

Sir Anthony Grant: I am delighted that the hon. Gentleman is on his way towards supporting wider share ownership. I would go further than the hon. Gentleman's limited view. I encourage employee share schemes within the wider share ownership movement. The hon. Gentleman is well on the way.

I have never understood why it is somehow more moral for ownership to be vested in vast state monolithic bureaucracies than in many individuals. Wider share ownership promotes independence, thrift, provision for the family, support for industry and stability in the nation. Equally, it increases knowledge of our economic and commercial affairs. It was encouraging to see that the chairman of the Trustees Savings Bank received a lot of questioning and heckling from quite humble shareholders at a recent meeting. That is healthy and encouraging. Above all, wider share ownership is a bulwark against the ever-encroaching tentacles of the state in our society.

Ownership takes many forms. Privatisation is just one example that I wholly support. It also embraces the rise in the unit trust movement, investment trusts and the large increase in pension funds, which has benefited many people. Wider share ownership and industry need efficient markets to raise the capital and investment that they require. The City has always provided that with an efficiency and honesty that have been the envy of the rest of the world. We should not forget the development of the unlisted security markets. This is extremely helpful for industry. The third division for even smaller firms is also helpful. They represent a thoroughly healthy aspect that is extremely helpful for industry.

Sometimes I agree that the City's view or the investor's view is perhaps a little short term compared perhaps with Japan, which has an entirely different system. Sometimes the City is a little remote from industry. Therefore, I welcome the work of the CBI-City task force. It is always encouraging to find market makers in the City taking the trouble to go out and meet representatives of industry to find out exactly what is happening on the shop floor, instead of staring at computer screens.

I have spent much of my life working in the City in one form or another, and I am delighted that my hon. Friend the Paymaster General is on the Government Front Bench. I said earlier that there was a tendency for people to come to the City who were long on cunning and short on morals. If some of those people said, "My word is my bond" one might be well advised to take their bond. However, that applies to a minority.

The City is overwhelmingly populated by people of dedication, honour and ability, and they are unique and admired in many countries. It is entirely wrong to portray the City — as the popular press is inclined to do — as composed of computer-crazed yuppies feverishly buying and selling Porsche motor cars. That is far from the truth. Young and old in the City work exceptionally hard. Indeed, in the recent crisis I went to see the market makers operating, and they were working exceptionally hard to maintain the market. They were certainly answering telephones. They were responding to the needs and worries of their clients and customers in a manner that is to their eternal credit.

I believe that the City will weather the storm. Having given that praise, I want to make one or two observations on what the market should bear in mind. In the City we should remember that commerce and trade flourish more readily and speedily by word of honour than by litigation. The City should realise — most people in the City do realise this—that the spirit of the law is more important than the letter of the law in City transactions. Creating

[Sir Anthony Grant]

wealth is just as important as redistributing it. It should be just as rewarding, profitable and prestigious in a free capitalist society to start a small business or manage a medium one as to arrange mergers and takeovers within the square mile. People are very much aware of that. The strength of the economy is such under the management of my right hon. Friend the Chancellor and his colleagues that we can weather the storm and disregard the gloomy prognostications implied in the Opposition's motion. We can spread share ownership for the benefit of our people and of our nation.

8.26 pm

Ms. Hilary Armstrong (Durham, North-West): It seems that we are really debating either whether intervention in the market is practical and possible or the way that we should proceed. The Chancellor was saying that it is not a matter of whether, but of when we intervene.

The reality of the Government's policies over the past seven years is that the Government have been preaching —and I did not want to use that word—that we must leave everything to the market. They have said that the market will look after everyone and we should trust the market. What have we learned about the market in the past seven years? What have people learned in my constituency? What has been the experience of people over the past seven years? People in my constituency have heard the Government extolling the virtues of the market. Workers have been told that for the sake of efficiency the market demands that the work force be trimmed and, for example, the thousands who worked at British Steel in Consett were told that the market demanded that they should lose their jobs. The Government said that they could not, would not and must not intervene. The market must be allowed its freedom.

As consumers, people have been encouraged to spend, spend, spend. The market encouraged that. Family credit has been extended to a crippling level. The Government may have been concerned about public sector borrowing, but they have been happy for the markets to encourage private borrowing to record levels.

Many people have been left with serious problems of personal debt. They have also been encouraged in recent months and, indeed, years to invest in the stock market —such investment being in the guise of the reconstruction of ownership of British industry. That is part of the apparent crusade, as the hon. Member for Cambridgeshire, South-West (Sir A. Grant) has said, to spread control, share ownership and the receipt of profit.

During the past few weeks, those few private investors who were encouraged to invest have found that, far from entering a sane and stable market, they have entered a casino. Again, they were told that the markets would work on their own.

Throughout their recent lives, people in my constituency have been offered that view. For most of their lives, they have contested it, because the details of their daily lives has demonstrated to them that the free market has no humanity, and no respect for liberty or dignity. The market is out of control, and, if I may quote the Chancellor, it is absurd. People have struggled with those views in recent times, because they have been told that they are wrong; they have been preached at. What price have they paid for holding their view, and for the Government's sticking to their view?

I am not one to spread gloom or revel in misery, but we must face the facts, and they are that a number of manufacturing jobs in my constituency has declined by over a third since the Government came into office. In the north, we still have the highest level of unemployment in mainland Britain. We still have the frightening position that half of the unemployed men in the north have been out of work for over a year, and that half of those have been unemployed for more than two years. However, perhaps the most distressing fact of all is that 40 per cent. of all unemployed men in our region are under the age of 30, and 60 per cent. of registered unemployed women in the north are also under 30. It is very difficult, when we face such facts—that is not a nice word, but facts they are—to believe that we are on a sound and growing economic base.

For the past few weeks, we have been controlled by indices: the *Financial Times* index, the Dow Jones index and the Japanese index, which I shall not attempt to pronounce. Those indices have been the news. They have been debated here, they have been gossiped about, they have dominated the newspapers. They are a bit strange to the folk in Durham, North-west, but they, too, read the newspapers, listen to the news and try to deal with what is going on. When I saw some of them last weekend, they said, "What is going on? What has changed? For all these years we have been told that no one can intervene in the market; that it is not right; that the Government cannot do it." Suddenly, the Government have found it necessary to intervene, have worked hard at finding out how they should do so and, through the Chancellor, have put a floor on the losses that might be experienced by the underwriters in the BP share sell-out.

Some of those people asked, "Why is intervention possible for them but not for us? Why is it possible for the City and not for the folk of the north? Why is it possible for the *Financial Times* index, but not for manufacturing industry?" People, authorities and public bodies in the north have worked hard, and have begun to claw their way out of the recession that the collapse of manufacturing industry brought. Now, however, there is a fear that the storm of the stock exchange will push optimism and growth down again. We looked everywhere for help. We even looked for it in the Autumn Statement, but the Chancellor gave us little hope. He said that, even with his boundless optimism, he could see unemployment falling only to 2·6 million by 1991.

We believe that a sound economy must be based on sound industrial development, with investment in manufacturing, research and development and proper education and training, so that young people who are among the masses of unemployed in the north feel that they have a real opportunity to contribute to our society. The Government have sacrificed those things to their doctrinaire belief in the free market. For us, the message of the past few weeks is that the economy is far too important to leave to chance.

The Chancellor was not prepared to leave the BP share issue to chance. The increased prosperity that he has preached to us has missed nearly half of Britain's population. A truly successful economy would spread the benefit of prosperity to all of our people, not just half of them and we await anxiously the commitment of the

Chancellor and the Government to securing a strong, prosperous economy for the benefit of all our people. However, we fear that the Government are not interested.

8.37 pm

Mr. Nicholas Budgen (Wolverhampton, South-West): I am grateful to you, Mr. Deputy Speaker, for calling me at this point, because, as I drove to the House this afternoon, I had the great pleasure of hearing a programme in whih the hon. Member for Durham, North-West (Ms. Armstrong) took part. I noticed with what charm and independence she spoke of her distinguished and much-revered father, and how well she came over, and I was interested, therefore, to listen to her speech. Sadly, I do not feel that I can comment on all that she said, but I am sure that she will be a doughty proponent of her Socialist views and supporter of her constituents.

I am sure that you will agree. Mr. Deputy Speaker, from your many years of listening to speeches in this place, that, whenever a great event occurs, everyone says, "That is an illustration of why my particular nostrum ought to be adopted." No matter what the event is, those who have been in favour of growth at any time are in favour of growth; those who have been in favour of devaluation at any time say that this is an illustration of why there should be devaluation; those who are rising men or would-be retreads suggest ways in which they might assist the Government in the circumstances.

It is all very predictable. My hon. Friend the Paymaster General, the new chairman of the Tory party—he used to be a nark with me and he is now before me in his role as the nark — used to be good at reflecting upon Victorian novelists. My recollection is that in Surtees there was a splendid character who believed that the nation's ills would all be cured if more baronets were created. I suppose that one could put forward a respectable argument even for that; that as the thrust towards material advancement dies, so a second injection of energy should be put into our industrialists, so that if, when they get to 50 and are fat and rich, they could know that by working for another 10 years they might finish up as 60-year-old baronets, they would create wealth for themselves and those dependent upon them. That is a nice combination of Tory paternalism and Conservative materialism.

I want to make two points. First, when the crisis occurred people reached for their recollections of what happened after the 1929 crash. Almost everybody in the House was brought up in the Keynesian consensus and we were all told that after 1929 what went wrong was that credit was dramatically reduced. So we heard immediately from the Chancellor that he would make liquidity available so that the mistakes of 1929 would not be repeated.

I took the trouble to look up some of the figures for the period between 1922 and 1929. After the first world war there was a period of inflation which was corrected by monetary means. It used to be thought of as raising interest rates by slamming down on credit. The position between 1922 and 1929 was entirely different from the present position.

I do not want to bore the House at length, but there is a useful book by Mr. D. Sheppard on the growth and role of United Kingdom financial institutions between 1880 and 1962. That shows that between 1921 and 1929 the money supply was consistently contracting. Also, during that same period the gross deposits of all United Kingdom commercial banks were consistently contracting.

The 1929 crash did not come against the background of London houses increasing in value by 25 per cent. It did not come against the background of sterling M3 increasing by 20 per cent. It did not even come against the background of a high rate of growth of 4 per cent., much higher than we have ever consistently been able to achieve in this economy. So to pretend that it is now necessary to ease liquidity because of the lessons of 1929 is just wrong.

If the Government wish to ease liquidity for other reasons, that is another matter. If they want to go for growth, if they think that 4 per cent. is an inadequate level of growth and if they think that it would be in the interests of social cohesion that London houses should increase in value by, say, 50 per cent. per annum, that is one thing. Let them argue it on that basis. But let them not argue it on the basis that the lesson of 1929 inexorably forces them to increase credit in the present circumstances.

Secondly, I underline my support for the splendid speech of my hon. Friend the Member for Horsham (Sir P. Hordern). He expressed, in a most elegant way, the scepticism that I feel towards the international agreements that have been such a feature of the Government's economic policy these last two years.

It is a bit rough for the Opposition to table a motion censuring the Government for a market collapse resulting

"from failures in international economic co-operation".

There has been the most enormous change in the Government's policy towards international economic policy. The Government are doing everything they possibly can to follow the policies of Mr. Callaghan in 1978. What more can the Government do? The Government used to follow strict monetarist lines. They used to say that the way in which other nation states manage their economies was nothing to do with them. They used to say that all that stuff about the convoy system was dangerous and irrelevant. Now they have been converted to the 1978 policies, yet the Opposition are rough enough to complain about it. What can the Government do to get a good word from the Opposition?

The policy will surely will not work. First, we want most of all to demonstrate that our economy is different from that of the Americans. If that is so, why do we want to get into the same boat as the Americans? Why do we want to say that our economic salvation is dependent upon the Americans doing something that they are unlikely to do? After all, if the Americans fail to curb their deficit, which, as everybody in the House fully understands, is fairly unlikely to be done, at any rate quickly, surely the proper answer to investors who may be looking to the Government for guidance will be that the British markets are tarred with the same defects as the American markets. Surely we want politely to disassociate ourselves from the ructions of American markets.

Moreover, is it really likely, if we believe that our salvation comes from economic changes in America, that the American electorate is likely to be vastly influenced by rather impertinent suggestions from foreign politicians. If, for the sake of argument, Mr. Reagan offered a great deal of advice to the electorate in Wolverhampton, I cannot think that they would be grateful for it. I am not saying they would be grateful for my advice, but they might be even less grateful for President Reagan's advice.

[Mr. Nicholas Budgen]

My right hon. Friend the Chancellor used not to be a great believer in international economic co-operation, but he said this afternoon that these measures were now possible because of the worldwide reduction in rates of inflation. Next year, we shall have 4·5 per cent. inflation. What does my right hon. Friend the Chancellor think that looks like from the point of view of some of our generation brought up in Germany who know the social effects of Weimar? Somebody whose family may have fled from Germany believes that Weimar played an important part in the creation of the social instability which preceded the rise of Hitler. Such a person is not likely to think that 4·5 per cent. inflation is a great triumph over inflation. When such a person hears that the British economy will be substantially relaxed at a time of 4·5 per cent. inflation he may well say, "OK. Get on with inflation if you want to in your economy, but, thank you very much indeed, we have nil inflation in West Germany and that is how we want to keep it."

I hope that we shall learn from the failures of the 1978 experiment and will pursue a policy of decent diffidence in the advice that we give to other nation states, and that we shall not pretend that anything that has gone wrong with the economy has been caused by other nation states or that our salvation will be achieved by impertinently pressing our views on them.

Several Hon. Members *rose*——

Mr. Deputy Speaker (Mr. Harold Walker): Order. I understand that the Front Bench spokesmen will be seeking to catch my eye at 9.10 pm, which means that there is little time left. I hope that it will be spread thinly.

8.49 pm

Mr. Austin Mitchell (Great Grimsby): I shall not attempt to follow the hon. Member for Wolverhampton, South-West (Mr. Budgen) on his paradoxical path, except to observe that the Chancellor in his 1979 guise would have been better at replying to such arguments than he is in his 1987 guise. Therein lies the flaw in the argument, because in his 1979 guise he produced the disasters of 1979 to 1982—thanks to the deflationary policies that the hon. Gentleman was espousing.

We have come to the small print in the Government's prospectus—"not to be read until after the election," and "what does up must come down." The Government have lived by the markets, and they will now die by them. Their contribution to the real economy has been disastrous. Our manufacturing output still has not reached the level of the second quarter of 1979. Investment is still 7 per cent. lower than it was in 1979. Then, we had a surplus in manufactured trade—£2·7 billion in cash terms or £8·8 billion on a unit value basis—but we now have a deficit of £9 billion which is a turn around of £18 billion in adjusted terms. Our growth has been based on a North sea bubble, a consumer boom and asset inflation. One has compounded the other by the continuous creation of collateral, with no sustance to it. Tragically, it has sucked in imports. They have been rising in the past three months twice as fast as exports, and even those manufactured exports have become heavily dependent on the United States market, which will become much more difficult to enter as the dollar declines.

To end this fundamental disequilibrium in the world economy, the dollar must decline and probably by about 20 per cent. if the American economy is to pick up. It is no use trying to shore it up by measures such as the Louvre agreement, which then causes distortions in the economy.

