

PO-CH/NL/0075
PART C

Part C.

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Begins: 1/11/84
Ends: 21/12/84.


PO -CH /NL/0075

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PART C

Chancellor's (Lawson) Papers:

**MINISTERIAL SPEECHES AND
SPEAKING ENGAGEMENTS FOR
1984**

Disposal Directions: 25 Years

Phelan
28/7/95



FROM: A M ELLIS
DATE: 1 NOVEMBER 1984

PS/CHANCELLOR

C For your
clearance by 10am
Friday morning if possible.
Puo

Looks OK PWP
cc Mr Fitchew
Mr Mortimer
Miss Simpson
Mr Ridley
Mr Portillo

SPEECH TO SELSDON GROUP ON 2 NOVEMBER

The Economic Secretary proposes to release the attached extracts from his speech to the Selsdon Group on the European Budget which he is making at 4.15 tomorrow afternoon. It would be released through Central Office.

2. He would be grateful for the Chancellor's approval for the release.

A M ELLIS

Ian Stewart MP for Hertfordshire North and Economic Secretary to the Treasury, in a speech to a conference held by the Selsdon Group this afternoon said:

Shortly after the UK joined the European Community the Labour Government made great play of renegotiating the terms of our membership and held a referendum in 1975. It is difficult not to conclude that the renegotiation was a charade designed merely to carry the referendum and to dish the Labour anti-marketeters. In terms of limiting the payments that the UK made to the Community Budget, it was useless. Harold Wilson had told the House of Commons in March 1975: "The arrangements which the Community has now agreed would, if Britain remains a member of the EEC, give us an assurance of the repayment of hard cash if we found ourselves in the future paying an unfair share of the Community Budget." Not a single penny did we get as a result. In 1978 and 1979, the last two years for which Labour was responsible for our contribution to the European Budget, the figures were at record levels. Reckoned in today's money, in each of those years our net contribution was about £1,500 million, and the 1975 so-called renegotiation left us with no mechanism to gain redress.

So when the Conservatives came back to power in 1979 the problem was acute and urgent. For the next four years we managed to negotiate total net refunds of some £2,500 million. The last of this series of refunds, those for 1983, encountered every kind of obstacle. But that long running saga is now at last concluded. The refund has been paid, the cheque received, the money banked.

In future, we shall have a 66 per cent rebate of our net contributions each year, which will be deducted from our payments and not refunded to us through the European Budget. So we will get the reduction automatically. This is undoubtedly one of the main achievements of Fontainebleau. The snag with the old system of refunds was that it involved the Community in untold wrangling every year, not only with other member states but also with the European Parliament, which repeatedly blocked our 1983 refunds this year although

they had been agreed by the Council of Ministers and the European Commission.

But the Community had to go to the very brink of insolvency before the Fontainebleau agreement became possible. And there still remain a number of outstanding questions to resolve. One of the most important of these was to cope with the overrun of expenditure in the transitional period before the new system comes into operation with increased own resources.

For 1984 the Commission originally suggested that a very large sum of extra finance would be needed, some 2.3 billion ecu or about £1,360 million. By tough negotiation we have been able to get that figure down by more than half, to about £600 million, or 1,003 million ecu. But the European Parliament wanted to increase it again by almost half, to 1,476 million ecu. Almost incredibly, the British Labour Group voted for this increase. The clear implication must be that, much as they mistrust the Community, the Socialist passion for Government expenditure of any sort is still a more powerful emotion. Fortunately, the 1,003 million ecu limit remains. And we have made it quite clear that Britain will not contribute its share until plans for budget discipline have been agreed, so that expenditure does not continue to run out of control in future.



FROM PAUL PEGLER

DATE: 1 November 1984

MR MAKEHAM

(Paul)

*Amid on 2/11, too
late to be shown
to Chancellor*

MOT

2/11

cc: PS/Chancellor
PS/FST
PS/EST
Sir P Middleton
Sir T Burns
Mr Littler
Mr Battishill
Mr Lavelle
Mr R I G Allen
Ms Conn
Mr Culpin
Mr Folger
Mr Hall
Mr Mowl
Mr Kelly
Mr Halligan
Mr Palmer
Mr Watts
Mr Bosely
Mr Ridely
Mr Lord
Mr Portillo
Mrs Borowski
(Industry)
Dept for
Scotland

CHIEF SECRETARY'S SPEECH TO SCOTTISH COUNCIL, 2 NOVEMBER

I attach a final version of the speech which the Chief Secretary will make at Aviemore tomorrow morning.

PAUL PEGLER

Assistant Private Secretary

SPEECH BY THE RT HON PETER REES, QC., MP.,
CHIEF SECRETARY TO THE TREASURY,
IN AVIEMORE ON - FRIDAY, 2 NOVEMBER 1984

INTRODUCTION

I CONGRATULATE THE COUNCIL ON THE CHOICE OF SUCH
A CHALLENGING, STIMULATING THEME. I ALSO CONGRATULATE THEM
ON THE CHOICE OF AVIEMORE FOR THE SITE OF THIS CONFERENCE.
IT IS ALWAYS REFRESHING TO HAVE THE OPPORTUNITY TO VIEW
DEVELOPMENTS FROM A SCOTTISH PERSPECTIVE. WHETHER IT BE THE
CLARITY OF THE AIR OR THE WARMTH OF SCOTTISH HOSPITALITY I
DO NOT KNOW, BUT CLEARLY THERE HAS BEEN A MOST STIMULATING
EXCHANGE OF EXPERIENCE AND VIEWS.

2 CHANGE HAS BEEN AN ESSENTIAL THEME OF THIS FORUM. AS
HERACLITUS SAID IN 500 BC "NOTHING IS PERMANENT BUT CHANGE".
I SUSPECT THAT THE PACE OF CHANGE IS FASTER NOW THAN WHEN
HE WROTE. BUT OF COURSE EVERYTHING IS RELATIVE.

3 I HAVE BEEN INVITED BY THE COUNCIL TO REFLECT WITH YOU
ABOUT THE CHANGES WITHIN THE FINANCIAL SECTOR AND THE ROLE

OF THE FINANCIAL SECTOR AS AN AGENT OF CHANGE. CLEARLY THIS IS A QUESTION TO WHICH WE MUST ADDRESS OUR MINDS SINCE FINANCIAL SERVICES ARE A SIGNIFICANT FORCE WITHIN OUR ECONOMY. THEY CONSTITUTE 14 PER CENT OF GDP IN ENGLAND IN 1982 AND 11 PER CENT IN SCOTLAND. IN CASE ANY CONCLUSIONS SHOULD BE DRAWN FROM THIS DIFFERENCE, I SHOULD SAY THAT I SUSPECT THAT IS DUE TO THE GREATER WEIGHT ATTACHED TO AGRICULTURE AND TO OIL IN THE SCOTTISH ECONOMY. AGAIN TO PUT THESE FIGURES IN THEIR TRUE PERSPECTIVE THE SERVICE SECTOR AS A WHOLE PROVIDES ABOUT HALF OF THE UK GDP. I HOPE THAT IN GIVING THAT STATISTIC I SHALL NOT BE ACCUSED OF PARTIALITY TO ANY PARTICULAR FORM OF ECONOMIC ACTIVITY. I MERELY WANT TO STATE THE FACTS.