As the dollar declines, it is essential that the pound declines with it. The Chancellor's key mistake in recent months has been to kill the goose that laid the golden egg. The devaluation in sterling that stimulated the economy has been totally reversed. Thanks to high interest rates—our interest rates are historically high in real terms, and high compared with our competitors—there has been an appreciation in our exchange rate of 18 per cent. since last September alone. That spells disaster. The terms for manufactured trade are now higher than they were in the disastrous year of 1981. It is essential for the Chancellor to get down the pound by bringing down interest rates. Why, when he has such a low borrowing requirement, are interest rates so high? Clearly, the answer is to reward money and his friends.

The present expansion in the economy is good only in contrast with a deflationary Europe, where it is appallingly bad. The Government dare not risk the sort of expansion that would bring down unemployment, because they cannot face the social strains of growth or the improvement in the power and strength of working people and trade unions.

We need some protection for the small investor—the small saver or small pension buyer—who has been lured into the financial market. There was an interesting contrast in the BP shares issue. Some 250,000 suckers were conned by a £20 million advertising campaign into paying an inflated price for BP shares. Yet the Government have not rushed to help them—they will be prosecuted if they do not fulfil their commitments—but they help the underwriters and speculators. Yesterday a massive number of shares were traded on a bed-and-breakfast basis to establish a tax loss for capital gains purposes, which will be supported by the Government buy-back scheme for those shares. Somebody is able to make a killing thanks to the underpinning that the Government have introduced. Yet they have conned the small investor, who has been lured into a financial jungle, where, to change the image, the bears, will now be turned loose, and where institutions and firms will be at greater risk and more likely to dip into the small investor's funds without giving him any effective protection.

The Government have not announced the implementation of section 62. The compensation schemes are not being introduced as a matter of urgency. Nothing has been done about the complaints procedures and there will be no special protection for personal pension schemes. The independent representatives on the regulatory bodies have no backing and are pathetic compared with the power of people from the big companies that are regulating themselves. So this has been a disastrous blow to an economy that is becoming a jungle, into which the investor has been lured without effective protection. The weather is now turning cold and hard and there will never be a glad, confident morning again for the stock exchange or the Government—just at a time when the real economy will be facing all the difficulties produced by the over-valuation that the Government have generated.

8.56 pm

Mr. Anthony Nelson (Chichester): Time and consideration for hon. Members who wish to contribute to the debate do not permit me to answer all the points raised by the hon. Member for Great Grimsby (Mr. Mitchell), who spoke with colourful journalistic rhetoric.

It is a travesty to suggest that the Government do not wish to pursue policies that will lead to higher employment because they are frightened of a resurgence in the power of the trade unions. In their economic and employment policies the Government are creating a resurgence in employment. They are determined to ensure that people's labours are usefully used and that the full potential of our economy is realised. I welcome the success of the Government's policies in that regard.

I do not regret the purge that the financial markets have been through. On a slightly pessimistic note, the markets may be in for yet more falls. There is a case for further correction; the dollar is still high, as are some stock markets. The point to which we should apply ourselves is not whether the risk-takers involved in the market may have lost or gained but the impact of it on the economy. In the short term, the effect may be salutary and in the long term it may be beneficial.

Despite what hon. Members, particularly Conservative Members, have said, we should have the right to talk to our American allies about the extent of which their economic policy will have an impact on us. Whether America listens or not, and whatever our limited impact may be, we are influenced by what happens there and by the economic policies the United States pursues. A large part of its federal deficit, as well as its trade deficits, must be financed out of Eurodollar markets internationally.

A large part of its financial requirement of capital for industry is funded through the United Kingdom stock and bond markets, which are still the largest international markets in the world for raising funds.

I believe that that gives us the credentials to enable us to say to the United States that we look to it to reduce progressively the budget deficits beyond the Gramm-Rudman requirement and that a net reduction of $2 billion over the $23 billion provided for under the Gramm-Rudman rules will not be significant in the totality of world markets or influential in restoring confidence. The longer the Americans wait and the less they do, the more international markets will demand. The longer they prevaricate, the deeper they will have to cut.

Even if it has been forced on the Government by events, I welcome the reduction in interest rates. All hon. Members should recognise that there is no better way of feeding cash flow into companies that employ people and produce wealth for the country than by reducing interest rates. That helps the companies' working capital and margins far more than the most imaginative schemes of employment and industrial support that any Government of any political persuasion could dream up.

We have to bear in mind that just as much as tax cuts, reductions in interest rates, if they feed through to reductions in mortgage interest rates, help people's propensity to spend. It feeds directly into the net money in people's pocket and should, we hope sustain us next year, not into a recession but into a period of continued growth, demand for products and investment in British industry.

I believe that there may be a more limited scope for tax cuts in next year's Budget than many commentators and hon. Members believe. If I may say so, the Chancellor and Treasury Ministers should be cautious and circumspect about saying too much or hoping for too much. Circumstances may change if the withdrawal of about a trillion dollars from international markets has an impact on levels of demand in the economy. I hope for further reductions in taxation, but we may have to be more cautious than some people have led us to expect.

I agree with a point that was well made by the hon. Member for Caithness and Sutherland (Mr. Maclennan). He emphasised the importance of export credit for our industry. If the exchange value of sterling is high in the next few months and rises further — my professional judgment is that it will rise considerably further—British industry will need even more support.

I would expect Labour Members, many of whom represent areas with substantial manufacturing and industrial companies such as shipbuilding, car industries and so on which need industrial credit, to urge the Government, as some Conservative Members are doing and I am doing now, to look again at the expenditure proposals on export credit and at the proposed reduction in the cover provided for in expenditure next year. We will have to look much carefully at our export performance and ways of boosting our trade to get the sort of growth that will carry us through the storms ahead.

My last 30 seconds gives me an opportunity to mention the lessons of the market. We will have to look carefully at leverage bids, which have become an outrage and are of questionable economic and industrial significance. We should look carefully at the policies of the banks which have been prepared to lend billions of pounds to the smallest of companies to make takeover bids and at the other extreme have been prepared to lend £1 million to a man earning £6,000 a year. At the very least, there are questions that the banking industry should ask itself about the quality of its credit policies. We should also look at the margin dealing and some of the salaries that will inevitably come down in the City.

Those are salutary and purging effects of what has happened in the market and they will not be bad. However, to suggest that what has happened will be fundamentally deleterious to the prospects for the economy or should turn the Government from the path they have set would be an error of judgment. For all those reasons, I hope that the Government will not heed the siren voices of those who would turn them away from the path on which they are set.

9.4 pm

Mr. Calum A. Macdonald (Western Isles): I listened carefully to the Chancellor's speech and to those of Conservative Members. The speeches contained many proud, indeed smug, boasts about the supposed strength of the economy. We have heard, not just the Government's fine words, but, apparently, industry's too. We listened to the right hon. and learned Member for Richmond, Yorks (Mr. Brittan) read out all sorts of declarations of confidence and buoyancy from the Teesside chamber of commerce. However, it is odd that at the same time as we hear those smug and confident words it remains the case that investment in manufacturing industry is still 7 per cent. lower than in 1979.

[Mr. Calum A. Macdonald]

I regard that figure as not merely superficially odd but extremely significant. It provides a real index of the confidence of manufacturing industry — or, more appropriately, its lack of confidence—in the future of the British economy after eight years of Conservative government. British industry's action — or rather inaction — through its failure to invest speaks much louder than its words or those of the Government. Manufacturing industry is not putting its money where the Chancellor's mouth is.

Why is manufacturing industry failing to invest? The captains of industry see very clearly that underneath the glitter and gloss of the casino economy, and the hype of the stock market, the foundations of the real economy are crumbling. That point was made by the director-general of the CBI last Saturday in Glasgow when he contrasted the investment of the United Kingdom with that of Germany. He said that the Germans were spending

"£2,000 per worker more on fixed investment and twice as much on research and development, graduating 40 per cent. more engineers and scientists and training 3,000 more young people".

Education, training, research and development are the essential foundations of a modern economy, and they have been utterly neglected by the Government. Nothing in yesterday's Autumn Statement or in the Government's programme for this Parliament will remedy that neglect. That explains the mysterious fact that while the Chancellor claims that the British economy is in its strongest state for years — it was described as "seaworthy" by one Conservative Member tonight—our economy is, in fact, moving further and further into deficit on its manufacturing trade. The failure to invest, both public and private, explains why the manufacturing trade deficit will reach a staggering £9 billion next year and why, most revealingly, the Chancellor himself predicts that our manufacturing exports will grow by only 2 per cent. next year, while our imports will grow by 5 per cent. In my constituency we know something about boats, and I must say that I do not find the word "seaworthy" at all apt to describe that state of affairs.

The Government's inaction in tackling the problems of the real economy contrasts markedly and sadly with their readiness to bail out the lame ducks of the City. Why is a lame duck in the City more meritorious than what used to be called a lame duck in industry? Why is it right to intervene to prevent a "disorderly aftermath" of the market in the City—in the Chancellor's delicate phrase —but not in industry? Why is it right to intervene to rescue stockbrokers from losses, but not to give people jobs? Those are the questions that the Opposition ask tonight, and the Government's lack of an answer serves only to expose their hypocrisy.

9.7 pm

Mr. Mike Woodcock (Ellesmere Port and Neston): I realise that I shall have to be extremely brief, but we have ranged far and wide in this debate and in the closing minutes I want to take us to another country. On the day of the crash I was in New Zealand talking to a conference of managers. New Zealand is a very interesting country right now. It is going through some fundamental economic changes. Management is eager for new ideas of how to develop business confidence and managerial confidence.

When I arrived in Auckland, I changed flights on to a new airline called Ansett New Zealand — a private operator that has been allowed to break the public monopoly for the first time. The new competition is shaking up the standards of the complacent national carrier. Meals are being served for the first time and terminals are being smartened up—a vivid reminder of the power of competition.

Until 1984, New Zealand was one of the most inefficient economies outside the Eastern bloc. Now, far-reaching deregulation is leading to the emergence of many successful entrepreneurial companies. The new free trade policy means that much of manufacturing industry is facing competition for the first time, and managers in newly corporatised industries are coming to terms with economic reality. As the Government turn their attention to efficiency in social services, managers in many other sectors are having to face fundamental changes. Already, much dead wood has been shaken out of New Zealand industries.

On my brief visit I discovered that New Zealand is facing economic realism for the first time in many decades and that it is learning lessons similar to those that we have learnt in the United Kingdom. While I was in New Zealand the country received another, very distinguished, visitor from this place. He is sitting on the Opposition Front Bench and is to reply to the debate in a few minutes' time. He is something of a disciple of economic realism —certainly a good deal more so than many of his hon. Friends. If New Zealand press comment is to be believed, he said that he had gone there to learn and not to advise. That is probably just as well, because his advice, if it followed the Opposition's beliefs, would have been unlikely to have been taken. He could have learnt a great deal more by staying at home and listening to my right hon. Friend the Chancellor.

Unlike the British Labour party, the Labour party in New Zealand has discovered a little economic realism. It is amazing that it has implemented with such vigour policies generally associated with the Right.

The right hon. and learned Member for Monklands, East (Mr. Smith) quoted from *The Sunday Times*. I shall quote from last week's edition; the leader stated:

"A student of O level economics could have produced a better essay on the crash than the Shadow Cabinet's statement."

The wealth of any nation is determined by the commercial activity of its organisations. Any Government's job is to create the economic circumstances in which businesses can survive and succeed. What irks the Opposition so much is that we have achieved that so successfully. It is why so many overseas Finance Ministers have increasing respect for the United Kingdom.

We need only to look around the world to see examples in the number of so-called Socialist republics now introducing capitalist principles. China, the oldest civilisation in the world and with 25 per cent. of the world's population, is now experimenting successfully with capitalist principles. [HON. MEMBERS: "What about the time?"] I know that the debate is drawing to a close, and I am about to conclude my remarks. The reality is that is the Governments of other countries had been as prudent as this Government, there would not be a world financial crisis.

I must repeat that *The Sunday Times* said—[HON. MEMBERS: "Sit down."] Opposition Members may not like it, but I remind them that *The Sunday Times* said:

" A student of O level economics could have produced a better essay on the crash than the Shadow Cabinet's statement."

I will not go quite that far, but I do believe that the Opposition would be as qualified to handle our economy as King Herod would be to act as a babysitter.

9.12 pm

Mr. Bryan Gould (Dagenham): It is pleasant to begin by congratulating the hon. Member for Boothferry (Mr. Davis) on an excellent maiden speech. He spoke in a fluent and attractive manner and his speech had the additional merit of containing much with which I agreed. He will certainly hear an echo from the Opposition Benches of his tribute to his much respected predecessor.

Much has been heard following the week of the stock market crash, both in this debate and outside the House, of the supposed parallels between this crash and that of 1929. Fears have been expressed that, unless a proper response is made, the crash could presage a recession on the scale of the great depression of the 1930s. Of course, it is important to avoid the sort of response that monetarist precepts — those at the heart of the Government's economic policy until recently — would dictate and that would plunge the world into a new recession. Memories of the great depression have burnt deep into the public consciousness. There is no one who would not agree that a repeat of that experience should be avoided at all costs. Even the Chancellor, as his Mansion house speech last night made clear, finds it difficult not to pay at least lip service to that proposition.

Oddly enough, the Chancellor does not need to face that problem in precisely those terms—but for reasons that, perhaps, he would not find entirely welcome. Far from being poised on the brink of recession, as we were in 1929, we have actually already experienced it. The true parallel with 1929 is 1979, and the eight years since then offer the closest match with the great depression in the 1930s. It was in the years following 1979 that the Government made the mistakes in policy that the Chancellor now castigates.

Mr. Quentin Davies: Will the hon. Gentleman give way?

Mr. Gould: No.

No one listening to the Chancellor's complacent, not to say boastful, performance during the last few weeks, in marked contrast to his uncertain and confidence-sapping performance today, would get any clue that on the issues that matter our experience from 1979 until now has been far worse than during the eight-year period from 1929 to 1937, the years of the great depression.

Mr. Quentin Davies *rose*——

Mr. Gould: Perhaps if the hon. Gentleman listens he will learn something.

During the great depression manufacturing output in Britain rose by 38 per cent. In the eight years to 1987 manufacturing output had barely clawed back to where it was in 1979. During the great depression — the great unemployment of popular memory — the jobless total rose by 219,000. The equivalent during the past eight years is no less than 1·7 million. From 1929 to 1937 manufacturing employment rose by 10 per cent., whereas during the eight years of this Tory Government it has fallen by 27 per cent. Those figures, which are dramatically worse than those for the great depression, illustrate all too well why Opposition Members believe that the Chancellor's performance during the past few weeks has been nothing more than a confidence trick. Those disastrous figures for the real economy not only give the lie to the Chancellor's boasting; they also give us an important clue to why the stock market crash has occurred.

In the wake of the stock market crash, the Chancellor, true to form, has not been slow to cast the blame on others. The markets, whose sagacity he has hymned for so long have now been condemned as absurd; the Americans, whose performance on inflation and unemployment has been so much better than our own supposed success, as vouchsafed to us, have been told that their budget deficit has caused all the difficulties; and the Germans, with by far the strongest economy in Europe, have been lectured by the Chancellor and told to cut interest rates which are less than half the level of ours. None of the Chancellor's excuses explains why the British equity market has collapsed and crashed further and faster than other major markets, nor does it explain why the response to the ouChancellor's bullish pronouncements has been a thumbs down from the City.