HISTORIAL PERSPECTIVE

4 IF WE STEP BACK FOR A MOMENT AND TAKE A LONG HISTORICAL PERSPECTIVE THEN WE FIND THAT THE SERVICE SECTOR HAS ALWAYS BEEN AN IMPORTANT SOURCE OF EMPLOYMENT. IN 1841, FOR EXAMPLE, IT PROVIDED EMPLOYMENT FOR 27 PER CENT OF THE WORKFORCE. ITS IMPORTANCE INCREASED OVER THE YEARS. IN 1911 IT PROVIDED EMPLOYMENT FOR 36 PER CENT, IN 1931 FOR 49 PER CENT AND IN 1982 FOR 63 PER CENT.

5 SIMILAR TRENDS ARE OF COURSE APPARENT IN OTHER INDUSTRIALISED COUNTRIES. IN ALL, THE EMERGENCE OF THE SERVICE SECTOR IS NOT A RECENT PHENOMENON. NOR IN FACT IS IT NECESSARILY A SYMPTOM OF A DECLINE IN MANUFACTURING. IN FACT THE DEVELOPMENT OF SERVICES AND MANUFACTURING HAVE BEEN INTERTWINED.

6 THE DEVELOPMENT OF FINANCIAL SERVICES IN THE PAST IS MUCH HARDER TO TRACE AS THE DEFINITION HAS CHANGED GREATLY OVER TIME. WHAT WAS CALLED "COMMERCIAL OCCUPATIONS", COVERING DISTRIBUTION AND FINANCE, MADE UP 1 PER CENT OF THE WORKFORCE IN 1851, NEARLY 3 PER CENT BY 1881 AND NEARLY 8 PER CENT BY 1921.

7 I BELIEVE THAT THE KEY TO THE DEVELOPMENT OF THE FINANCIAL SERVICE SECTOR HAS BEEN ITS FLEXIBILITY, ITS ENVIABLE CAPACITY TO ADAPT TO CHANGES IN THE ECONOMY.

LET ME INSTANCE THE EVOLUTION FROM PRIVATE BANKS TO JOINT STOCK BANKS FOLLOWED ULTIMATELY BY THE DEVELOPMENT OF PENSION FUNDS, INSURANCE COMPANIES AND BUILDING SOCIETIES.

LET ME INSTANCE THE DEVELOPMENT OF NEW SERVICES. IT MAY BE HARD TO RECALL THAT THERE WAS A TIME IN THE LAST CENTURY WHEN FOREIGN EXCHANGE BUSINESS WAS REGARDED AS A NOVELTY. AT THE RISK OF STOKING THE FLAMES OF CONTROVERSY I RECALL THAT IN THE 1870s LONDON BANKERS WERE COMPLAINING ABOUT THE NEW PERNICIOUS PRACTICE OF SCOTTISH BANKS IN ACCEPTING FOREIGN BILLS.

8 LET ME INSTANCE THE TIMELY RESPONSE OF THE MONEY MARKETS, THE STOCK MARKET AND THE INSURANCE WORLD TO THE NEW DEMANDS PLACED UPON THEM, INVOLVING INEVITABLY CHANGES IN TIME HONOURED BUSINESS PRACTICE.

9 FINANCIAL INSTITUTIONS HAVE ALWAYS BEEN AMONG THE FIRST TO CAPITALISE ON IMPROVEMENTS IN TRANSPORT AND COMMUNICATIONS. I SEEM TO RECALL THAT THE FIRST ROTHSCHILDS TO COME TO LONDON DEPENDED IN PART FOR THEIR SUCCESS DURING THE NAPOLEONIC WARS TO THE PIGEON POST. LATER IN THE 19 CENTURY THE COMING OF RAILWAYS, STEAM SHIPS, CABLE AND WIRELESS TELEGRAPHY REVOLUTIONALISED THE COURSE OF BUSINESS. TODAY WE ARE CAUGHT

UP IN ANOTHER REVOLUTION. ANGUS GROSSART'S PAPER POINTS OUT THE WAY IN WHICH IMMEDIATE INFORMATION ON ALL THE MAJOR CAPITAL AND FINANCIAL MARKETS CAN NOW BE MADE AVAILABLE TO THOSE WHO NEED IT.

CENTRAL DEBATE: MARKET V STATE

10 OF COURSE CHANGES IN THE STRUCTURE OF THE ECONOMY HAVE NOT PROCEEDED INDEPENDENTLY OF GOVERNMENT. THE POST-WAR PERIOD IN PARTICULAR HAS SEEN A HUGE INCREASE IN STATE INTERVENTION: DIRECTLY, THROUGH NATIONALISATION AND THE INCREASE IN STATE ACTIVITIES; INDIRECTLY THROUGH A WEBB OF CONTROLS, REGULATIONS AND FISCAL BURDENS AND INCENTIVES. IT MUST BE A MATTER FOR DEBATE WHETHER THIS PERIOD HAS RUN ITS COURSE. SPEAKING FROM ADMITTEDLY A PARTISAN POSITION I WOULD ASSERT THAT IT HAS.

11 AT THE RISK OF SOUNDING STRIDENT I WOULD ASSERT THAT ONE REASON AT LEAST FOR OUR COMPARATIVELY POOR INDUSTRIAL PERFORMANCE SINCE THE WAR HAS BEEN THE FACT THAT THE INVISIBLE HAND OF THE MARKET HAS ALL TOO OFTEN BEEN OBSTRUCTED AND

RESTRAINED BY THE VERY VISIBLE HAND OF GOVERNMENT. THE ROLE OF MARKET FORCES AS OPPOSED TO STATE INTERVENTION LIES AT THE VERY HEART OF SO MUCH POLITICAL DEBATE.

12 I CAN HARDLY CONCEAL WHERE I STAND ON THIS. I FAVOUR RELIANCE ON MARKETS AND ON CHOICE. MARKETS GIVE THE QUICKEST SIGNAL TO BUSINESSMEN AND OTHER DECISION MAKERS. INTERFERENCE WITH THE FREE OPERATION OF THE MARKET SUPPRESSES THESE SIGNALS AND PREVENTS THE EXPRESSION OF THESE PREFERENCES. WE DISCLAIM THE AMBITION TO KNOW BETTER THAN THE SUPPLIER AND THE CUSTOMER WHAT BEST BEFITS THEIR NEEDS. THAT SAID, WE DO OF COURSE RECOGNISE THAT GOVERNMENTS HAVE A ROLE. THEY SET THE FINANCIAL FRAMEWORK. THEY HAVE A DUTY TO FOSTER COMPETITION, TO PREVENT THE ABUSE OF MONOPOLY POWER AND TO PROVIDE PROTECTION FOR INVESTORS.

13 THE WHOLE THRUST OF OUR POLICY OVER THE PAST FEW YEARS AND I DARE FORECAST OVER THE REST OF THIS PARLIAMENT IS TO MAKE MARKETS WORK AND TO WORK BETTER. IN THIS FORUM I SHALL CONCENTRATE ON WHAT HAS HAPPENED IN THE FINANCIAL SECTOR.

FINANCIAL SECTOR

14 WITHOUT I HOPE SOUNDING AT ALL COMPLACENT - BECAUSE MUCH MORE REMAINS TO BE DONE - LET ME REMIND YOU OF THE WIDE RANGE OF LEGISLATIVE CONTROLS AND OTHER DISTORTIONS WHICH HAVE BEEN ABOLISHED BY THIS GOVERNMENT: WE ABOLISHED FOREIGN EXCHANGE CONTROLS IN 1979. ONE OF THE FIRST AND I DARE SAY ONE OF THE MOST IMPORTANT MEASURES UNDERTAKEN BY THIS GOVERNMENT. THE UNITED KINGDOM NOW HAS ONE OF THE MOST LIBERAL SYSTEMS IN THE WORLD. WE ABOLISHED DIVIDEND CONTROLS ALSO IN 1979 SO GIVING COMPANIES THE RIGHT TO PURSUE THEIR OWN DISTRIBUTION POLICIES AND ELIMINATING A DISTORTION FROM CAPITAL MARKETS. SIMILARLY CONTROLS ON BANKS' BALANCE SHEETS, THE SUPPLEMENTARY SPECIAL DEPOSITS SCHEME, WERE ABOLISHED IN 1980. HIRE PURCHASE CONTROLS WERE ABOLISHED IN 1982. THIS FORM OF CREDIT NOW COMPETES IN EQUAL TERMS WITH, FOR EXAMPLE, BANK LOANS. THE TAX SYSTEM HAS A GREATER MEASURE OF NEUTRALITY - THOUGH MUCH MORE REMAINS TO BE DONE. FOR EXAMPLE, THE LAST FINANCE ACT ACHIEVES, I HOPE, A GREATER PARITY IN THE TAX TREATMENT OF BANKS AND BUILDING SOCIETIES.

15 BUT I EMPHASISE AGAIN THAT MORE REMAINS TO BE DONE AND MORE WILL BE DONE DURING THIS PARLIAMENT. WE SHALL, FOR EXAMPLE, BE TAKING THE FINAL STEP TO PERMIT THE TRUSTEE SAVINGS BANKS TO DEVELOP INTO FULLY FLEDGED PRIVATE SECTOR BANKS. WE SHALL MAKE KNOWN SHORTLY OUR CONCLUSIONS ON THE GREEN PAPER ON BUILDING SOCIETIES PUBLISHED IN JULY OF THIS YEAR, WITHOUT TURNING THEM INTO A SOURCE OF FUNDS FOR COMMERCE OR INDUSTRY OR OF GENERAL CONSUMER CREDIT WE BELIEVE THAT THEY SHOULD WITHIN CLEAR LIMITS BE ALLOWED TO EXTEND THE SCOPE OF THEIR LENDING AND TO OFFER VARIOUS FINANCIAL SERVICES WHICH HAVE BEEN DENIED TO THEM UP TO NOW. WE SEE NO REASON WHY THEY SHOULD NOT PROVIDE CHEQUES AND PERSONAL LOANS. OF COURSE AS THEY MOVE INTO NEW AREAS THEIR PRUDENTIAL REQUIREMENTS WILL NEED TO BE STRENGTHENED. WE HAVE JUST OUTLINED OUR PROPOSALS FOR A SYSTEM OF SELF-REGULATION, WITHIN A NEW STATUTORY FRAMEWORK, FOR THE SECURITIES INDUSTRY. A WHITE PAPER SETTING OUT OUR CONCLUSIONS IN MORE DETAIL WILL ISSUE SHORTLY. OUR RESPONSE TO THE GOWER REPORT ON INSOLVENCY WILL COME OUT VERY SOON.

16 IT WILL TAKE SOME TIME FOR ALL THESE MEASURES TO WORK THEIR WAY THROUGH. IT MAY INDEED NOT BE EASY TO FORECAST

ALL THE UNEXPECTED CONSEQUENCES THAT MAY FLOW FROM THEM. BUT I HOPE THAT THE SIGNAL IS CLEAR. I HOPE THAT THE LIBERALISATION OF FINANCIAL MARKETS WILL STIMULATE STILL FURTHER THE RANGE AND VITALITY OF FINANCIAL SERVICES OFFERED AND SO ULTIMATELY THE ECONOMIC ACTIVITIES ON WHICH THIS COUNTRY DEPENDS.

WHOLE ECONOMY

17 I COME THEREFORE TO THE ROLE OF THE FINANCIAL SECTOR IN THE ECONOMY AS A WHOLE. IT IS OF COURSE CRUCIAL. NOT ONLY DOES IT PROVIDE FUNDS FOR DIRECTING INVESTMENT BUT IT ALSO GUIDES AND DIRECTS THAT INVESTMENT. THE OPERATORS IN THAT SECTOR HAVE TO TAKE A VIEW ON THE BEST MIXTURE OF RISKS AND RETURNS. I EMPHASISE THAT THIS IS NOT A MONOLITHIC VIEW, BUT A SPECTRUM OF VIEWS ABOUT POTENTIAL INVESTMENTS. IN VIEW OF THE IMPORTANCE OF ITS ROLE IT HAS OF COURSE BEEN THE SUBJECT OF CLOSE SCRUTINY BY SUCCESSIVE GOVERNMENTS AND IT HAS AT TIMES BEEN INFLUENCED BY, AND EVEN SUPERSEDED BY, GOVERNMENT INTERVENTION.

WILSON ON THE AVAILABILITY OF CREDIT

18 IT HAS SOMETIMES BEEN SUGGESTED THAT INVESTMENT IN THE UK HAS BEEN CONSTRAINED BY A SHORTAGE OF AVAILABLE CAPITAL. MORE RECENTLY IT HAS BEEN ARGUED VIGOROUSLY THAT FLOW OF CAPITAL ABROAD HAS DAMAGED OUR DOMESTIC PROSPECTS. INTERESTINGLY THE WILSON COMMITTEE, CHAIRED BY A FORMER LABOUR PRIME MINISTER, FOUND NO SUCH SHORTAGE. THE COMMITTEE FOUND THAT COMPANIES WERE FAILING TO INVEST NOT BECAUSE THEY COULD NOT OBTAIN FUNDS BUT BECAUSE THEY COULD NOT EARN SUFFICIENT PROFIT TO REPAY THEIR BORROWING. THE REAL FACT INHIBITING INVESTMENT WAS THE DECLINING LEVEL OF PROFITABILITY IN THE 1970s.

19 THIS TREND HAS FORTUNATELY BEEN REVERSED IN RECENT YEARS. THE FINANCIAL POSITION OF THE COMPANY SECTOR HAS IMPROVED SUBSTANTIALLY. PROFITS WERE UP BY NEARLY A QUARTER BETWEEN THE FIRST-HALF OF LAST YEAR AND THE FIRST-HALF OF THIS. THE NET REAL PRE-TAX RATE OF RETURN FOR ALL INDUSTRIAL AND COMMERCIAL COMPANIES ROSE TO 10 PER CENT IN 1983, THE HIGHEST LEVEL SINCE 1964. PROPOSALS THEREFORE THAT THE STATE SHOULD

ALLOCATE FUNDS TO INDUSTRY START I BELIEVE FROM A FALSE PREMISS.

THERE HAS BEEN NO GENERAL FAILURE ON THE PART OF THE FINANCIAL SECTOR TO PROVIDE FUNDS.