The truth is that the crash is the eminently predictable result of the constant priority that Governments around the world, led by the Chancellor and the Government, have given to the money economy at the expense of the real economy. The whole thesis of monetarism, of which I believe I can claim to be the longest standing political opponent, is, after all, that only monetary measures matter, and that the real economy will look after itself. We know, and even the Chancellor knows, that our experience has been the reverse of what monetarist theory led many to believe. Monetary policy has proved to be capricious and difficult to control and has had only a marginal and delayed effect on monetary objectives such as inflation, but its impact on the real economy was immediate and devastating.

The Chancellor has professed himself unconcerned at the truly appalling figures for British manufacturing output, investment, employment and trade under the Government. He has blithely assured us that we can rely on services to make us prosperous and he even had the gall to tell the House that the £13 billion turnround in our manufactured trade was "neither here nor there". This callous and foolish disregard for the real economy and of those who live and work in it has been matched by his rejoicing at the successes of the financial sector. The Porsche-driving City whizzkids have now passed into popular mythology, but the phenomenon and the sense of resentment and injustice which it engendered are real enough.

The financial sector has prospered at the expense of the real economy because the Chancellor's policies deliberately made it so. The Chancellor created a huge money-go-round, on which the financiers enjoyed the ride, while the rest of us were taken for a ride. Money which under more sensible policies would have been invested in our industrial base has instead helped us to soak up a huge degree of asset inflation, of which the long bull market and soaring house prices in the south-east of England have been the most obvious signs.

The growth in the value of assets has been artificially inflated by an over-valued exchange rate and that has

[Mr. Gould]

attracted yet more money. Overnight capital gains were a much more attractive prospect than the uncertain returns from manufacturing investment. We were well and truly launched into a vicious circle. Personal incomes in the City soared. Banks and other City firms became hugely profitable on the back of high interest rates, a spiralling stock market, a rash of takeover bids by firms that would rather buy than invest, and the easy profits from the Government's privatisation programme. Short-termism, so lucrative for the money men but so damaging to those who try to sell their goods in international markets, became the only game to play.

High interest rates hurt industry, especially investment in capital equipment, research and development, and training on which our future prosperity depends. The real economy, and those whose jobs and livelihoods depend on it, has also suffered grievously from the over-valued pound that high interest rates have produced. Perhaps the most telling indicator of the damage that has been done is that, while exports of manufactures have risen by 20 per cent. since 1979, imports of manufactures rose by no less than 70 per cent., or three and a half times faster over the same period.

The disparity between the real and the money economy could be sustained. In the long term, the money economy cannot follow a different course from the real economy, which is lagging behind. The long-awaited bear market simply had to happen. The only question was——

Mr. Higgins *rose*——

Mr. Gould: I am sorry, I shall not give way.

The only question was its speed and timing. In market terms, it was clear that the longest bull market ever known was bound to come to an end sooner or later.

Mr. Higgins: Will the hon. Gentleman give way?

Mr. Gould: No, I shall not.

In case Opposition Members did not recognise my earlier words, may I point out that they came from the speech that the Chancellor made last night. It is a pity that he had not thought to warn small investors in the BP share issue about that possibility.

Mr. Higgins: I thank the hon. Gentleman for giving way. However, in plagiarising his own article from *The Sunday Times* of last week almost word for word, has he not overlooked the fact that it was a bad article? It was hopelessly and entirely inconsistent. The hon. Gentleman cannot accuse the Chancellor of being a monetarist and at the same time say that he is pumping too much money into the economy.

Mr. Gould: I was afraid that it might be a mistake to give way to the hon. Gentleman. Whatever the merits of that article in *The Sunday Times,* it certainly made a great impact on him if he can recognise it so clearly.

If the stock market crash was an inevitable corrective for the mistakes and excesses of economic policies here and in other countries, which is what the Chancellor is now, in effect, admitting, where do we go from here? In many respects, the Chancellor has now renounced many of the mistakes that did so much damage. Thankfully, the theory of monetarism has now largely been abandoned. Apart from the hon. Member for Wolverhampton, South-West (Mr. Budgen), who now pays any attention to the monthly sterling M3 figure? Who among the array of hon. Members on the Conservative Back Benches can tell me the current annualised level of growth of sterling M3? How many takers are there? How many Conservative Members understand it?

Sir Peter Hordern: The annual growth is 18 per cent. of M3. The hon. Gentleman will recognise, as my right hon. Friend explained in the Grey Book that was published yesterday, that that was because of the liberalisation of the financial services that my right hon. Friend has brought about.

Mr. Gould: That was a brave attempt by the hon. Gentleman to save his colleagues from embarrassment. Even then, he did not quite get the answer right. The answer is 19·5 per cent. in the year to September. That answer and Conservative Members' inability to answer are the most telling possible indictments of how fundamentally and thoroughly they have cast away what was once the bedrock of the medium-term financial strategy.

Even the Chancellor's ideological objections to public spending seem now to have been mitigated, since he is now inclined to boast about its increase. The Chancellor even boasts now about public spending, at least on a selective basis. He overlooks the fact that he has been forced to abandon his objective of cutting public spending in real terms, and, when that proved impossible, of even simply holding it steady. He has also demonstrated that he will understand the damage that his policies cause. We know that because we have seen his readiness to abandon them —surreptitously, of course—to produce a pre-election mini-boom. The relaxation of monetary policy, the boost to public spending and the depreciation of sterling at the end of last year all played their part, but, once again, they have now been reversed.

The difficulty is that the Chancellor, although having substantially recanted in many respects and having abandoned monetarism and its theory, still lives in the shadow of monetarism. He is rather like a pagan worshipper whose idol has crumbled but, for want of anything better to do, still goes through the old rituals, shuffles through the old steps and bangs the old drums. That makes the Chancellor's analysis of the current process so fatally flawed. His monetarist attitude leads him to focus, almost exclusively, it seems, on the American budget deficit as the cause of all our problems. If the Americans were to follow the Chancellor's monetarist advice, and if interest rates and taxes were to be raised or social security benefits were to be cut, it could only bring the threat of world-wide recession so much closer. The Chancellor's lectures to the Americans about their budget deficit suggest that he has failed to learn any lesson. It is not even clear that he understands the problem himself. At one point in his Mansion house speech last night he said that one of the factors which had provoked the crash was

"doubts . . . about whether the United States had the political will to hold interest rates at whatever level was necessary, not merely to maintain dollar stability, but also to ensure that the deficit, so long as it endured, was soundly financed."

That and other passages in his speech last night sound suspiciously like advice to the Americans to raise interest rates. How does that square with the passage later in his speech in which he warned against the contractionary policies which had plunged us into recession into 1929? If the Chancellor's public message is so garbled, it is no wonder that the Prime Minister felt constrained to send a private message to clear up the confusion.

The Chancellor remains preoccupied with the monetary policy which caused our problems in the first place, and he risks precipitating a recession if the Americans take his advice to reinforce financial orthodoxy. The real economy is the key to the solution to our problems. The American trade deficit, not the budget deficit, threatens the stability of the world's economic order. There can be no stability until a new balance is struck between surplus countries such as Japan and Germany and those countries such as the United States and United Kingdom which have used excessively high interest rates to prop up their currencies and have accordingly got themselves into difficulty. The extent of the dollar overvaluation——

Mr. Cash *rose*——

Mr. Gould: The hon. Gentleman should know that I shall not give way.

The extent of the American overvaluation is so gross as to be unmistakable. In 1986, the value of American exports had fallen 18 per cent. from their 1980 level, whereas the value of their imports had risen by no less than 104 per cent. Their balance of payments had moved from a surplus of $6·3 billion in 1981 to a deficit of $141 billion in 1986. There is no way in which that trading problem can be overcome by indirect signals to the markets, such as increases in interest rates—indeed, that would make it worse — increases in taxes or cuts in social security payments. There is only one solution to the problem, and that is, to get American interest rates and the exchange rate down.

Similar conclusions must be reached in respect of our own economy. If the Chancellor's prescriptions have been so successful, and if our economy is in such good shape, why are our interest rates more than twice as high as German interest rates? The Government always said that the key to lower interest rates was to bring public sector borrowing under control. If that control has been established, why does the Chancellor still have to hold interest rates at such a high levels? Can any Conservative Member, including the Chancellor, give a straight answer to a simple question: why must we hold interest rates at their present level?

Mr. Cash *rose*——

Mr. Gould: I suspect that the hon. Gentleman does not have an answer to that question.

Mr. Cash: Will the hon. Gentleman give an answer to a straight question?

Mr. Gould: I gave way on the always risky assumption——

Mr. Speaker: Order. If the hon. Gentleman has given way, he has given way and that is that.

Mr. Cash: Will the hon. Gentleman give an answer to a straight question? Would he advise the President of the United States to veto the trade Bill which is currently going between Congress and the Senate? That lies at the root of many of his questions.

Mr. Gould: Despite your intervention, which I understand, Mr. Speaker, I repeat that it was a risky business to have allowed the hon. Gentleman to intervene on the assumption that he would answer my question.

Sir Peter Tapsell (East Lindsey) *rose*——

Mr. Gould: I may get an answer this time.

Sir Peter Tapsell: If I may give a personal response to the hon. Gentleman's question, we do not have to hold our interest rates at their present level. We can reduce them again and will do so.

Mr. Gould: That is a very encouraging answer, but the true answer is that we shall not reduce interest rates and they will be held at an excessively high level for one simple reason. The hon. Gentleman knows that reason, and the Chancellor would also concede the point. Unless interest rates are maintained, the pound will fall. The Chancellor claims that he has introduced a strong currency. It is a strong currency which has to be sustained by record interest rates and by 3 million unemployed. So much for a strong currency. If interest rates were reduced, who could doubt that the pound would fall substantially and that the impending balance of payments deficit would be virtually impossible to manage, if it were not for the immense benefit of North sea oil?

Mr. Ian Taylor *rose*——

Mr. Gould: The Chancellor is in the position of a small business man who, having won the pools, congratulate himself on his business acumen because he has spent every penny on keeping his business afloat. He has done nothing with North sea oil to strengthen our industrial base. He has done nothing to prepare for or invest in our future. Even the assets which have been built up abroad are no more than a pension fund for what he clearly foresees as a geriatric economy when the oil has run out.

Interest rates are the crucial determinant of the policy stance. Interest rates will show whether the Chancellor continues to reinforce past mistakes and to favour the money economy at the expense of the real economy. If interest rates are kept high, the City will applaud, but the real economy will be damaged. Unfortunately for that economy, it is already clear that the Chancellor has again opted for the money men and the financial establishment. Yesterday's feeble 0·5 per cent. cut did no more than complete the reversal of the mistake of August. We already see the consequences of the Chancellor's post election strategy in the 18 per cent. loss of price competitiveness suffered by British industry over the past year.

It is little wonder that the CBI, despite its brave talk, shows in its latest Quarterly Trends survey that the outlook for exports and manufacturing output is now much gloomier. It is little wonder that the Chancellor is now compelled to forcast a substantial dropping-off in the rate of growth and a worsening of the balance of payments deficit.

The casualties of the Chancellor's mistaken policies, of which the stock market crash is only a symptom, are many and varied. They include any residual confidence in the Government's economic strategy, the future of their privatisation programme and the exaggerated lifestyles and incomes of the money men in the City. No one needs shed any tears over them.

As always, the real casualties will be ignored by the right hon. and hon. Gentlemen on the Conservative Benches. The unemployed will have their hopes dashed all over again. The regions and the inner cities will be condemned again to de-industrialisation and deprivation. Families in poverty will have their precarious living

[Mr. Gould]

standards further eroded. Those who try to create this country's wealth will lose out to those who merely manipulate it. Only the Labour party speaks up against a policy that is so technically and morally wrong. Only the Labour party speaks up for the national interest and for a society that will be condemned to yet more bitterness and division. We shall continue to speak up until the next election gives us the chance to correct the mistakes that have been so damaging to this country.

Mr. Allan Rogers: On a point of order, Mr. Speaker. Will you give any time to make allowances for the Liberal and — Oh, I am sorry, there are no Liberal or SDP Members in the Chamber.

Mr. Speaker: That is not a point of order.

9.35 pm

The Financial Secretary to the Treasury (Mr. Norman Lamont): First, I join the hon. Member for Dagenham (Mr. Gould) in congratulating my hon. Friend the Member for Boothferry (Mr. Davis) on his excellent maiden speech. We all appreciated his tribute to his predecessor, Sir Paul Bryan, who is much respected in this House. I believe that both sides of the House appreciated my hon. Friend's plea for the need to avoid a global recession. I certainly also appreciated his conclusion that the economy was well placed to weather this storm. It was an excellent speech and we look forward to hearing him again.

Although this has been a debate on an extremely serious matter, some hon. Members seemed to herald the crash of the financial markets with a degree of glee, not to say relish. Indeed, the hon. Member for Cardiff, West (Mr. Morgan) displayed a degree of relish, although he made his speech with some charm. The hon. Gentleman displayed that relish because he felt that two things were consequential to the collapse of the markets. First, he hoped that the collapse meant the end to privatisation; and, secondly, that it would put a stop to the growth of wider share ownership. I must tell the hon. Gentleman that the privatisation programme will certainly continue, and my right hon. Friend the Chancellor——

Mr. Morgan: Will the right hon. Gentleman give way?

Mr. Lamont: In a moment. In his Autumn Statement my right hon. Friend made it clear that we are planning on the proceeds of £5 billion this year and for the two years following that. No doubt it could be argued that the state of the market can affect prices, but, when the time comes, I see no reason why we should not proceed. Indeed, we shall certainly proceed with the privatisation of water and electricity.

Mr. Morgan: I should like to correct what the Minister has said. I said that had the BP shares sale been timed for one week later, or had the crash in the stock market been one week earlier, it would have put an end to privatisation —I am sure Conservative Members would agree—for at least the next decade.

Mr. Lamont: I am grateful to the hon. Gentleman for intervening.

The hon. Gentleman also argued that the collapse of the financial markets would lead to the end of wider share ownership. However, we certainly intend that that policy should be pursued, and why not? Wider share ownership is something that is industrially and educationally desirable. We believe that it is wholly in the interests of this country to encourage people to have a stake in the great British companies. We have always said that there are risks as well as benefits involved in wider share ownership. I believe that the people understand that and accept those risks. I do not believe that the appetite for wider share ownership and for privatisation will be diminished.

We had hoped that the hon. Member for Dagenham would join us in the cause for wider share ownership. After all, it was he who, not so long ago in *The Times* on 16 September, said:

> "The idea of owning shares is catching on and as Socialists we should support it."

It is true that the hon. Gentleman's idea of shares is a little different from that held by everyone else. One is not allowed to pay money for them, or to own them direct, or to sell them. When the hon. Gentleman exposed his views to the Labour party conference he was, of course, jeered and he received a rough reception. It is no wonder that his hon. Friend the Member for Hackney, South and Shoreditch (Mr. Sedgemore) said that the only casualty of the crisis was Bryan Gould. The hon. Gentleman has been putting forward his alternative to popular capitalism—something that he calls popular socialism, which, as my hon. Friend the Member for Cambridgeshire, South-West (Sir A. Grant) said, is an idea that is not catching on. It seems about as paradoxical as the idea of boiling ice.

Mr. Gould: As the right hon. Gentleman was kind enough to mention me, he gives me the chance to make clear, as I always have done, that what I advocate as a form of share ownership is employee share ownership schemes in which the shares are held collectively and not traded on the stock exchange. That would provide us with an additional means of extending social ownership, and offer a form of popular socialism which I am sure my hon. Friend the Member for Hackney, South and Shoreditch (Mr. Sedgemore) would endorse. I am also grateful for the endorsement and interest of the Minister.