OVERSEAS INVESTMENT

20 BUT THEN IT IS ARGUED THAT THE ABOLITION OF EXCHANGE CONTROLS HAS ACCELERATED THE FLOW OF CAPITAL ABROAD. IT IS CERTAINLY TRUE THAT THIS HAS ALLOWED THE UNITED KINGDOM TO INCREASE ITS STOCK OF NET FOREIGN ASSETS FROM £10 BILLION AT THE END OF 1978 TO £56 BILLION AT THE END OF 1983. BUT THE OBVIOUS ADVANTAGES ARE SOMETIMES IGNORED. WE ARE ALREADY RECEIVING A GREAT FLOW OF INCOME AND WILL CONTINUE TO DO SO IN THE YEARS AHEAD. OUR INVESTMENT ABROAD HELPS TO PROMOTE UK EXPORTS BY ESTABLISHING DISTRIBUTION NETWORKS AND BY OPENING THE WAY TO ORDERS FOR BRITISH CAPITAL GOODS. IT MODERATED THE RISE IN THE VALUE OF THE POUND IN 1980 AND 1981 AT THE PEAK OF NORTH SEA PRODUCTION AND SO LIMITED THE IMPACT ON BRITISH EXPORTS. I HAVE IN FACT TO ADMIT THAT IN RELATION TO NATIONAL INCOME THE CURRENT STOCK OF OVERSEAS ASSETS IS STILL LOW BY HISTORICAL STANDARDS. THROUGHOUT THE 19TH CENTURY

WHEN THE UNITED KINGDOM WAS THE WORLDS LEADING TRADING NATION
AND WHEN SCOTLAND MADE A SPECIAL CONTRIBUTION TO OUR IMPERIAL
POSITION OUR OVERSEAS ASSETS ROSE CONTINUOUSLY REACHING A
LEVEL OF NEARLY TWICE NATIONAL INCOME JUST BEFORE THE FIRST
WORLD WAR.

21 I BELIEVE THEREFORE THAT THE EVIDENCE DOES NOT SUPPORT
THE POPULAR BELIEF THAT THESE FLOWS OF CAPITAL HAVE WEAKENED
OUR POSITION AT HOME. WHAT IS IMPORTANT IS THE COST OF CAPITAL
RELATIVE TO POTENTIAL PROFITS AND RISKS AND THAT IS WHY THE
GOVERNMENT REMAINS DETERMINED TO RESTRICT ITS OWN BORROWING
AND TO GET INTEREST RATES DOWN.

INTERNATIONAL DIMENSION

22 BUT THE INTERNATIONAL DIMENSION IS IMPORTANT FOR ANOTHER
REASON. THE FREEING OF MARKETS IN FINANCIAL SERVICES IS NOT
JUST A NATIONAL ISSUE. FINANCIAL MARKETS SPAN THE WORLD AND
IT MUST BE TO EVERYONE'S LONG-TERM ADVANTAGE TO BREAK DOWN
BARRIERS TO LOOSE TRADE IN SERVICES.

23 THE SERVICE SECTOR, IN ALL ITS ASPECTS, NOW PLAY A KEY ROLE IN THE DEVELOPED ECONOMIES. THIS IS PARTICULARLY TRUE FOR THE UNITED KINGDOM WITH ITS LARGE AND VERY COMPETITIVE SERVICE SECTOR. OUR EXPORTS OF SERVICES WORLD WIDE ARE CURRENTLY RUNNING AT ABOUT £20 BILLION A YEAR (ABOUT HALF OUR MANUFACTURED EXPORTS), WHILE OUR EXPORTS OF SERVICES TO THE EUROPEAN COMMUNITY AMOUNT TO ABOUT £4 BILLION A YEAR.

24 OUR FIRST PRIORITY THEREFORE MUST BE TO ESTABLISH A REAL COMMON MARKET IN SERVICES AS WELL AS IN GOODS. SINCE WE JOINED THE COMMUNITY OUR TRADE IN VIRTUALLY ALL SERVICES HAS GROWN IN BOTH VOLUME AND REAL MONEY TERMS. ONE OF THE MAIN CONSTRAINTS OF THE DEVELOPMENT OF TRADE AND FINANCIAL SERVICES WITHIN THE COMMUNITY IS THE DIFFERING REGULATORY REGIMES ADOPTED BY MEMBER STATES. IT IS CRUCIAL - AND THIS POINT HAS BEEN MADE WITH INCREASING VIGOUR OVER THE PAST FEW YEARS BY MINISTERS IN THE DEBATES OF THE COMMUNITY - THAT WE NOW MAKE MORE RAPID PROGRESS IN AREAS SUCH AS INSURANCE. WE HAVE LONG HAD EFFECTIVE FREEDOM IN THIS COUNTRY FOR THE ESTABLISHMENT OF INSURANCE COMPANIES. WE LOOK TO OUR COMMUNITY PARTNERS TO ESTABLISH THE SAME FREEDOM IN THEIR COUNTRIES.

25 LOOKING FURTHER AHEAD OUR ULTIMATE AIM MUST BE AN
INTERNATIONAL FRAMEWORK GOVERNING TRADE IN SERVICES, SIMILAR
TO THAT EXISTING WITHIN THE GATT FOR TRADE IN GOODS. THEY
MUST TRY AND GET IT ACCEPTED AS THE INTERNATIONAL NORM THAT
THE IMPOSITION OF CONTROLS ON THE FREE FLOW OF SERVICES WILL
BE THE EXCEPTION REQUIRING SPECIAL JUSTIFICATION. WE AND
THE AMERICANS PLACED PARTICULAR EMPHASIS ON THIS AT THE LAST
GATT MINISTERIAL MEETING AND WE LOOKED TO FURTHER PROGRESS
IN THIS FIELD OVER THE NEXT FEW YEARS.

26 OVER THE LAST TWO DECADES THERE HAS BEEN A SPECTACULAR
DEVELOPMENT OF INTERNATIONAL BANKING AND WITH IT THE BUSINESS
OF PROFESSIONAL INVESTMENT MANAGEMENT. IT IS ESTIMATED THAT
BRITISH MERCHANT BANKS AND OTHER PROFESSIONAL INVESTMENT
MANAGERS CURRENTLY MANAGE OVER £150 BILLION OF INVESTMENTS.
SCOTLAND HAS OF COURSE MADE A PARTICULAR AND IMPORTANT
CONTRIBUTION IN THIS FIELD AND ALTHOUGH IT MAY PERHAPS BE
INVIDIOUS TO SINGLE OUT ANY PARTICULAR AREA CHARLOTTE SQUARE
IN EDINBURGH HAS LONG HAD AN ENVIABLE INTERNATIONAL REPUTATION.

27 WE ARE NOW BEGINNING I BELIEVE TO SEE GLOBALLY DEVELOPMENTS
IN INTERNATIONAL INVESTMENT WHICH MAY PARALLEL THOSE OF EARLIER
YEARS IN INTERNATIONAL BANKING. IT IS PARTLY IN RESPONSE
TO SUCH INTERNATIONAL DEVELOPMENTS AND CHALLENGES THAT CHANGES
ARE NOW TAKING PLACE TO ENSURE THAT BRITISH FINANCIAL
INSTITUTIONS WILL REMAIN EQUIPPED TO TAKE A FULL AND COMPETITIVE
PART ACROSS THE WORLD.