Mr. Lamont: Even employee shares go up and down. If they are not allowed to be traded, I do not know how the hon. Gentleman will establish any value for them, or how they will benefit employees. I do not think that the hon. Gentleman knows either.

Much of the debate has been about whether a recession is now inevitable. The hon. Member for Hackney, South and Shoreditch, perhaps supported by my hon. Friend the Member for Wolverhampton, South-West (Mr. Budgen), has taken a pessimistic view, which is not that of the Government. My right hon. Friend the Chancellor made it clear last night that it is our view that a recession is not inevitable and can be avoided provided that the right policies are followed. I am glad to see that I have the support of the hon. Member for Dagenham in this, because he made an interesting and prophetic speech, issued by Transport House on 29 September, one month before the stock market collapsed, amazingly entitled,

> "Gould speaks on stock market collapse".

If the speech was really issued on 29 September, the hon. Gentleman should be a rich man, and he is certainly a prescient one. In it he said that he did not believe that the stock market crash meant a recession——

Mr. Gould *rose*——

Mr. Lamont: —provided that the correct policies were followed.

My right hon Friend has made it clear that what turned the 1929 stock market crash into a recession was the inadequate response of the authorities and the drift to protectionism that followed in its wake. My right hon. Friend hs responded in a different way this year with a cut in interest rates, and has said that it is incumbent on other counries not to pursue overtight monetary policies. As my right hon. Friend the Member for Guildford (Mr. Howell) said, right hon. and hon. Members on the Opposition Benches cannot wait for the moment for deficit spending to begin. They do not understand how the recovery has happened. They want to anticipate the recession. They say that they do not want it to occur, yet they want to go deep into deficit spending now. I am certain that nothing would have undermined the confidence of the market more than if my right hon. Friend had abandoned his policies on public spending. That would have been received with a shattering lack of confidence by the markets.

The key requirement is to ensure that industry and business do not overnight lose the confidence in our economic prospects that has been building up so strongly in recent years, here and overseas. If confidence is retained, the other effects of the share fall can, and will be contained.

The right hon. and learned Member for Monklands, East (Mr. Smith) called on my right hon. Friend the Chancellor to take industrial action, to participate in international discussions. He was not very specific about what he wanted my right hon. Friend to do. He was not very specific about anything, including the slur that he cast on my right hon. Friend. The hon. Member for Dagenham has made it clear what he thinks should happen. He says that we and the United States and everybody else should devalue together. The hon. Gentleman is being absolutely true to form, because he has believed for years that the answer to every problem is to devalue.

Mr. Gould: Quite apart from any question of whether the exchange rate should go down, what does the Minister say about the fact that over the last year British industry has endured an 18 per cent. increase in the real exchange rate? Presumably the Minister believes in market forces. Does he not accept that an 18 per cent. increase in prices is at least likely to be noticed by some of our potential customers?

Mr. Lamont: The hon. Gentleman's facts are wrong, and he has repeated word for word what he said in his speech. There has not been an 18 per cent. loss in competitiveness. I shall give the hon. Gentleman a percentage, but it is not 18 per cent. *[Interruption.]*

Mr. Speaker: Order. There is no point in hon. Members shouting from sedentary positions.

Mr. Lamont: The right hon. and learned Member for Monklands, East paid my right hon. Friend a compliment when he said that because of the great strength of the British economy my right hon. Friend should play a leading part in international discussions on these problems. Nobody would have asked the right hon. Member for Leeds, East (Mr. Healey), when he was Chancellor, to summon an international conference, because nobody would have come. If some people had come, they would have left their cheque books at home because they would have thought that the conference had been called to bail out the British economy.

The right hon. and learned Member for Monklands, East was extremely unfair to my right hon. Friend, who played a leading part in the Plaza agreement of 1985. That agreement was designed to deal with some of the problems that we still face. As a result of the agreement we saw a 50 per cent. appreciation in the deutschmark and in the yen. We also saw the acceptance of a commitment by the United States for a reduction in the United States deficit. Since the Plaza accord of 1985 there has been a reduction of about one-third.

My hon. Friend the Member for Chichester (Mr. Nelson) and my right hon. and learned Friend the Member for Richmond, Yorks (Mr. Brittan) emphasised that it is essential and extremely urgent that the United States should go further than is implied by Gramm-Rudman 2. This is an extremely important analysis, although it is disputed by some, though not all, Opposition Front-Bench Members. However, it is widely accepted in the financial community.

During the speech of my right hon. Friend the Chancellor there was a most extraordinary intervention by the Leader of the Opposition. My right hon. Friend clearly said that the right hon. and learned Member for Monklands, East was criticising the Government for not doing enough about the United States deficit. However, not once, twice or three times, but time and time again, and year after year, the Opposition are on record urging us to follow the same path as the United States and have ever more borrowing. The extraordinary thing is not that they urged us to do that, because that is what we expect them to do and is running true to form, but that the Leader of the Opposition intervened in my right hon. Friend's speech to deny that they had ever urged this course upon the Government.

I shall put on the record what the right hon. Member for Birmingham, Sparkbrook (Mr. Hattersley) said, because it could not be clearer. This is one of a series. He praised America and said:

> "Having . . . taken the advice of the Labour party, and not being afraid of borrowing, the President of the United States has created 5 million new jobs and a growth rate of 8 per cent. per annum."—*[Official Report*, 31 July 1984; Vol. 65, c. 298.]

The right hon. Gentleman talked about

> "not being afraid of borrowing,"

yet the Leader of the Opposition denied that that was the course——

Mr. Gould: That is wrong.

Mr. Lamont: Perhaps I am wrong. Perhaps I am doing the right hon. Gentleman an injustice. The hon. Member for Dagenham takes a completely different line. In his September speech he said that the great danger was that the United States would correct its deficit far too quickly. What a message for the Labour party to send to the United States. At a time when the whole financial community is of the view that the great danger is the deficit of the United States, we know that Labour speeches are not just listened to in the United States but plagiarised. We know that they are closely followed. We do not want any plagiarism of the fear of the hon. Member for Dagenham that the deficit will be reduced too quickly. When the whole world wants that deficit reduced quickly, the response of the Labour party is that the danger is that it will be reduced too quickly.

[Mr. Lamont]

When the proposition that the deficit might be reduced too quickly was put to Mr. Volker, he said:

"That, at present, is not a problem that is keeping me awake at night."

Mr. Eric S. Heffer (Liverpool, Walton): Is the right hon. Gentleman aware that over the years many Labour Members have argued that we should follow neither the United States nor any other capitalist Government?

Mr. Lamont: The hon. Gentleman is always consistent in his convictions. I am sorry that he was not able to intervene in the debate and give us his view, which I know is shared by some of his Friends, that the day that they have been waiting for all their lives has arrived; the collapse of capitalism is upon us. That view is not even shared by his right hon. and hon Friends on the Front Bench.

Mr. Allan Roberts (Bootle): We have had 16 minutes of claptrap. Will the Minister now tell us what his Government intend to do?

Mr. Lamont: I have explained what the Government will do internationally. I reaffirm that the Government will continue with the policies that my right hon. Friend outlined last night at the Mansion House. I am perfectly entitled to reply to the points made by the hon. Member for Dagenham, especially when they are so feeble and so easily knocked down.

One respect in which the debate has differed from the discussion in the newspapers is that I have not read one article or comment that has implied that what happened in the financial markets was the fault of the Government. The only person who has expressed that view is the hon. Member for Dagenham. He thinks that what has happened in the financial markets is all the fault of monetarism. The trouble is that he cannot make up his mind whether my right hon. Friend has abandoned monetarism or whether he is a dogmatic monetarist. Most people will not be too worried about those arcane points, because they know that the policies of my right hon. Friend have worked and have been outstandingly successful.

Mr. John Smith *rose*——

Mr. Lamont: No, I shall not give way.

The hon. Member for Dagenham thinks that it is essential somehow to link the Government to the crisis. He has produced the most extraordinary reasons for this. I could not have been more amazed when he repeated, not just the content, but word for word what he said in his extraordinarily prescient speech of 29 September, one month before the stock exchange crashed. He revealed a remarkable sentiment. He said that monetarism had produced

"the overvalued currency, the product of excessively high interest rates"

and he repeated tonight that

"the product of excessively high interest rates artificially raised the value of assets at the expense of the real economy."

That is extraordinarily interesting. It shows why Opposition Members endlessly talk absolute nonsense. I would have thought that the hon. Member for Dagenham must know that if interest rates rise that lowers the value of assets on the stock exchange and lowers the value of bonds and monetary assets. If that really is the hon. Gentleman's view, I thoroughly understand why he has been totally puzzled by the Government's timely response in cutting interest rates in the light of world developments. The hon. Gentleman does not know whether he is coming or going on interest rates.

The hon. Gentleman painted a harsh picture of the economy. However, he perhaps forgets that when he came back to the House after his personal triumph of co-ordinating the Labour party's third consecutive unsuccessful election campaign he showed signs of getting to grips with economic policy. During the debate on the Second Reading of the Finance Bill he said:

"I do not think anyone need to be too alarmed. No major crisis is in prospect. I would argue that the prospects for our own economy depend very much on our own efforts rather than on the impact of the development of world economic factors."

I do not criticise the hon. Gentleman's lack of foresight over the stock market crash. He made up for that later.

The hon. Gentleman then said that he wanted to envisage a position in which this country was being completely privatised. He said that if a prospectus was being drawn up for the country it would state that the

"prospect was not entirely unpromising."

He said that output was rising "relatively fast" and that unemployment appeared to be falling.

With regard to the balance of payments, the hon. Gentleman spoke of a

"deficit of the size that is likely over the next year or two . . . is likely to be manageable."—[*Official Report,* 8 July 1987; Vol. 119, c. 364-65].

Ms. Armstrong *rose*——

Mr. Gould: Will the right hon. Gentleman give way?

Mr. Lamont: I shall give way in a minute. The picture painted by the hon. Gentleman was perhaps a little grudging, but it was completely different from the picture that he painted in a most opportunistic way today.

Mr. Gould: The Minister really cannot get away with the dishonesty of partially quoting from my speeches and statements. If he had the honesty and gumption to complete the quotations — he does not have the time now — he would know that I concluded my speech by saying that if this country's economy was privatised the shareholders would sack the directors. That remains my view.

Mr. Lamont: As the hon. Gentleman says, time does not permit. However, I would have been happy to read out what the hon. Gentleman said about the economy, because it was extremely different from what he said tonight.

The hon. Gentleman always talks about the divergence between the money economy and what he calls the real economy. The real economy is doing extraodinarily well. Instead of talking about the real economy, the hon. Gentleman should give the real facts about the real economy. The real facts are that industrial production is at record levels, export volumes in 1987 are 9·5 per cent. up on last year's figures and unemployment is falling sharply.

The hon. Gentleman betrays his positive dislike of the financial services industry. He seems to believe that the financial services industry and the City are not part of what he calls the real economy. However, the City, which he has attacked and criticised tonight, has generated more than £9 billion of invisible earnings. The City and the financial services industry employ more than 2·25 million people. Do they not count as working in the real economy? Surely the hon. Gentleman is aware that the City serves, not just the needs of British industry, but the needs of industry worldwide. It is one of our most outstandingly successful industries. It contributes to real wealth in this country, and it has every bit as much claim to be included in the real economy as everything else that the hon. Gentleman describes.

The Government have two advantages. First, we have taken difficult decisions in the past, and the British economy is strong. Secondly, we have been re-elected, and we therefore have the mandate, the authority and the freedom of manoeuvre to continue with the policies which have brought us success, and which we shall continue to follow.

I urge my hon. Friends to reject the motion.

Question put, That the original words stand part of the Question:—

The House divided: Ayes 213, Noes 333.

Division No. 40] **[10.00 pm**

AYES

Abbott, Ms Diane
Adams, Allen *(Paisley N)*
Allen, Graham
Alton, David
Anderson, Donald
Archer, Rt Hon Peter
Armstrong, Ms Hilary
Ashdown, Paddy
Ashton, Joe
Banks, Tony *(Newham NW)*
Barnes, Harry *(Derbyshire NE)*
Barnes, Mrs Rosie *(Greenwich)*
Barron, Kevin
Battle, John
Beckett, Margaret
Bell, Stuart
Benn, Rt Hon Tony
Bennett, A. F. *(D'nt'n & R'dish)*
Bermingham, Gerald
Bidwell, Sydney
Blair, Tony
Boyes, Roland
Bradley, Keith
Bray, Dr Jeremy
Brown, Gordon *(D'mline E)*
Brown, Ron *(Edinburgh Leith)*
Buchan, Norman
Buckley, George
Caborn, Richard
Callaghan, Jim
Campbell, Ron *(Blyth Valley)*
Campbell-Savours, D. N.
Canavan, Dennis
Carlile, Alex *(Mont'g)*
Cartwright, John
Clark, Dr David *(S Shields)*
Clarke, Tom *(Monklands W)*
Clay, Bob
Clelland, David
Clwyd, Mrs Ann
Cohen, Harry
Coleman, Donald
Cook, Frank *(Stockton N)*
Cook, Robin *(Livingston)*
Corbett, Robin
Corbyn, Jeremy
Cousins, Jim
Cox, Tom
Crowther, Stan
Cryer, Bob
Cummings, J.
Cunliffe, Lawrence
Dalyell, Tam
Darling, Alastair
Davies, Rt Hon Denzil *(Llanelli)*
Davies, Ron *(Caerphilly)*
Davis, Terry *(B'ham Hodge H'l)*
Dixon, Don
Dobson, Frank
Doran, Frank
Douglas, Dick
Duffy, A. E. P.
Dunnachie, James
Dunwoody, Hon Mrs Gwyneth
Eadie, Alexander
Eastham, Ken
Evans, John *(St Helens N)*
Ewing, Harry *(Falkirk E)*
Fatchett, Derek
Faulds, Andrew
Fearn, Ronald
Field, Frank *(Birkenhead)*
Fields, Terry *(L'pool B G'n)*
Fisher, Mark
Flannery, Martin
Flynn, Paul
Foot, Rt Hon Michael
Foster, Derek
Foulkes, George
Fraser, John
Fyfe, Mrs Maria
Galbraith, Samuel
Garrett, John *(Norwich South)*
George, Bruce
Gilbert, Rt Hon Dr John
Godman, Dr Norman A.
Golding, Mrs Llin
Gordon, Ms Mildred
Gould, Bryan
Graham, Thomas
Griffiths, Nigel *(Edinburgh S)*
Griffiths, Win *(Bridgend)*
Grocott, Bruce
Hardy, Peter
Hattersley, Rt Hon Roy
Healey, Rt Hon Denis
Heffer, Eric S.
Henderson, Douglas
Hinchliffe, David
Hogg, N. *(C'nauld & Kilsyth)*
Holland, Stuart
Home Robertson, John
Hood, James
Howell, Rt Hon D. *(S'heath)*
Hoyle, Doug
Hughes, John *(Coventry NE)*
Hughes, Robert *(Aberdeen N)*
Hughes, Roy *(Newport E)*
Hughes, Sean *(Knowsley S)*
Hughes, Simon *(Southwark)*
Illsley, Eric
Ingram, Adam
Johnston, Sir Russell
Jones, Barry *(Alyn & Deeside)*
Jones, Martyn *(Clwyd S W)*
Kennedy, Charles
Kinnock, Rt Hon Neil
Lambie, David
Lamond, James
Leadbitter, Ted
Leighton, Ron
Lestor, Miss Joan *(Eccles)*
Lewis, Terry
Litherland, Robert
Livsey, Richard
Lloyd, Tony *(Stretford)*
Lofthouse, Geoffrey
Loyden, Eddie
McAllion, John
McAvoy, Tom
Macdonald, Calum
McFall, John
McKay, Allen *(Penistone)*
McKelvey, William
McLeish, Henry
Maclennan, Robert
McTaggart, Bob
McWilliam, John
Madden, Max
Mahon, Mrs Alice
Marek, Dr John
Marshall, David *(Shettleston)*
Marshall, Jim *(Leicester S)*
Martin, Michael *(Springburn)*
Martlew, Eric
Meacher, Michael
Meale, Alan
Michie, Bill *(Sheffield Heeley)*
Millan, Rt Hon Bruce
Mitchell, Austin *(G't Grimsby)*
Moonie, Dr Lewis
Morgan, Rhodri
Morris, Rt Hon J *(Aberavon)*
Mowlam, Mrs Marjorie
Mullin, Chris
Murphy, Paul
Nellist, Dave
Oakes, Rt Hon Gordon
O'Brien, William
O'Neill, Martin
Orme, Rt Hon Stanley
Patchett, Terry
Pike, Peter
Powell, Ray *(Ogmore)*
Prescott, John
Quin, Ms Joyce
Radice, Giles
Randall, Stuart
Redmond, Martin
Rees, Rt Hon Merlyn
Reid, John
Richardson, Ms Jo
Roberts, Allan *(Bootle)*
Robinson, Geoffrey
Rogers, Allan
Rooker, Jeff
Ross, Ernie *(Dundee W)*
Rowlands, Ted
Ruddock, Ms Joan
Sedgemore, Brian
Sheerman, Barry
Sheldon, Rt Hon Robert
Shore, Rt Hon Peter
Short, Clare
Skinner, Dennis
Smith, Andrew *(Oxford E)*
Smith, C. *(Isl'ton & F'bury)*
Smith, Rt Hon J. *(Monk'ds E)*
Snape, Peter
Soley, Clive
Spearing, Nigel
Steel, Rt Hon David
Steinberg, Gerald
Stott, Roger
Strang, Gavin
Straw, Jack
Taylor, Mrs Ann *(Dewsbury)*
Taylor, Matthew *(Truro)*
Thomas, Dafydd Elis
Turner, Dennis
Vaz, Keith
Wall, Pat
Wallace, James
Walley, Ms Joan
Wardell, Gareth *(Gower)*
Wareing, Robert N.
Welsh, Michael *(Doncaster N)*
Williams, Alan W. *(Carm'then)*
Winnick, David
Wise, Mrs Audrey
Worthington, Anthony
Wray, James
Young, David *(Bolton SE)*

Tellers for the Ayes:
Mr. Frank Haynes and
Mr. Alan Michael.

NOES

Adley, Robert
Alexander, Richard
Alison, Rt Hon Michael
Allason, Rupert
Amess, David
Amos, Alan
Arbuthnot, James
Arnold, Jacques *(Gravesham)*
Arnold, Tom *(Hazel Grove)*
Ashby, David
Aspinwall, Jack
Atkins, Robert
Atkinson, David
Baker, Rt Hon K. *(Mole Valley)*
Baker, Nicholas *(Dorset N)*
Baldry, Tony
Banks, Robert *(Harrogate)*
Batiste, Spencer
Bellingham, Henry
Bendall, Vivian
Bennett, Nicholas *(Pembroke)*
Benyon, W.
Bevan, David Gilroy
Biggs-Davison, Sir John
Blackburn, Dr John G.
Blaker, Rt Hon Sir Peter
Body, Sir Richard
Bonsor, Sir Nicholas
Boswell, Tim
Bottomley, Peter
Bottomley, Mrs Virginia
Bowden, A *(Brighton K'pto'n)*
Bowden, Gerald *(Dulwich)*
Bowis, John
Boyson, Rt Hon Dr Sir Rhodes
Braine, Rt Hon Sir Bernard
Brandon-Bravo, Martin
Brazier, Julian
Bright, Graham
Brittan, Rt Hon Leon
Brooke, Hon Peter
Browne, John *(Winchester)*

Bruce, Ian *(Dorset South)*
Buchanan-Smith, Rt Hon Alick
Budgen, Nicholas
Burns, Simon
Burt, Alistair
Butcher, John
Butler, Chris
Butterfill, John
Carlisle, John, *(Luton N)*
Carlisle, Kenneth *(Lincoln)*
Carrington, Matthew
Carttiss, Michael
Cash, William
Chalker, Rt Hon Mrs Lynda
Channon, Rt Hon Paul
Chapman, Sydney
Chope, Christopher
Churchill, Mr
Clark, Hon Alan *(Plym'th S'n)*
Clark, Dr Michael *(Rochford)*
Clark, Sir W. *(Croydon S)*
Colvin, Michael
Conway, Derek
Coombs, Anthony *(Wyre F'rest)*
Coombs, Simon *(Swindon)*
Cope, John
Cormack, Patrick
Couchman, James
Cran, James
Critchley, Julian
Currie, Mrs Edwina
Curry, David
Davies, Q. *(Stamf'd & Spald'g)*
Davis, David *(Boothferry)*
Day, Stephen
Devlin, Tim
Dickens, Geoffrey
Dicks, Terry
Dorrell, Stephen
Douglas-Hamilton, Lord James
Dover, Den
Dunn, Bob
Durant, Tony
Dykes, Hugh
Emery, Sir Peter
Evans, David *(Welwyn Hatf'd)*
Evennett, David
Fallon, Michael
Favell, Tony
Fenner, Dame Peggy
Field, Barry *(Isle of Wight)*
Finsberg, Sir Geoffrey
Fookes, Miss Janet
Forman, Nigel
Forsyth, Michael *(Stirling)*
Forth, Eric
Fowler, Rt Hon Norman
Fox, Sir Marcus
Franks, Cecil
Freeman, Roger
French, Douglas
Fry, Peter
Gale, Roger
Gardiner, George
Gill, Christopher
Gilmour, Rt Hon Sir Ian
Glyn, Dr Alan
Goodhart, Sir Philip
Goodlad, Alastair
Goodson-Wickes, Dr Charles
Gorman, Mrs Teresa
Gorst, John
Gow, Ian
Gower, Sir Raymond
Grant, Sir Anthony *(CambsSW)*
Greenway, Harry *(Ealing N)*
Greenway, John *(Rydale)*
Gregory, Conal
Griffiths, Sir Eldon *(Bury St E')*
Griffiths, Peter *(Portsmouth N)*
Grist, Ian
Ground, Patrick
Grylls, Michael
Gummer, Rt Hon John Selwyn
Hamilton, Hon A. *(Epsom)*
Hamilton, Neil *(Tatton)*
Hampson, Dr Keith
Hanley, Jeremy
Hannam, John
Hargreaves, A. *(B'ham H'll Gr')*
Hargreaves, Ken *(Hyndburn)*
Harris, David
Haselhurst, Alan
Hawkins, Christopher
Hayes, Jerry
Hayhoe, Rt Hon Sir Barney
Hayward, Robert
Heathcoat-Amory, David
Heseltine, Rt Hon Michael
Hicks, Mrs Maureen *(Wolv' NE)*
Higgins, Rt Hon Terence L.
Hind, Kenneth
Hogg, Hon Douglas *(Gr'th'm)*
Holt, Richard
Hordern, Sir Peter
Howard, Michael
Howarth, Alan *(Strat'd-on-A)*
Howarth, G. *(Cannock & B'wd)*
Howe, Rt Hon Sir Geoffrey
Howell, Rt Hon David *(G'dford)*
Howell, Ralph *(North Norfolk)*
Hughes, Robert G. *(Harrow W)*
Hunt, David *(Wirral W)*
Hunt, John *(Ravensbourne)*
Irvine, Michael
Irving, Charles
Jack, Michael
Jackson, Robert
Janman, Timothy
Jessel, Toby
Johnson Smith, Sir Geoffrey
Jones, Robert B *(Herts W)*
Kellett-Bowman, Mrs Elaine
Key, Robert
King, Roger *(B'ham N'thfield)*
Kirkhope, Timothy
Knapman, Roger
Knight, Greg *(Derby North)*
Knight, Dame Jill *(Edgbaston)*
Knowles, Michael
Knox, David
Lamont, Rt Hon Norman
Lang, Ian
Latham, Michael
Lawrence, Ivan
Lawson, Rt Hon Nigel
Leigh, Edward *(Gainsbor'gh)*
Lennox-Boyd, Hon Mark
Lester, Jim *(Broxtowe)*
Lightbown, David
Lilley, Peter
Lloyd, Sir Ian *(Havant)*
Lloyd, Peter *(Fareham)*
Lord, Michael
Luce, Rt Hon Richard
Lyell, Sir Nicholas
McCrindle, Robert
Macfarlane, Neil
MacGregor, John
MacKay, Andrew *(E Berkshire)*
Maclean, David
McLoughlin, Patrick
McNair-Wilson, M. *(Newbury)*
McNair-Wilson, P. *(New Forest)*
Madel, David
Major, Rt Hon John
Malins, Humfrey
Mans, Keith
Maples, John
Marlow, Tony
Marshall, John *(Hendon S)*
Marshall, Michael *(Arundel)*
Martin, David *(Portsmouth S)*
Mates, Michael
Maude, Hon Francis
Mawhinney, Dr Brian
Maxwell-Hyslop, Robin
Mellor, David
Meyer, Sir Anthony
Miller, Hal
Mills, Iain
Miscampbell, Norman
Mitchell, Andrew *(Gedling)*
Mitchell, David *(Hants NW)*
Moate, Roger
Monro, Sir Hector
Moore, Rt Hon John
Morrison, Hon C. *(Devizes)*
Morrison, Hon P *(Chester)*
Moss, Malcolm
Moynihan, Hon C.
Mudd, David
Neale, Gerrard
Nelson, Anthony
Neubert, Michael
Newton, Tony
Nicholls, Patrick
Nicholson, David *(Taunton)*
Nicholson, Miss E. *(Devon W)*
Onslow, Cranley
Oppenheim, Phillip
Paice, James
Patnick, Irvine
Patten, Chris *(Bath)*
Patten, John *(Oxford W)*
Pawsey, James
Peacock, Mrs Elizabeth
Porter, Barry *(Wirral S)*
Porter, David *(Waveney)*
Portillo, Michael
Powell, William *(Corby)*
Price, Sir David
Raffan, Keith
Raison, Rt Hon Timothy
Redwood, John
Renton, Tim
Rhodes James, Robert
Rhys Williams, Sir Brandon
Riddick, Graham
Ridley, Rt Hon Nicholas
Ridsdale, Sir Julian
Roberts, Wyn *(Conwy)*
Roe, Mrs Marion
Rossi, Sir Hugh
Rost, Peter
Rowe, Andrew
Rumbold, Mrs Angela
Ryder, Richard
Sackville, Hon Tom
Sainsbury, Hon Tim
Sayeed, Jonathan
Scott, Nicholas
Shaw, David *(Dover)*
Shaw, Sir Giles *(Pudsey)*
Shaw, Sir Michael *(Scarb')*
Shelton, William *(Streatham)*
Shephard, Mrs G. *(Norfolk SW)*
Shepherd, Colin *(Hereford)*
Shepherd, Richard *(Aldridge)*
Sims, Roger
Skeet, Sir Trevor
Smith, Tim *(Beaconsfield)*
Soames, Hon Nicholas
Speed, Keith
Speller, Tony
Spicer, Jim *(Dorset W)*
Spicer, Michael *(S Worcs)*
Squire, Robin
Stanbrook, Ivor
Stanley, Rt Hon John
Steen, Anthony
Stern, Michael
Stevens, Lewis
Stewart, Allan *(Eastwood)*
Stewart, Andrew *(Sherwood)*
Stradling Thomas, Sir John
Sumberg, David
Summerson, Hugo
Tapsell, Sir Peter
Taylor, Ian *(Esher)*
Taylor, John M *(Solihull)*
Taylor, Teddy *(S'end E)*
Tebbit, Rt Hon Norman
Temple-Morris, Peter
Thompson, D. *(Calder Valley)*
Thompson, Patrick *(Norwich N)*
Thorne, Neil
Thornton, Malcolm
Thurnham, Peter
Townend, John *(Bridlington)*
Townsend, Cyril D. *(B'heath)*
Tracey, Richard
Tredinnick, David
Trippier, David
Trotter, Neville
Twinn, Dr Ian
Vaughan, Sir Gerard
Viggers, Peter
Waddington, Rt Hon David
Wakeham, Rt Hon John
Waldegrave, Hon William
Walden, George
Waller, Gary
Ward, John
Wardle, C. *(Bexhill)*
Warren, Kenneth
Watts, John
Wells, Bowen
Wheeler, John
Whitney, Ray
Widdecombe, Miss Ann
Wiggin, Jerry
Wilkinson, John
Wilshire, David
Winterton, Mrs Ann
Winterton, Nicholas
Wolfson, Mark
Wood, Timothy
Woodcock, Mike
Yeo, Tim
Young, Sir George *(Acton)*

Tellers for the Noes:
Mr. Robert Boscawen and
Mr. Tristan Garel-Jones.

Question accordingly negatived.

Question, That the proposed words be there added, *put forthwith pursuant to Standing Order No. 30 (Questions on amendments), and agreed to.*

MR. SPEAKER *forthwith declared the main Question, as amended, to be agreed to.*

Resolved,

That this House congratulates Her Majesty's Government on restoring the public finances to such strength and soundness that the British economy is growing faster and unemployment falling more rapidly than in any other major industrialised country while inflation remains low, thus enabling the United Kingdom once again to play a major role in international financial discussions and providing sufficient resources, despite the halving of the nation's oil revenues, to enable them to increase spending on the National Health Service, education, law and order, and other priority programmes above previous plans, while ensuring that public spending as a whole continues to grow more slowly than national income and while public borrowing, even without any benefit from privatisation proceeds, has been reduced to its lowest level for 17 years.

PUBLIC ACCOUNTS COMMISSION

Ordered,

That Mr. Roy Beggs be added to the Public Accounts Commission.—*[Mr. David Hunt.]*

BUSINESS OF THE HOUSE

Motion made, and Question proposed,

That, at the sitting on Tuesday 10th November, if proceedings on the Motion in the name of Mr. John Wakeham relating to House of Commons (Services) have not been disposed of before Seven o'clock, Mr. Speaker shall at that hour put the Question on any Amendment which may have been moved, and shall then put forthwith the Question on any other Amendments selected by him which may then be moved, and on the main Question or the main Question, as amended.—*[Mr. David Hunt.]*

Hon. Members: Object.

Underground Fire (Dronfield)

Motion made, and Question proposed, That this House do now adjourn.—*[Mr. Dorrell.]*

10.15 pm

Mr. Harry Barnes (Derbyshire, North-East): It is appropriate that we should be discussing this subject on Guy Fawkes night in the House of Commons on a motion to adjourn the House. I hope that we are not tempting fate too much. I assure you, Mr. Speaker, that the Dronfield fire was not started by gunpowder. However, the way in which it did start is something of a mystery. The speculation is that there was a surface fire that moved underground.