28 WE HAVE TO FACE THE FACT TOO THAT OTHER COMPETITIVE CENTRES
ARE DEVELOPING. WE HAVE WATCHED WITH PARTICULAR INTEREST
MOVES CURRENTLY BEING MADE IN JAPAN TO LIBERALISE AND
INTERNATIONALISE THEIR MARKETS. OF COURSE WE WELCOME THESE
MOVES, JUST AS WE HAVE WELCOMED MOVES - EVEN THOUGH WE MUST
EXPECT MUCH MORE - TO LIBERALISE OUR TRADE IN MANUFACTURED
GOODS. JUST AS WE HAVE EXTENDED AN HOSPITABLE WELCOME TO
JAPANESE HOUSES IN THIS COUNTRY, SO BRITISH INSTITUTIONS ARE
ENTITLED TO PLAY A SIGNIFICANT AND BENEFICIAL ROLE IN JAPANESE
MARKETS.

29 YOU MAY HAVE NOTICED THAT TALKS WERE HELD RECENTLY BETWEEN

BRITISH AND JAPANESE OFFICIALS IN TOKYO TO DISCUSS SOME OF THESE QUESTIONS. I AM GLAD TO SAY THAT A GREAT DEAL OF COMMON INTEREST AND UNDERSTANDING ABOUT FUTURE DEVELOPMENTS WERE IDENTIFIED. THE JAPANESE AUTHORITIES GAVE HELPFUL INDICATIONS OF FUTURE OPPORTUNITIES FOR OUR INSTITUTIONS AND IMMEDIATELY AWARDED LICENSES TO CERTAIN OUTSTANDING APPLICANTS.

SCOTTISH INNOVATION IN FINANCIAL SERVICES

30 SO A REVOLUTION IN WORLD FINANCIAL SERVICES IS WELL UNDERWAY. WE MUST AND WILL RISE TO THE CHALLENGES AND OPPORTUNITIES THAT REVOLUTION PROVIDES. EVERYTHING WILL OF COURSE DEPEND ON THE POSITIVE OUTLOOK AND COMMERCIAL JUDGEMENT OF THE INDIVIDUAL MANAGERS CONCERNED. PEOPLE AT RISK ARE THOSE WHO REJECT CHANGE SIMPLY BECAUSE IT IS CHANGE.

31 I BELIEVE THAT SCOTTISH FINANCIAL INSTITUTIONS ARE FULLY READY TO MEET THESE CHALLENGES. WE HAVE NOTED WITH ADMIRATION THEIR CAPACITY FOR INNOVATION AND ADAPTATION. WE RECALL OF COURSE THE FORMATION IN 1964 OF THE SCOTTISH STOCK EXCHANGE

WHICH LED THE WAY TO THE AMALGAMATION OF LOCAL EXCHANGES THROUGHOUT THE UNITED KINGDOM CULMINATING IN THE CREATION OF THE UNITED STOCK EXCHANGE IN 1973. WE HAVE NOTED TOO THAT THE SCOTTISH STOCK EXCHANGE PIONEERED THE USE OF COMPUTERS TO IMPROVE THE SETTLEMENT OF BUSINESS. THEY WERE WATCHED WITH APPROVAL AND RESPECT FOR THE WAY IN WHICH SCOTTISH FINANCIAL INSTITUTIONS ROSE TO THE CHALLENGE OF RAISING DEVELOPMENT CAPITAL FOR THE NORTH SEA AND THE WAY IN WHICH THEY GRASPED THE OPPORTUNITIES OFFERED BY THE ABOLITION OF EXCHANGE CONTROLS. CURRENTLY WE HAVE OBSERVED THAT SCOTTISH INSTITUTIONS ARE IN THE LEAD WITH FIELD TRIALS OF HOME BANKING, WITH POINT OF SALE PROCEDURES AND THE COLLABORATIVE VENTURES OF BUILDING SOCIETIES. THE ADVERTISEMENT RECENTLY PLACED IN THE NATIONAL PRESS BY ONE OF THE SCOTTISH CLEARING BANKS (BANK OF SCOTLAND,) WAS HEADED "SCOTLAND 4. THE REST 0". ALLOWING FOR AN ELEMENT OF CALEDONIAN PRIDE IT TOLD A REAL STORY.

PERORATION

32 I WOULD THEREFORE LIKE TO CONCLUDE BY CONGRATULATING SCOTTISH FINANCIAL INSTITUTIONS ON WHAT THEY HAVE DONE, BY ASSURING THEM THAT THEIR EFFORTS HAVE NOT PASSED UNNOTICED SOUTH OF THE BORDER AND BY EXPRESSING THE HOPE - THE CONFIDENT HOPE - THAT THEY WILL RISE TO THE CHALLENGES IN THE YEAR TO COME PROVIDING AN EVEN BETTER SERVICE FOR THEIR INDIVIDUAL AND CORPORATE CLIENTS IN SCOTLAND, IN THE UNITED KINGDOM AS A WHOLE, IN THE EUROPEAN COMMUNITY AND INDEED IN THE WORLD OUTSIDE.



FROM; PAUL PEGLER
DATE; 12 November 1984

MR MAKEHAM

— Look OK to me
DLP

c/Content?

MOM

12/11

[Handwritten initials]

- cc:Principal Private Secretary
- PS/FST
- PS/EST
- Mr Culpin
- Mr Bostock
- Mr Pickford
- Mr Walker
- Mr Sowden
- Mr Portillo
- Mr Lord

CHIEF SECRETARY'S SPEECH TO INTERNATIONAL CHAMBER OF COMMERCE;

14 NOVEMBER

... I attach a final version of the speech as dictated today by the Chief Secretary. Any comments and suggested amendments should reach this office no later than lunch time on Wednesday, 14 November.

Paul Pegler

PAUL PEGLER
Assistant Private Secretary

INTERNATIONAL CHAMBER OF COMMERCE

IT IS A GREAT PLEASURE AND PRIVILEGE FOR ME TO REPLY TO THE TOAST OF HER MAJESTY'S GOVERNMENT AT THIS THE CHAMBER'S ANNUAL DINNER. THE CHAMBER MAKES A MASSIVE CONTRIBUTION IN MANY FIELDS. IN NO FIELD HOWEVER ARE ITS VIEWS MORE REVERED THAN IN THE FIELD OF INTERNATIONAL TRADE POLICY. INDEED I APPROACH MY TASK THIS EVENING IN A RATHER CHASTENED MOOD HAVING READ THE DISCUSSION PAPER OF THE CHAMBER'S TRADE POLICY COMMITTEE ^{PREPARED} ~~PERHAPS~~ BY SIR REAY GEDDES AND MR SIDNEY GOLT. IN IT THEY SUGGEST THAT THE INTERNATIONAL TRADE DEBATE SHOULD BE OPENED UP "MORE RIGOROUSLY" AND AT A HIGHER LEVEL OF SOPHISITICATION THAN IT HAS BEEN ACCUSTOMED TO IN RECENT YEARS. AS I HAVE BEEN A MODEST CONTRIBUTOR TO THAT DEBATE BOTH AT THE TREASURY AND IN THE DEPARTMENT OF TRADE I BOW MY HEAD IN SHAME.