The fire was on a private industrial estate in Dronfield, Derbyshire which was built in the 1970s. It was established from a tip in an area where there had been industrial waste from an iron and steel works and former railway sidings. It started two years ago on the south-east embankment of the industrial estate at a firm called Cronite Alloys Ltd. The embankment is 40 to 45 ft high and the fire started to develop at the lower regions of the bank near the river below it. It moved over 100 yards in two years, gathering momentum and threatening buildings at Henry Toole Ltd, which has since had to move to Chesterfield, and at Butler Die-Casting Ltd., which owns the land Henry Toole is on. All the time it was gathering in ferocity and speed. If it had not been stopped it would have been heading for the major gas supply into Dronfield and parts of south Yorkshire.

The problem was fully discovered only in February this year when there was heavy snow, which meant that the problem areas could be seen. The fire has since been diverted by a firm called Waddingtons, which was next in line for the fire. It built a barrier and grouted the area. The fire has now turned and moved towards Armeg Ltd and Fusion Ltd.

A magistrates court in July determined that the district council should take action to put the fire out. The North-East Derbyshire district council does not own the land, but it has been taking action since then. It has attempted to deaden the fire by grouting. It is providing an inert protective barrier around the fire and excavating heated areas of the embankment and sealing them off.

One problem is that the temperatures are much higher than were estimated. The body of the embankment is 700 deg C above the level estimated. It is giving off greater steam and dust emissions than were imagined, which is producing problems for the workers and residents in the neighbouring area. The residents have this week been involved in problems created by the work being done there. That slowed up the process.

According to the initial court ruling, the process should have been finished by now, but it will not be completed until January. The work has been much more expensive than was envisaged initially because of the time involved and the amount of grouting that needs to be done. It was originally estimated that it would cost the district council £300,000 to put out the fire but on present estimates the work needed will cost £500,000.

How is that money to be found? At the moment, the work is being paid for by a small non-metropolitan district council whose total budget is only £4·8 million — a council which the Government would describe as prudent, because it operates within its budget and has never been subject to any penalty clauses. If the council takes action

[Mr. Harry Barnes]

to recover the money from the firms concerned as is its statutory duty under section 99 of the Public Health Act 1936, the firms will become bankrupt and jobs will be lost on the estate. If the council has to spend so much money without being able to recoup it, it will suffer grant penalty losses and will have to pay the interest charges on temporary loans. If that happens, an 8p increase will be required in respect of the district precept, which represents a 25 per cent. rate increase.

We have to add to those problems the fact that valuation losses will be suffered because of firms moving out and the fact that valuation and revenue losses will be incurred in my constituency if Renisham park pit is closed and in the district if Arkwright pit is closed. Early-day motion 231 opposes that move, but the development is being pushed hard by the coal board. If those pits close, the district council will be in serious difficulties.

The council is in the unenviable position of having debts relating to remedial work on land that it does not own when the general body of its ratepayers cannot benefit in any way from the expenditure. Representations have been made to the Department of the Environment but have led to no offer of financial help. We received a letter from the Under-Secretary which states:

"You will, I know, be disappointed that your campaign on behalf of the local authorities and the industrialists should not have secured Government assistance for them but you may be assured that the case you have made has been considered most carefully and sympathetically."

We require more than tea and sympathy. We need financial assistance to handle our problems.

What measures could the Government and the House take to meet all or part of the costs involved? Several possibilities are open to us. First, section 1 of the Derelict Land Act 1982 could perhaps be used as the land concerned was used for tipping and now requires reclamation before it can be of any benefit to the area. It will need landscaping and tree planting. We shall need to improve the appearance of the estate for residents and for those using the main Sheffield to Chesterfield road. The embankment, which supports the industrial estate, is now subject to subsidence because of the burn beneath. The application of the Derelict Land Act would therefore seem appropriate. However, the Department of the Environment interprets the matter differently and does not see that as a possibility.

The second possibility would be to amend the Derelict Land Act. At the moment, the fact that the area is occupied or partly occupied means that the Act cannot apply.

The third possibility would be for the Department of Trade and Industry, through an amendment to legislation, to make available to councils funds that could later be recouped by those councils under the Public Health Act 1936. We do not want the issue partitioned between Government Departments so that we fall foul of that divide.

The fourth possibility would be to waive all grant losses and penalties, so that the sympathy described in the Minister's letter could be expressed in hard cash. The fifth possibility would be a special grant to the council because it cannot recover money from the firms involved. That could be done by means of a private Bill.

The sixth possibility is the Bellwin scheme — something frequently mentioned in the House in recent days in connection with the storm damage in southern England. A circular from Lord Bellwin on 14 April 1983 shows that a wider interpretation of the word "damage" can be made. It states:

"It is to provide special financial assistance to local authorities who, as a consequence of emergency, would otherwise incur an undue financial burden in providing relief and carrying out immediate works to safeguard life or property or prevent suffering or severe inconvenience to affected communities."

I think that under that definition funds could be made available to my council.

A further circular issued on 21 October concerned the recent storm damage. It said that after an initial rate payment 75 per cent. of the remaining costs of district councils would be met by the Department of the Environment from central funds, and the remaining 25 per cent. which would have to be paid by the district councils would not be subject to rate penalties. It may not be known generally that district councils, as distinct from county councils, cannot levy a penny rate initially, but only a rate of 0·15p in the pound.

There is a seventh possibility, which shows the lesson to be learned from Dronfield, and that is to provide funds that could be applied to wider areas. Would the Department of the Environment respond favourably to a Bill to set up a general disaster fund system so that central contingency funds are available for storm damage and other emergencies such as underground fires? I am referring not only to the fire in Dronfield, but to the coal seam that caught light at Oakthorpe colliery. Much of the burden of the costs there were carried by British Coal, although it had disclaimed responsibility. The fund could also be used for floods. A deputation from Strabane district council has visited the House today, and will visit it again tomorrow to tell us about its flooding problems.

The fund could cover the emergency that nearly occurred and indeed nearly did occur at Killamarsh, when there was an explosion at the chemical reclamation plant of Leigh Environmentals. That caused all sorts of problems in the area. The Minister is well aware of that case because in his previous office he had responsibility for small firms and he received a deputation from that company. Indeed, he wrote a sympathetic letter saying that an inquiry should be undertaken. Unfortunately, in his new position, he has now refused to set up that inquiry.

Such a general disaster fund would have all-party support in the House, especially after the storms suffered recently in the south of England. That has all-party support in Strabane, where, perhaps amazingly for this House, the representation from the district council is presented by a delegation made up of independent, Sinn Fein, Democratic Unionist, Social Democratic Labour party and Official Unionist councillors. Perhaps a similar arrangement of Labour and Conservative councillors who are affected by the problems at Dronfield could be brought about.

I ask the Department of the Environment seriously to consider action and not just issue sympathy to my constituency, so that the avenues that I have mentioned, or some combination of those avenues, are used to prevent the district council from being placed in an embarrassing financial position.

10.30 pm

The Parliamentary Under-Secretary of State for the Environment (Mr. David Trippier): I am grateful for the

Chief Economic Adviser to the Treasury

Terry,

Phil Wynn Owen is sending a note to the C.Ex giving advice on Walter Ellis's request to incorporate the C.Ex's opening remarks in the Keynes Conference book. He wonders if there are any particular points you think he should make – e.g. about who gets royalties etc?

Speak to

Philip W-O

Economic Director
Walter Eltis
Direct Line 01-211 4849
Secretary 01-211 6914

No bilateral meeting with Chancellor

(P8)

NEDO cc Sir T. Burns
Mr Odling-Smee

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12 November 1987

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1

13/11/87

Mr Wynn Owen
Sir P Middleton
FER Butler
Mr Monck
Mr Burgner
Mr P Gray

Dear Chancellor,

PUBLICATION OF THE PROCEEDINGS OF THE NEDO KEYNES CONFERENCE

You will be delighted to know that we have a firm contract for the publication of the Keynes Conference papers. The publisher will be Macmillan and they have undertaken to publish the book by the end of September 1988 at a reasonable hard cover price of £30 (for a book of approximately 250,000 words) provided that we meet their production schedule. This requires that we let them have the text of all the articles by the end of December this year, which means effectively by **18 December**.

Your article, which has already received very favourable attention from Sam Brittan and Sarah Hogg, will read admirably in the book apart from the first and last paragraphs which were addressed rather specifically to those actually present on 15-18 September.

As there are so many pressures on your time I have taken the liberty of suggesting how these two paragraphs could be amended for publication in the Macmillan volume. You may well prefer to have a more striking opening - I have done no more than slightly reformulate what you wrote in September. You may also think of a title that is more interesting than "Introduction" which I am suggesting.

We have checked the quotations from the Full Employment White Paper, and corrected a couple of secretarial inaccuracies.

I enclose my suggested draft for the printers, which is attached to your September typescript with all corrections marked, and I hope you will consider this appropriate.

It occurs to me that the stock market crash and your present efforts to work with other Finance Ministers to limit the damage may conceivably lead you to wish to add a paragraph or two of further reflections to the final page. These could be added to the proofs as late as April next year (by when we shall know a good deal more than we know now about the new international environment - if there is a new environment).

279/11/48

If you think it at all possible that you may wish to add something, I will ask Macmillan to leave a page free after your article. This would give it extra prominence if you decide to add nothing and allow you to write a little more if new events appear to merit a few further sentences.

If I hear nothing to the contrary, I shall assume that you are entirely happy for me to send the edited text of your article to the printers in a few weeks' time.

Yours sincerely

Walter Eltis

PS You are quite right that I reported the London Business School's results too uncritically in my concluding comments on 18 September. I will have far fuller and more detailed concluding reflections in the book, and so far as the LBS is concerned, bring out the contrast between their balanced budget multiplier position where demand supposedly rises in the short term when government expenditure and taxation are both increased and the new reverse-balanced budget multiplier theorem which states that a parallel addition to public expenditure and taxation reduces supply and therefore GNP in the medium term because extra income taxes which are passed on raise labour costs and therefore cut employment. Your advisers may not know of the enclosed article which seeks to document the reverse-balanced budget multiplier theorem for several countries, including our own.

(1038/730/330)

INTRODUCTION

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer

I warmly commend the National Economic Development Office for organising this distinguished conference on the relevance to economic policy of Keynes' General Theory After Fifty Years. The papers, which have been prepared by an impressive international cast of economists, have clearly been carefully designed to illuminate most of the key issues which lie at the heart of macroeconomic policy in the modern world.

"The difficulty", wrote Keynes in his Preface to the General Theory, "lies, not in the new ideas, but in escaping from the old ones, which ramify, for those brought up as most of us have been, into every corner of our minds".

For most today, I suspect, the ideas with which we were brought up were Keynesian ideas. Certainly that is true in my case, having read Politics, Philosophy and Economics at Oxford in the early 'fifties, with the endearingly eccentric Roy Harrod, Keynes's pupil and biographer, as my economics tutor.

Of course, practical Keynesianism in those days - and I was always more interested in the practical application of economics to policy: my taste for theory was satisfied by philosophy - practical Keynesianism in those days was rather different from what it was subsequently to become.

The first text I was given to read was the 1944 Employment Policy White Paper:[1] then seven years old and the locus classicus of the application of Keynesian theory to practical policy. A few quotations convey the flavour:

---

[1] Employment Policy, (Cmd)6527, HMSO, May 1944.

> "Action taken by the Government to maintain expenditure will be fruitless unless wages and prices are kept reasonably stable. This is of vital importance to any employment policy, and must be clearly understood by all sections of the public". (Para 49)

Again,

> "It would be a disaster if the intention of the Government to maintain total expenditure were interpreted as exonerating the citizen from the duty of fending for himself and resulted in a weakening of personal enterprise. For if an expansion of total expenditure were applied to cure unemployment of a type due, not to absence of jobs, but to failure of workers to move to places and occupations where they were needed, the policy of the Government would be frustrated and a dangerous rise in prices might follow". (Para 56)

And again,

> "None of the main proposals contained in this Paper involves deliberate planning for a deficit in the National Budget in years of sub-normal trade activity..." (Para 74)

> "...to the extent that the policies proposed in this Paper affect the balancing of the Budget in a particular year, they certainly do not contemplate any departure from the principle that the budget must be balanced over a longer period". (Para 77)

And so on.

It was the subsequent degeneration of so-called Keynesian policy that led to the appalling and deeply damaging holocaust of inflation in the 1970s - something which Keynes himself, the author of <u>A Treatise on Money</u>, would have regarded with horror. Nevertheless it is hard to deny that there is inflationary bias at the heart of the <u>General Theory</u>.

If it took some time for the overriding need for macroeconomic policy to be directed towards the suppression of inflation to dawn on me, I can only plead the fact that, in those days, the inflationary danger was less obvious. During the first 10 years after I went down from Oxford, for example, inflation in Britain oscillated about an average of barely 3 per cent, with no sign of any acceleration.

Instead, my growing disenchantment began with, on the one hand, distaste for the increasing tendency for Government intervention in the micro-economy, of which incomes policy, of which I was publicly critical right from the start, was perhaps the prime but by no means the only example; and, on the other hand, disappointment with Britain's overall economic performance compared with our major competitors - although here I was perhaps slow to spot that our most successful competitors were those whose policies were least influenced by Keynesianism.

Unlike most of the Keynesians, Keynes himself was of course a free-market man through and through. Indeed, one of the purposes of the General Theory was to demonstrate that unemployment could be conquered in the context of a free economy - something which many in the 1930s had come to doubt, just as many in the 1970s had come to doubt that inflation could be conquered in a free democracy.

But the turning point, for me as no doubt for many (though clearly not all) others, was when inflation began to take off in the late 'sixties. It then became clearly the pre-eminent economic challenge, as it has remained ever since.

I suppose the views I finally arrived at can be summarised in terms of two inter-connected reversals of the post-War conventional wisdom. The first is the conviction that the recipe for economic success is the greatest practicable market freedom within an overall framework of firm financial discipline - precisely how that financial discipline is best applied being essentially a second-order question, though clearly one of considerable practical and operational importance. This contrasts with the approach that culminated in the debacle of the 1970s, in which ever-increasing erosion of market freedom was accompanied by the progressive abandonment of financial discipline.

The second reversal is that which I set out in my Mais lecture in 1984. That is to say, instead of seeking to use macroeconomic policy to promote growth and microeconomic policy to suppress inflation - or the symptoms of inflation - we must direct macroeconomic policy to the suppression of inflation and rely on microeconomic (or supply side) policy to provide the conditions conducive to improved economic performance in terms of growth and employment.

I believe that any dispassionate observer must concede that, despite the problems that undoubtedly remain, the experience of the past eight years, and in particular the past five years, has vindicated this new (though in historical terms old) approach.

The budget deficit, even without the benefit of privatisation proceeds, has been more than halved, and real interest rates have consistently been historically high, while a succession of supply side reforms designed to allow the market to work better have been introduced.

The result has not merely been five years of low inflation - though it needs to be lower still - but a sustained period of growth at some 3 per cent a year that is almost unprecedented in British economic history and during which we have out-performed most of our principal competitors.

I mentioned earlier my concern that the <u>General Theory</u>, despite the fact that it is unquestionably a work of considerable substance which has profoundly influenced economic thinking throughout the world, and indeed despite Keynes's earlier works, embodies a somewhat cavalier attitude towards inflation. This is seen, for example, in the notion, implicit in the <u>General Theory</u>, that inflation is a useful way of curing unemployment by reducing real wages. This attitude was no doubt a product of the circumstances of the great slump in which the book was written. But it is shared, with no similar excuse, by those who advocate so-called Keynesian policies today.