2 LET ME HOWEVER, TODAY TRY AND GIVE YOU SOME THOUGHTS ON THE THRUST OF THIS GOVERNMENT'S POLICIES AS THEY RELATE TO THE UNITED KINGDOM MARKET, THE EUROPEAN COMMUNITY MARKET AND THE MARKETS OF THE WORLD. LET ME TRY AND DEMONSTRATE THAT A CONSISTENT THEME RUNS THROUGH OUR APPROACH TO ALL THESE THREE AREAS OF ECONOMIC ACTIVITY. I NEED HARDLY EMPHASISE THAT THE CONNECTING THREAD IS OUR RELIANCE ON THE FREE PLAY OF MARKET FORCES RATHER THAN CENTRALISED STATE DIRECTION. WE BELIEVE THAT MARKETS ULTIMATELY MAKE FOR THE MOST EFFICIENT ALLOCATION OF RESOURCE AND GIVE THE QUICKEST SIGNALS TO BUSINESSMEN AND OTHER DECISION MAKERS. WE BELIEVE THAT MARKETS ALLOW FOR THE CLEAREST EXPRESSION OF CONSUMER CHOICE.

UK ECONOMY

3 AT HOME I NEED HARDLY REMIND YOU THAT WE HAVE SWEEPED AWAY PAY AND PRICE CONTROLS. WE HAVE ABOLISHED EXCHANGE CONTROL.

WE HAVE RETURNED TO PRIVATE OWNERSHIP PART OF AN OVER-LARGE PUBLIC SECTOR THIS WILL BE A CONTINUING THEME OF THIS GOVERNMENT. WE ALSO BELIEVE THAT INDUSTRIAL SUBSIDY SHOULD BE THE EXCEPTION RATHER THAN THE RULE AND WE ARE SHIFTING, ALBEIT GRADUALLY, THE EMPHASIS OF OUR INDUSTRIAL AND REGIONAL POLICIES. THESE EFFORTS SUSTAINED OVER THIS PARLIAMENT ARE WE BELIEVE GRADUALLY LOOSENING UP BOTH OUR INDUSTRIAL AND FINANCIAL MARKETS.

EUROPEAN COMMUNITY

4 THE EUROPEAN COMMUNITY IS IN THEORY THE LARGEST AND RICHEST MARKET IN THE WORLD. IN THEORY THERE ARE NO BARRIERS TO TRADE OR TO THE MOVEMENT OF CAPITAL OR LABOUR WITHIN THAT MARKET.

5 THE INTERNAL MARKET FOR MANUFACTURED GOODS IS WORKING MORE FREELY. BUT THERE ARE THREE AREAS WHERE THE COMMUNITY'S

INTERNAL MARKET REQUIRES PATIENT AND SUSTAINED TREATMENT: TRADE
AND INVISIBLES, HARMONISATION OF TRADING STANDARDS AND
AGRICULTURE.

6 IT IS NOTICABLE THAT WE, THE FEDERAL REPUBLIC OF GERMANY
, THE NETHERLANDS AND DENMARK ARE THE ONLY MEMBER STATES WHICH
ARE FREE OF EXCHANGE CONTROL. THE WEB OF NATIONAL EXCHANGE
CONTROLS GO AGAINST THE SPIRIT OF THE TREATY OF ROME. OUR
INSURANCE INDUSTRY CANNOT OFFER DIRECT INSURANCE IN ANOTHER
MEMBER STATE - EVEN IN WEST GERMANY - WITHOUT THE EXPENSE
OF SETTING UP A SUBSIDIARY THERE. WE REGARD IT AS A HIGH
PRIORITY TO REMOVE THIS BARRIER AS SOON AS POSSIBLE. ALL
OF THESE ARE FIELDS WHICH THE INTERNAL MARKET COUNCILS INITIATED
UNDER THE GERMANY PRESIDENCY MUST CONTINUE TO LABOUR.

7 DIFFERING TRADING STANDARDS WITHIN THE COMMUNITY PRODUCE

BARRIERS THAT ARE EASY TO UNDERESTIMATE. DIFFERENT TECHNICAL SPECIFICATIONS, OFTEN DESIGNED TO PRODUCE SIMILAR RESULTS, LOAD UNNECESSARY COSTS ON TO EXPORTERS. THE UNITED KINGDOM HAS TAKEN A LEAD, ALONG WITH FRANCE AND WEST GERMANY, IN ENCOURAGING THE RECOGNITION OF MUTUAL STANDARDS. WE HAVE ALSO BEEN STRONG ADVOCATES OF COMMON STANDARDS IN NEW INDUSTRIES SUCH AS TELECOMMUNICATIONS AND ADVANCED MANUFACTURING TECHNOLOGY.

8 I COME NEXT TO AGRICULTURE AND HERE I MUST TREAD AS DELICATELY AS AGAG. IN THIS SENSITIVE DEBATE IT IS I HOPE COMMON GROUND THAT THE EFFECT OF THE COMMON AGRICULTURAL POLICY HAS BEEN TO CREATE HIGH DOMESTIC SUPPORT PRICES AND TO GENERATE LARGE EXPORTABLE SURPLUSES. THIS IS NOT OF COURSE UNIQUE. THREE OUT OF EVERY FIVE HECTARES IN CULTIVATION IN THE USA PRODUCE COMMODITIES FOR EXPORT. THIS RESULTS I BELIEVE IN

A WASTE OF RESOURCES.

9 THE CAP'S EXPORT RESTITUTION HAS, PERHAPS A LITTLE UNFAIRLY, LONG BEEN ATTACKED AS A UNIQUE SOURCE OF DISTORTION IN WORLD TRADE. IN THE AFTERMATH OF GATT MINISTERIAL IN 1982 A COMMITTEE ON AGRICULTURAL TRADE WAS SET UP WHICH CONCLUDED:

THAT ALL DOMESTIC AGRICULTURAL SUPPORT SYSTEMS HAVE POTENTIALLY DISTORTING EFFECTS ON TRADE; THAT NEW GATT RULES SHOULD BE DESIGNED TO ENSURE STRICTER AND FAIRER TRADE CONDITIONS;

AND THAT ALL THOSE PRACTICES THAT PRESENTLY ESCAPE GATT RULES - THAT SHOULD BE OBSERVED THAT THE CAP'S EXPORT RESTITUTIONS ARE ALREADY COVERED BY GATT RULES - SHOULD BE BROUGHT WITHIN THEM.

10 THE FACTORS AFFECTING WORLD MARKETS FOR AGRICULTURE ARE COMPLEX AND THE ENTRENCHED INTERESTS ARE STRONG. BUT THE ESSENTIAL PROBLEM IS A SIMPLE ONE. THE DEVELOPED COUNTRIES PRODUCE SURPLUSES. THEY ARE DISPOSED OF ON WORLD MARKETS. THEY SERVE TO DEPRESS PRICES. DEVELOPING COUNTRIES WITH ECONOMIES MOST DEPENDENT ON AGRICULTURE SUFFER. OUR EXPORTS IN OTHER FIELDS - EXPORTS WHERE WE HAVE A TRUE COMPETITIVE ADVANTAGE - SUFFER. SO WE ARE ALL LOSERS.