It is not shared by this Government. Nor, indeed, is it shared by the British people, - otherwise I do not for a moment believe we would have been so convincingly re-elected to a third term of office. People know in their bones, now, not merely the immense economic and social harm that accelerating inflation is likely to inflict, but also how difficult and painful it is to bring it under control once it has been allowed to take off. Moreover, looking back, it must surely be clear that the success of so-called Keynesian policies in the 'fifties was not something that can now be repeated.

It is true that the exchange rate regime of Bretton Woods imposed a degree of financial discipline which prevented the excesses that were later to occur. But it is also, I believe, the case that for many years after the War we were living in a transitional phase: not only did money illusion persist for a considerable time, but even though financial discipline was gradually being eroded, people for some time behaved as if it were still in place - just as for some years after the restoration of financial discipline by the present Government, people behaved as if it were <u>not</u> there: hence to a considerable extent the high level of unemployment we have sadly experienced.

The papers presented at the Conference, which are published in this book, deal with this and other key questions which are of practical importance to me in the discharge of my responsibilities.

(1038/730/328)

psl/1A

CHANCELLOR'S INTRODUCTORY REMARKS TO THE KEYNES CONFERENCE, 15 SEPTEMBER 1987

I warmly commend the National Economic Development Office, and in particular their admirable Economic Director, Walter Eltis, for their enterprise in organising this Conference. It has clearly been carefully designed to illuminate most of the key issues which lie at the heart of macro-economic policy in the modern world, and Walter has assembled an impressive cast of economists to argue them out.

"The difficulty" wrote Keynes in his ~~Foreword~~ Preface to the General Theory, "lies, not in the new ideas, but in escaping from the old ones, which ramify, for those brought up as most of us have been, into every corner of our minds".

For most ~~of us here~~ today, I suspect, the ideas with which we were brought up were Keynesian ideas. Certainly that is true in my case, having read PPE at Oxford in the early 'fifties, with the endearingly eccentric Roy Harrod, Keynes's pupil and biographer, as my economics tutor.

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~~I shall not, I regret, be able to stay to listen to your discussions, but I have arranged to be given a full report of them. For you will be dealing with some of the key questions of practical importance to me in the discharge of my responsibilities, and I look forward to benefitting from your deliberations.~~

(P7)

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PLEASE NOTE EMBARGO

NOT FOR PUBLICATION, BROADCAST
OR USE ON CLUB TAPES BEFORE
2.30 pm GMT ON TUESDAY, 24 NOVEMBER 1987

24 November 1987

WORLD ECONOMY: THE NEXT STEPS

Attached is the text of a speech delivered today in London by the Chancellor of the Exchequer, the Rt Hon Nigel Lawson, MP to a meeting of the American Chamber of Commerce held jointly with the Canadian Chamber of Commerce.

PRESS OFFICE
HM TREASURY
PARLIAMENT STREET
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81/87

CHANCELLOR OF THE EXCHEQUER'S SPEECH

It is still only a little over five weeks since the worldwide stock market collapse. But that is not too soon to draw out some of the lessons, and consider the way forward.

What I want to do today, therefore, is to set out the steps that I believe need to be taken to keep the world economy on a course that avoids the twin dangers of recession on the one hand and renewed inflation on the other.

In large measure, the stock market collapse has simply been the inevitable correction of an unprecedentedly long and vigorous bull market which, like all bull markets, overreached itself. Despite the fact that both London and Wall Street have fallen as much as 30 per cent or so from their summer peaks, they are still no lower than they were a year ago.

But this collapse of confidence in the financial markets, however explicable in terms of a reaction to previous excesses, cannot fail to have some adverse effect on economic activity. Whether that effect is serious or not will depend, above all, on the way in which the governments of the major nations set about tackling the imbalances in the world economy with which the markets are now somewhat belatedly preoccupied.

To find the origins of these imbalances it is necessary to go back to the years prior to 1985, when the United States allowed its fiscal deficit to rise dramatically, far outstripping its own capacity to finance it out of its own domestic savings. It thus had to be financed by capital flows from overseas. And since the balance of payments always has to balance, the massive capital inflow was inevitably accompanied by an equally massive current account deficit. It was in this way that, within a few years, the United States turned an international creditor position built up over generations into that of a major international debtor.

At the same time, the markets pushed the external value of the dollar to ever dizzier heights, wholly divorced from economic fundamentals. As a result of all this, voices in the United States' Congress calling for the protectionist shutters to be put up became increasingly dominant.

It was primarily to meet this protectionist threat, and to deal with these imbalances, that the Finance Ministers of the five major industrial nations met in New York more than two years ago, and resolved to act together. We agreed to encourage a fall in the dollar against other major currencies. It did fall, very substantially. We agreed to resist the forces of protectionism. By and large, we have succeeded in doing so. And the United States accepted the urgent need to reduce its budget deficit. And it has reduced it, with the deficit for fiscal 1987 some $73 billion, or about a third below the deficit for fiscal 1986.

Thus when we met in Paris in February of this year, the decision to continue with the strategy - which also involved the surplus countries seeking to play their part in reducing the global imbalances by stimulating economic activity in their own countries - was taken against a background of sufficient adjustment to warrant fostering a period of exchange rate stability. Such stability, if attainable, provides a far better climate for world trade than a perpetuation of the wild gyrations in the dollar that had caused so much of the trouble in the first place.

The purpose of this necessarily brief account is to put recent events in context. The problem of the global imbalances had long since been identified and the policy prescriptions accepted. And considerable progress had been made.

But it was a slow process. Markets became restive and impatient. The US deficit was increasingly being financed, not by voluntary private flows of capital, but by central bank intervention, on a scale which was manifestly unsustainable. And the US authorities, too, were becoming impatient, and - provoked partly by events overseas - showed it, both in their comments on the Louvre accord and in their apparent unwillingness to allow interest rates to rise - a posture that seemed inconsistent, not merely with sustaining exchange rate stability, but even more fundamentally with attracting the funds needed to finance the deficit.

The fall in the financial markets was, in part at least, a reflection of fears of the breakdown of the common strategy on which we had embarked to reduce the imbalances. But in fact there is no other course that will solve that problem, without risking the twin dangers of recession and inflation. That is why it is important to seek to rebuild and reinforce that strategy.

The first pre-requisite, therefore, following the stock market collapse, was a renewed attack by the United States on its Budget deficit. I explained what was necessary, and why, in my speech at the Mansion House three weeks ago.

Accordingly, I warmly welcome the agreement that has now been reached. Secretary Baker had a difficult task in a pre-election year, and by dint of an enormous effort, to which I pay tribute, he has secured a successful outcome. I know that some have expressed disappointment about the size of the reductions, or their composition. But that overlooks what has been achieved: an agreement between the Administration and both parties in Congress to a package which includes cuts in all major spending programmes and increases in taxation - something that many once thought would be impossible. It is now up to Congress to complete the details and approve the package as soon as possible. Then the first major hurdle will have been overcome.

But there remain others.

The second hurdle is the need for the two big surplus countries, Japan and more particularly Germany, to commit themselves to further action to improve their economic momentum - and in the case of Japan, to open its markets more fully to imports. Precisely how they do this is, of course, a matter for them, so long as the action they take is adequate.

I believe it will be. It is encouraging, in particular, that the Bundesbank has already begun to acknowledge its own key role in the promotion of world economic stability with a modest reduction in short-term interest rates.

And then there is the third hurdle: the need, given appropriate economic policies, including the resolute avoidance of protectionism, to agree on concerted action designed to ensure a further period of exchange rate stability, albeit one that takes into account the decline in the dollar that has occurred so far. The alternative, a sharp further fall in the dollar, is not merely wholly unnecessary: it would be harmful to all concerned. For the United States, it would risk an upsurge in inflation and ultimately higher interest rates than any defence of the dollar stability would require. For the rest of the world, it would threaten a further dislocation to world trade and a further slowdown in economic activity.

Success in restoring stability will depend both on the pursuit of the right policies by deficit and surplus countries alike, and on their determination to give the necessary priority to maintaining stability, not simply by intervention, whose role, though important, is inevitably limited, but even more by the maintenance of appropriate interest rate differentials.

Interest rates in the United States will have to be set at a level that can both support the dollar and finance the deficit so long as it persists. That may well not mean higher interest rates now, but it does imply the readiness to act if and when the need arises. By the same token, surplus countries, and in particular Germany, will have to give more attention to world interest rate differentials, and monetary conditions in the industrialised world as a whole, in setting <u>their</u> rates.

The short point is this. International co-operation is the only sure way to keep the world economy on an even keel. The problems of the world economy, and in particular the persistence of current account imbalances, are unlikely to be solved if countries give overriding weight to domestic indicators of monetary policy to the exclusion of external indicators, any more than if they put short-term political objectives ahead of attention to economic fundamentals.

Ever since the dramatic worldwide collapse in the equity markets, I have made clear my view that, once the United States had completed its arrangements to reduce still further its budget deficit - and that of course includes the necessary Congressional approval - there should be an early meeting of the Group of Seven Finance Ministers and Central Bank Governors to work out a wider international agreement, in which Britain, of course, would play a full part. But let me be absolutely frank. There would be little point in holding a G7 meeting at all unless all those involved were prepared to contribute wholeheartedly to the stabilisation of the dollar. That is the third and final hurdle to be overcome.

I trust it will be. The world - and not least the United States - has suffered enough over the past ten years from huge swings in the external value of the dollar not to want to accept this as some kind of malign inevitability.

Of course, the approach I have outlined today will not produce overnight results. The correction of trade imbalances is bound to take time. And, indeed, the effect of the dollar fall over the past four weeks could well mean a further delay before the US trade balance shows a significant improvement - the notorious "J" curve. But given the right framework, I am confident that the innate resilience and dynamism of the US economy will make itself felt.

Nor, of course, is there any need for trade imbalances to disappear altogether. Indeed, since perfect current account balance throughout the world - even if the defective international statistics made that possible - would necessarily mean no net international capital flows at all, any such outcome is inherently improbable and certainly undesirable.

I have spoken so far of the major industrial nations of the world, who will be sitting round the table when the G7 meeting takes place. But there are others, too, who will have to be prevailed upon to play their part - Taiwan and Korea, in particular, who regard open markets abroad as their right, yet engage in widespread protection at home against imports from developed countries. Their economies are now too important to be lost beneath the radar screen. Taiwan alone, heavily protected, and with its currency closely linked to the dollar, now has a current account surplus of some \$20 billion - almost a quarter of its GDP, compared with around 4 per cent for Germany and Japan. And its foreign exchange reserves of \$65 billion are sufficient to cover as much as three years' imports.

On this issue, as on so many others, the United States and Europe have a common interest which will be best served by acting together. Meanwhile, I am confident that, provided those of us in positions of responsibility in the major nations of the world keep our heads and, together, pursue the right policies with patience and determination, there will be no question of a world recession.

It is fortunate that, given the difficult period we have now entered, the British economy is particularly well placed. We have the advantage that our Election is behind us, and not just in front of us, and has resulted in the return, with a large majority, of a Government whose commitment to sound finance and business success is not in doubt. And on the economic front, the public finances are exceptionally strong, and the economy itself is in robust health, with business confidence high, and investment intentions unimpaired, as yesterday's CBI monthly inquiry, based on a survey taken <u>after</u> the stock market fall, has clearly demonstrated.

There is, of course, a clear link between sound public finances and a strong economy. But even now, there are some who do not seem to appreciate what it is.

When I last had the pleasure of addressing the American Chamber of Commerce, shortly after my 1985 Budget, I mentioned the pressure I was then under from some quarters to borrow more money and spend more, so as to boost demand in the economy and achieve faster growth and more jobs.

That pressure was nothing new. Ever since we first began to reduce Government borrowing, we had been assured that this would remove any possibility of achieving growth and reducing unemployment. We rejected that advice, and have reduced Government borrowing steadily. As a result, this year, even if we had not had any privatisation proceeds at all, it looks as if the public sector borrowing requirement would have been as low as $1\frac{1}{2}$ per cent of GDP. With privatisation proceeds, it is down to only one quarter of one per cent of GDP.

I do not need to theorise about the benefits that have been brought by this policy, coupled as it has been with a readiness to keep interest rates at whatever level is necessary to curb inflation, and supply side measures to free up markets and break down rigidities. The facts speak for themselves. We are in our seventh year of steady growth. Inflation remains low. And over a million and a quarter more jobs have been created since 1983 - more than in the rest of Europe put together.

Growth this year has been particularly rapid, and looks like turning out at 4 per cent, faster than any other major industrial country. But this is no flash in the pan. Growth in the UK has been above 3 per cent in three out of the last four years.

The current year has also seen a welcome fall in unemployment. In spite of the rapid growth in the number of jobs, unemployment in Britain continued to rise, albeit modestly, until June of last year. But since then it has fallen dramatically - faster than at any time since the War, and faster than in any other major industrial country. And all regions, not just the South-East, are sharing in this welcome progress.

Peering into the future is a particularly tricky business at the moment. But I see no reason why the pattern of steady growth, low inflation, and falling unemployment should not continue.

The plain fact is that the British economy is sounder than it has been since the War. Not only are the public finances strong. Britain's industrial performance has been transformed.

Productivity in manufacturing industry has shot up during the 1980s after a dismal performance in the 1960s and 1970s, rising faster than in any other major nation, even including Japan. Industrial relations have improved out of all recognition. Business profitability has improved for five years in succession - the best performance for more than a generation. And after decades of decline, British manufacturers are successfully maintaining their share of expanding world trade.

In one sense, I may be preaching to the converted, because many of you here today are here <u>because</u> you have invested in Britain. Out of 322 new foreign investment decisions made in the UK last year, over half were made by US companies. I understand that 96 of the Fortune top 100 American manufacturing companies have investments in the UK. That form of endorsement is worth far more than mere words.

When I spoke to you last time, we had just seen the end of a year-long coal strike - a trauma which would once have thrown the economy right off course, but which we were able to take in our stride. Since then, the oil price has collapsed - and again, although a major oil-exporting nation - we have taken it in our stride. Just as we have taken in our stride the sharp rise and fall of the dollar over the past four years. So I am confident that we can equally take the current world difficulties in our stride.

The task over the coming weeks is to agree on the right solution to those difficulties, and to co-operate in implementing that solution. I can assure you that this country will play its full part.

P7

Sir T. Burns 11/8/2

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10 PM ON FRIDAY, 11 DECEMBER 1987

11 December 1987

CHANCELLOR SPEAKS TO CBI WALES

The Chancellor of the Exchequer, the Rt Hon Nigel Lawson MP, spoke to members of the Confederation of British Industry, Wales, in Cardiff today (11 December).

The text of the speech is attached.

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90/87

CHANCELLOR OF THE EXCHEQUER'S SPEECH TO CBI WALES, 11 DECEMBER 1987

1987 has been a further year of achievement for the British economy. Growth looks like turning out at 4 per cent, ahead of the already strong performance of recent years, and faster than not only any other major European country, but the United States and Japan too. Manufacturing industry is leading the way, with output up 6 per cent, and exports up no less than 11 per cent, comparing the latest three months with the same period in 1986. And unemployment has fallen rapidly, by 50,000 a month over the past six months, at a faster rate than any other major country.

In the past, periods of rapid growth such as we have experienced these past five years invariably led to a resurgence of inflation, which more often than not choked off the growth. But this time, although prices this year have risen faster than last year as the one-off benefit of the oil price fall has been lost, inflation has remained low throughout. And the news today, that the RPI rose by 4.1 per cent in the year to November, means that inflation is lower than it has been for the past six months, and in line with the forecast I made at the time of the Budget that inflation in the fourth quarter of the year would be around 4 per cent.

The Transformation of the Welsh Economy

A number of the reasons for the new strength of the British economy are well illustrated by what has happened to Wales during the 1980s.

There is a stereotype view of the Welsh economy: coal, steel, and heavy industry in the South; sheep and mountains in the North. Like most stereotypes, it was only, at best, a rough approximation to the truth. And now it is downright misleading.

The plain fact is that the Welsh economy has been transformed. It now has a wide range of new and forward-looking industries, attracting new investment at home and overseas, and rapidly creating more jobs.

The Welsh economy went through a difficult period of adjustment in the early 1980s, which for some people was little short of traumatic. But the older industries on which parts of Wales had traditionally depended for employment were, and in most cases still are, under pressure in all the advanced industrial countries. The worldwide overcapacity, the increasing competition from the newly industrialising countries, and the consequent need to become more efficient, meant shedding jobs and investing in labour-saving technology.

The traditional industries were particularly hard hit by the world recession of 1979-81. In Britain, this finally exposed problems of overmanning and inefficiency that had been concealed for years, as governments had tried, against the odds, to shore up the old industries.

Everyone now accepts that this was misguided. Governments cannot stand in the way of industrial change. That simply makes the problem of adjustment worse when it finally, and inevitably, takes place. The only sensible approach has to be to help the older industries to adjust to the new environment, while above all creating the conditions in which new firms, new industries, and new jobs can come through.

That has been our policy. And the results are there for all to see.

The steel industry is in incomparably better shape than it was only a few years ago. In the case of the British Steel Corporation, the turnround has been reflected in the latest half-year figures, announced last week, which showed a profit of £190 million, and in our decision to return the company to the private sector as soon as practicable. Welsh steel plants have made a big contribution to this success, and Llanwern and Port Talbot - the two largest plants in the UK - are now acknowledged to be among the most modern and efficient steelworks in Europe.

At the same time, new industries and new businesses have set up in Wales, making for a much more broadly based economy. Let me take just a few examples. There has been a rapid increase in the number of firms producing electrical components. The first compact disc producer in the UK, Nimbus Records, was set up in Wales. No fewer than 36 biotechnology companies have sprung up in recent years. And the tourist industry is steadily expanding.

One sure sign of the vitality of an economy is the number of new businesses being created. The number of self-employed people in Wales has gone up by more than one-third since 1981, and now stands at nearly 14 per cent of the working population, a higher proportion than anywhere else in the United Kingdom.

Much of the new Welsh prosperity comes from local firms - companies like Laura Ashley and A B Electronics. But Wales has also attracted substantial inward investment - one-sixth of the total for the UK as a whole, in recent years, for a country with one-twentieth of the population.

The Japanese have been particularly prominent, and Wales has the greatest concentration of Japanese manufacturing units in Europe. In the last three weeks alone, three new Japanese firms have decided to come to Wales, and only today an existing Japanese firm announced its decision to increase its investment substantially.

There are now over 250 overseas-owned manufacturing plants in Wales, accounting for about one in five jobs in manufacturing. Indeed, overseas companies now provide more jobs than coal and steel put together.

These companies have been attracted because they have confidence in Wales as a place to do business, where they can invest successfully and make profits. Communications are important. South Wales already has good rail and road links with London and the South East, and the Government has recently appointed consultants to work on a scheme for the proposed second Severn crossing; and North Wales is close to the major conurbations of North West England.

Japanese firms, in particular, speak highly of the quality of the workforce in Wales. In a survey last year, six out of ten companies said that productivity was as good or better than in Japan, and nine out of ten had not lost a single day from strikes since 1980. These qualities matter far more than any amount of Government assistance.

The new vitality of the Welsh economy has led to a rapid fall in unemployment. Over the past 18 months, unemployment has fallen at a faster rate than anywhere else in the country. Seasonally adjusted unemployment in Wales is at its lowest level for 5½ years. And in most cases, these jobs are completely new jobs, in new firms or new ventures.

In short, Wales has developed rapidly from the traditional base it still had ten years ago to a diversified economy with a wide range of industries, and a high proportion of small businesses and self-employed people. The change in the nature of the economy has meant changes in the physical environment, too, with the old pit wheels disappearing, and brand new factories replacing them. Towns and cities, too, have been modernised, and the important and exciting Cardiff Bay development project will enhance that process here.

The latest indications suggest that the Welsh economy is set to continue the excellent progress of recent years. Industrial production in the second quarter of this year was 5 per cent higher than a year ago. Factory allocations by the Welsh Development Agency last year ran at record levels. And your own CBI Quarterly Survey, published in October, showed business optimism at a high level, with orders and output expected to rise.

The Outlook for the World Economy

The 1980s, and 1987 in particular, have thus been a period of remarkable success for the British economy. What we now have to do is to build on that success.

There are some people who always assume that the worst is going to happen, so that, whatever turns out, it must be better than they expected. And more important, there are still many professional economic pundits who seem to be constitutionally incapable of accepting that the policies of sound money, low budget deficits, and free markets, which have been increasingly followed by most major countries in the 1980s, have led to the five years of steady growth and low inflation which the world economy has now enjoyed. They have seized on every hiccup to suggest that growth is about to disappear, that all budget deficits need to be expanded to sustain it, and, in general, that they were right all along. Now they have seized on the worldwide stock market collapse and claim it to be the harbinger of world recession.

But the plain fact is that there is no evidence whatever to support this gloomy prognosis. Most concern has focused on the United States, where all the evidence suggests that the US economy is growing strongly. Real GNP in the 12 months to the third quarter of this year grew by some 3 per cent and industrial production by nearly 5 per cent. Unemployment is at its lowest level since 1980. Yesterday's record US trade deficit also suggests a rapid growth in domestic demand.

Growth in Japan, the world's second largest economy, is also strong, after a pause in 1986. Industrial production has increased particularly sharply since the spring, and is now some 6 per cent higher than a year ago. The Canadian economy, too, is buoyant. And although the picture in parts of continental Europe, particularly in Germany, is much less encouraging, continued modest growth is expected.

As far as the UK is concerned, the latest figures show output continuing to grow strongly. In the Autumn Statement, while acknowledging all the uncertainties, I forecast that growth next year would run at 2½ per cent, with the non-oil economy growing at 3 per cent. Certainly this will be slower than this year's outstanding performance. But it is absurd to equate this slowdown with a danger of recession. 3 per cent growth is higher than was ever achieved in the 1970s, with the sole exception of 1973, and should bring about a further fall in unemployment.

International Cooperation

Let me be quite clear. I do not underestimate the risks to the continued health of the world economy. Although there is no evidence of impending recession, the stock market collapse is likely to lead to some slowdown of growth next year. And there are major imbalances in the world economy, particularly in the United States, which clearly need correction.

That is why the governments of the Group of Seven countries have already taken a number of steps to keep the world economy on an even keel.

The United States Administration, and representatives of both parties in Congress, have reached an outline agreement on a package of measures to reduce the budget deficit, and we now look to them to pass the necessary legislation this side of Christmas.

The German authorities have taken steps to speed up economic growth. Last week, they announced a new package of investment measures to add to the tax cuts due to come into force on 1 January, and the Bundesbank cut its key discount rate from 3 per cent to 2½ per cent, the lowest rate for nearly thirty years. This was part of a concerted move by most European countries: we led the way with a ½ per cent cut - on top of the one per cent cut we had already made since mid-October - and France and other countries followed suit.

These are significant steps. For some years now, there has been agreement that, to reduce the imbalances in the world economy, the United States would have to cut its budget deficit, and the surplus countries would need to take action to boost domestic demand, so that faster growth there would offset any slowdown in the US. The events of recent weeks show that countries are prepared to back their commitments with the necessary action. And this action has been taken as a result of close international co-operation.

But there is one remaining hurdle. That is the need to reach an international agreement to secure a further period of exchange rate stability, and in particular to stabilise the dollar.

The world has seen the effects of the period of dollar instability in the early 1980s, when the dollar rose substantially against the deutschemark and the yen, and continued to rise, even at a time when everybody agreed that it was seriously overvalued. This was one of the principal causes of the massive trade imbalances.

That has since turned round dramatically, and the danger we now face is a dollar undershoot. This would be equally harmful, leading to inflationary pressure in the United States; a further dislocation to world trade; and a dampening effect on confidence and hence on economic activity in the rest of the world. The supposed benefits are, I believe, illusory; not least because continued dollar depreciation is no guarantee at all of a speedy turnround in the American current account deficit . US exports are already growing fast and what is really needed is action to complement that by a dampening of domestic demand which in turn would reduce the growth of imports.

Moreover, exchange rate stability provides the best background for maintaining confidence. That is why we must work to achieve it. If we can do so, and can also avoid the greatest danger of all - protectionism - we shall have put in place the policy measures needed to keep the world economy on a track that avoids both recession and inflation.

Government and Business

The British Government has played its full part in international co-operation, and we shall continue to do so. And in our domestic policy, we shall continue to provide a climate in which businesses can succeed, as we have consistently done throughout our time in office. A climate in which inflation is low, markets are free, exchange rate volatility is minimised, and taxation is reduced.

But governments can only do so much. The transformation of the British economy in the 1980s has been due, in large measure, to the success of British managers in improving products, increasing efficiency, and harnessing the energies of their workforce. And the job of building on success depends equally on managers and the workforce.

The world becomes more, and not less, competitive. We cannot afford to rest on our laurels. Getting ahead and staying ahead entails looking to the future: more investment, more research and development, and more attention to training the workforce.

I know that the CBI quite rightly attaches great importance to education and training. Your education initiative will play a valuable part in complementing the reforms which are currently before the House of Commons to improve educational standards. We have also recently announced a rationalisation and improvement of Government training for the long-term unemployed.

But it is for industry, not for Government, to undertake training for specific skills: you know what skills you will need, and you can organise training accordingly. Those who complain of the shortage of skilled workers should ask themselves what steps they themselves are taking to ensure they have the skilled workforce they need in the years that lie ahead.

This is a time of great opportunity for British businesses. You have a background of steady growth and low inflation. You have achieved five years of steadily rising profitability - the best performance for a generation. You have made yourselves again respected in the world. And you have, for the foreseeable future, a Government that is firmly committed to your success.

That is a solid foundation on which to build. And while the stock market collapse may not help, it should not throw you off course. Provided governments take the right steps - and I believe that for the most part we have done, and will continue to do - there is no reason to fear recession.

The reborn confidence of British business and industry is well-founded, and we must see to it that it is the springboard to our further success.

Conclusion

In the past, one of our less endearing qualities as a nation has been to look on the gloomy side of things, and to underplay our own achievements.

I am glad to say that that is not what I sense today in Wales. You could not have achieved the signal success of revitalising the Welsh economy and, in particular, attracting so many overseas companies here, by presenting a face of gloom and doom. There is a new pride and a new confidence. And these are the qualities that are needed as we look forward to 1988 and beyond.

(P7)

FROM: A P HUDSON

DATE: 16 December 1987

MRS LOMAX

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Scholar
Mr Odling-Smee
Mr Culpin
Mr Pickford
Mr R I G Allen
Mr Ilett
Mr A C S Allan
Mr Neilson
Mr Blower
Mr Cropper
Mr Tyrie
Mr Call
Mr N Forman MP
Mr Norgrove No.10
Mr Footman (Bank)

CHANCELLOR'S SPEECH AT STOCK EXCHANGE CHRISTMAS LUNCH: FINAL VERSION

... I attach the final version of the speech. Many thanks to you and all in FIM who contributed.

APH

A P HUDSON

CHANCELLOR'S SPEECH AT STOCK EXCHANGE CHRISTMAS LUNCH, 16 DECEMBER 1987

At this lunch, two years ago, we were looking ahead, with a mixture of excitement and apprehension, to the Big Bang of October 1986.
At this lunch, a year ago, some were wondering what great event could be organised to mark the first anniversary of the Big Bang in October 1987.
Now we know.
Not perhaps the event we would have chosen.
But we should have realised that we could rely on dear old market forces to do the thing for us.
I understand there is no truth in the rumour that you are to follow your two best sellers, English Barometers 1680-1860, and Ormolu: The Work of Matthew Boulton, with a slim volume of memoirs entitled 'From Bang to Crash'.

One of the problems of a sharp fall in business, such as has accompanied the sharp fall in prices, is that it gives market participants time to engage in speculation of a non-pecuniary nature.
If anything, an even more hazardous occupation.

Much current speculation is about what the markets are trying to tell us - what is their message?
I think the message of the markets is clear.
It is that they were far too high three months ago.
What I find more puzzling is what the markets were trying to tell us three months ago.

Certainly, the fall was unusually sudden.
But I wouldn't want to draw any profound conclusions from the fact that virtually the whole of the 27 per cent fall in equity markets over the past two months occurred in the first two weeks.

What is perhaps more striking is the further evidence recent events have provided that we are now in an era of global markets.

Not that the share prices have moved in exactly the same way in every market.

A lot depends on what your base date is.

But if you compare equity prices now with a year ago - a conventional statistical comparison - it shows both London and Wall Street standing almost exactly where they were a year ago, but the less liquid markets of Continental Europe down some 30 per cent over the same period.

But it is scarcely surprising that, in an era of global markets, nations tend to move together to a considerable extent.

The great trend of our times towards globalisation - with all its risks and opportunities - was, of course, formally recognised here with the formation of the International Stock Exchange in 1986; and you have been adjusting to this sea change ever since - and are continuing to do so.

Indeed, this is admirably epitomized by the attendance at today's lunch, and I welcome those from overseas firms who are here for the first time.

For the City of London has not only consolidated its position as the undisputed financial centre of Europe: it is, in many areas, the number one financial centre in the world.

No firm with any aspiration to be a major player on the world financial scene can afford not to have a significant presence in London.

That doesn't mean, of course, that we aren't equally keen to see British firms spreading their wings in the major financial centres overseas.

I welcome today's announcement by the Tokyo Stock Exchange that it will shortly be admitting to its membership Barings, County NatWest, Kleinworts, and Schroders (the order is alphabetical).

And I have to say to our Japanese friends that there are other UK firms who would also like a fair crack of the whip, so I trust there will be a further round of licences before too long.

Meanwhile, I am confident that London will demonstrate - as indeed, by and large, it has since mid-October - that in foul weather as well as fair, it can lead the world.

And it will do so as part of an economy that is in very good shape, and I am determined that will remain so.

All the evidence that has emerged since the equity collapse in October has confirmed that so far from there being any incipient signs of recession, the British economy is moving ahead even more strongly than was previously realised.

And although our performance has been well above the world average, that is also true for the world economy.

Some slow down in growth next year would not be surprising, but it is a slow down from a more vigorous expansion that we thought we had - certainly no recession.

And just as growth will continue, so will this Government's commitment to wider share ownership, whether through privatisation - with British Steel now added to the list - or in other ways.

The appetite for share ownership that we have demonstrated exists among the people at large in this country is no mere ephemeral product of the longest bull market in history.

It is a permanent feature of immense social importance with potential for further growth.

You have only to walk and talk on the shop floor of a company whose employees hold shares to sense that - even now.

So I offer you as a New Year's resolution - particularly now that you have so much more time to think - a determination to find ways of serving this new market of the future even better than you do today.