11 WE SHALL CERTAINLY SUPPORT THE GATT IN ITS SEARCH FOR A FAIRER SYSTEM. WE ARE PRESSING FOR A REFORM OF THE CAP. THIS IS AN ESSENTIAL ELEMENT IN OUR PRESSURE FOR STERNER BUDGET DISCIPLINE THERE, AS AT HOME. WE HAVE CONSISTENTLY ADVOCATED PRICE RESTRAINT AND CHANGES TO INHIBIT A DEVELOPMENT OF COSTLY DIFFERENTIALS BETWEEN THE COMMUNITY AND WORLD PRICES.

WORLD MARKETS

12 THE LONDON SUMMIT IN JUNE URGED ALL COUNTRIES TO "RESIST CONTINUING PROTECTIONIST MEASURES", TO REDUCE BARRIERS TO TRADE AND TO MAKE RENEWED EFFORTS TO LIBERALISE AND EXPAND INTERNATIONAL TRADE IN MANUFACTURES, COMMODITIES AND SERVICES."SINCE I HAVE JUST BEEN TALKING ABOUT AGRICULTURE YOU MAY BE TEMPTED TO MURMUR THAT "FINE WORDS BUTTER NO PARSNIPS". THAT ME TRY AND MOVE FROM THE "LOW LEVEL OF GENERALISATION" WHICH REAY GEDDES AND SIDNEY GOLT IDENTIFIED.

13 NON-TARIFF BARRIERS TO TRADE ARE WE BELIEVE AN AREA WHICH DESERVE CONTINUING AND DETAILED STUDY. UNDOUBTEDLY THEY HAVE BECOME MORE PERVASIVE IN RECENT YEARS. ON ONE ESTIMATE THE DEGREE OF EFFECTIVE PROTECTION ACROSS THE WORLD PROVIDED BY SUCH BARRIERS IS NEARLY EQUIVALENT TO THAT RESULTING FROM

TARIFFS. IN MANY WAYS THEY PRESENT A GREATER THREAT THAN
TARIFFS. THEIR NUMBERS ARE LEGION - QUANTITATIVE IMPORT
RESTRICTIONS, DOMESTIC INDUSTRIAL SUBSIDIES, CHEAP EXPORT
CREDITS TO NAME BUT A FEW. THEIR EFFECTS ARE PARTICULARLY
DIFFICULT TO QUANTIFY, BUT THEY ARE A PRIORITY FOR THE NEXT
GATT NEGOTIATING ROUND.

14 INDEED, SINCE I WAS INVOLVED IN THE LAST NEGOTIATIONS
OVER THE MULTIFIBRE ARRANGEMENTS, I BELIEVE THAT THE GATT
MUST CAST A SHARP EYE OVER THESE. IT REMAINS IN FACT ONE
OF THE MOST IMPORTANT BARRIERS TO IMPORTS INTO THE UNITED
KINGDOM. IT CANNOT BE ACCEPTED WITHOUT QUESTION THAT "SPECIAL"
LOW COST IMPORTS PRESENT ANY LONGER A PARTICULAR PROBLEM.
INDEED PROTECTIONISM MAY NOT EVEN GUARANTEE A HIGH LEVEL OF
EMPLOYMENT IN THE TEXTILE INDUSTRY IN THE LONG-RUN - AND
CERTAINLY MAY DAMAGE EMPLOYMENT PROSPECTS IN OTHER INDUSTRIES.

15 SIMILARLY, WE MUST LOOK CRITICALLY AND REALISTICALLY AT PRESENT MEASURES ACROSS THE WORLD FOR THE COMPETITIVE SUBSIDISATION OF EXPORTS. THE OECD HAS PIONEERED VALUABLE WORK IN THIS FIELD WITH ITS CONSENSUS INTEREST RATES. I BELIEVE THAT WE MUST LOOK AT OTHER FORMS OF EXPORT SUBSIDISATION AND SEE WHETHER SOME KIND OF INTERNATIONAL CONSENSUS CAN BE EVOLVED. NO ONE IN THIS GOVERNMENT WOULD WANT TO SEE BRITISH EXPORTERS AT A COMPETITIVE DISADVANTAGE. BUT I HAVE TO EMPHASISE THAT IF A COMPETITION IN SUBSIDIES DEVELOPS - AND IN SOME CASES IT HAS ALREADY - WE DO NOT HAVE THE LONGEST PURSE.

16 IN GENERAL TERMS WE NEED TO LOOK AT THE WIDER ECONOMIC EFFECTS OF PROTECTIONIST MEASURES RATHER THAN CONCENTRATING ON THE IMMEDIATE SHORT-TERM BENEFITS TO THE INDUSTRY PROTECTED. IN MANY CASES THERE ARE HIDDEN COSTS. THE PROTECTION OF ONE

INDUSTRY MAY DAMAGE THE PROSPECTS OF ANOTHER. AND IN GENERAL TERMS PROTECTION AFFORDS FEW BENEFITS TO THE DOMESTIC CONSUMER. UNDER OUR PARLIAMENTARY SYSTEM THE COMPLAINTS OF SPECIAL INTEREST GROUPS ARE ~~READILY~~ ALL TOO AUDIBLE. THE MORE DEFUSE ANXIETIES OF CONSUMERS CAN ALL TOO OFTEN BE OVERLOOKED.

17 BUT THERE IS OF COURSE YET A FURTHER DIMENSION TO THIS PROBLEM. BARRIERS TO MARKETS REDUCE INTERNATIONAL TRADE. THEY ALSO THREATEN ECONOMIC DEVELOPMENT - PARTICULARLY THAT OF LESS DEVELOPED COUNTRIES. ALTHOUGH THE "DEBT CRISIS" MAY HAVE RECEDED SOMEWHAT THE LESS DEVELOPED COUNTRIES ARE FACED WITH AN ENORMOUS MOUNTAIN OF DEBT. THE INTEREST COSTS ALONE PRE-EMPT A HIGH PROPORTION OF THEIR EXPORT EARNINGS. AS MARTIN FELDSTEIN, PRESIDENT REAGAN'S FORMER CHAIRMAN OF THE COUNCIL OF ECONOMIC ADVISORS, HAS STRESSED -A SUSTAINABLE INCREASE IN EXPORTS, RATHER THAN CONTINUED IMPORT RESTRAINT

IS THE ONLY SATISFACTORY SOLUTION TO THIRD WORLD COUNTRIES' BALANCE OF PAYMENTS AND DEBT PROBLEM. AND SOLVING THAT PROBLEM IS IN THE INTERESTS OF BOTH DEBTOR AND CREDITOR COUNTRIES ALIKE. I HOPE THAT THOSE IMPECABLE SENTIMENTS WILL CONTINUE TO INFORM THE THINKING OF PRESIDENT REAGAN'S NEW ADMINISTRATION.

18 INDEED, THOUGH THE SAD EVENTS IN ETHIOPIA MAY AT THE MOMENT BE UPPERMOST IN OUR MINDS, I SOMETIMES THINK THAT SO FAR AS THE THIRD WORLD IS CONCERNED BILATERAL AID ULTIMATELY CAN BE NO SUBSTITUTE FOR A FREER FLOW OF TRADE. I FIND IT IRONIC THAT PEOPLE WHO TRUMPET LOUDEST ABOUT THE SCOPE AND SENSITIVITY OF OUR AID PROGRAMMES ARE OFTEN LOUDEST IN THEIR SUPPORT FOR IMPORT CONTROLS AND HEAVY SUBSIDISATION OF HOME INDUSTRIES. IT IS NO GOOD GIVING DEVELOPING COUNTRIES A BLOOD TRANSFUSION IF AT THE SAME TIME YOU ARE SEVERING A MAIN ARTERY.

19 THAT SAID, SOME OF THE THIRD WORLD COUNTRIES DISTORT AND RETARD THEIR OWN DEVELOPMENT BY A PANOPLY OF CONTROLS AND BARRIERS TO IMPORTS. IF WE ARE WILLING TO GIVE DEVELOPING COUNTRIES A BREATHING SPACE - AS WITH THE RECENT MEXICAN MULTI-YEAR RESCHEDULING AGREEMENT - THEY MUST USE THAT PERIOD NOT ONLY TO CUT BACK ON BORROWING BUT ALSO TO ADJUST THEIR ECONOMIES.

20 THEY SHOULD ALSO I BELIEVE REFLECT ON THEIR SOURCES OF FINANCE. THEIR NEED IN THE FUTURE MUST BE TO SUPPLEMENT OR SUBSTITUTE FOR BANK FINANCE. THEY COULD DO THIS BY GREATER RELIANCE ON DIRECT INVESTMENT OR ON FUNDS RAISED ON THE BOND MARKET. IN THE DECADE AFTER 1973, BANK LENDING TO DEBTOR COUNTRIES DOUBLED AS A PROPORTION OF TOTAL BORROWING, BUT THE INCREASE IN DIRECT INVESTMENT WAS VERY MUCH SLOWER. DEBTOR COUNTRIES MIGHT PAUSE TO CONSIDER WHETHER PAST INHIBITIONS,

WHICH I ADMIT MAY DERIVE FROM HISTORIC EXPERIENCES AND HISTORIC PREJUDICES - ARE REALLY JUSTIFIED.

21 I AM VERY CONCIOUS THAT IN ALL I HAVE SAID I MAY NOT HAVE ESCAPED THE LOW LEVEL OF GENERALISATION WHICH REAY GEDDES AND SIDNEY GOLT CRITICAL EYES HAVE DISCERNED. I AM ALSO CONCIOUS HOWEVER THAT, TO QUOTE DR JOHNSON, AFTER SUCH AN EXCELLENT DINNER I MAY HAVE EXHAUSTED TIME AND ENCROACHED ON ETERNITY. MAY I CONCLUDE THEREFORE BY PAYING TRIBUTE TO THE STIMULATING AND CONSTRUCTIVE CONTRIBUTIONS OF THE CHAMBER TO WHAT IS AND MUST CONTINUE TO BE A DEBATE OF CRITICAL IMPORTANCE NOT JUST TO OUR DOMESTIC MARKET OR TO THE INTERNAL MARKET OF THE EUROPEAN COMMUNITY BUT TO THE MARKETS OF THE WORLD.

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Transcript by
JAMES LEE of:

PRESS CONFERENCE GIVEN BY MR. IAN STEWART,
ECONOMIC SECRETARY TO THE TREASURY, ON
MONDAY, 12 NOVEMBER 1984

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MR. STEWART

Thank you for that introduction.

Good afternoon. I am sorry, as with all matters of this kind, it is not possible to give you an intimation in advance of the subject matter, but we thought it might be helpful to have an opportunity to talk about the pound note and the pound coin; although much of the political interest may be concentrated on other aspects of the Autumn Statement, this is an important announcement in its own right, and I wanted to have the opportunity of explaining to you some of the background to the decision and also give you an opportunity to ask questions about it.

The £1 note has been deteriorating in quality in recent years quite rapidly. One of the reasons for that is that it tends to get stuffed in pockets, like this one, and in that sense it tends to be treated more like a coin than as bank-notes used to be, being kept in a wallet or in the hip pocket, or whatever.

Under those circumstances, it has become increasingly difficult and increasingly expensive to maintain the quality of

the note in circulation. One of the aspects of this is that it is not now returned to banks for replacement as much as it used to be, and it is therefore difficult even at increasing cost for the Bank of England to maintain the quality of the notes in circulation.

This is a problem which has been found in many countries in the last few years. Just to mention a few examples: in France, the 10-franc coin was introduced - that is worth nearly £1 - in 1974 and the 10-franc note is no longer issued. The Germans also ten years ago introduced the 5-Deutschmark coin, which is worth more than the British pound. In Japan, the 500-yen is now in coin form and not in note form any longer; that is about £1.70 in equivalent purchasing power. The same as about the value of the Swiss 5-francs which has now been around for about 15 years, and no more notes of that denomination are being issued.

So this is a feature of the currency in many countries. The latest, I understand, who have introduced coins for the low-denomination notes in the last year are Australia and Norway and their notes will be phased out, I understand.

The £1 note had, by 1976, because of inflation at that time, fallen in purchasing power value to the level of the 10-shilling note when it was withdrawn in 1970, and so this is part of a trend - one of the things which I am afraid is the inevitable consequence of a period of high inflation in the 70s.

Now, as to the new £1 coin, new coins do always tend to be unpopular. They are unfamiliar when they are first issued and there is usually considerable public resistance for a period. In fact, the 50p in 1969 was very unpopular to start with. The 20p in 1982 did not go down well for quite some time, although when the public got used to these coins they found them very convenient and they have been perfectly well accepted and popular parts of the currency ever since.

The decision to have a coin in this form obviously was not one which we took lightly. We considered the specification of the coin, what would be convenient in use and one of the factors which influenced us very much in the choice of the type of coin for the £1 was that this format is particularly useful and convenient for the blind, and the institutions representing the blind have welcomed it very strongly and it has been found very practicable, because the combination of the thickness of the coin, which is unlike any other coins in the pocket, and the particular edge with the blend of graining and lettering, is easy to detect by feel.

The other factor, of course, which is of positive advantage in the coin over the note is that it is very convenient for ticket and vending machines, and I understand that several tens of thousands of vending machines and ticket machines have already been converted. I think some businesses have probably held back from converting meters or slot machines - I am thinking particularly of gas and electricity where a convenient coin of £1 value would be very helpful - and I would

expect a number of businesses which have not so far undertaken a full-scale conversion of slot machines would be more likely to do that in future.

The circulation of the coin is increasing steadily and the complaints which we had about it as we have about all new coins, tended to fall away over recent months.

I am sure there will be many questions you want to ask me about this, but perhaps I could just conclude by saying we did spend a lot of time thinking about the actual shape and form of this coin. £1 coins originally - they have been with us for about 500 years - the first one was authorized by Henry VII in 1489. The Early pounds were very broad and thin and not at all convenient for today's purposes.

The £1 coin has also taken various other shapes during its history. This, I think, is the largest £1 coin which has ever been struck. That was when the Royalist forces in the 1640s in the Civil War had to produce coin out of any available silver and at mints like Shrewsbury and Oxford where the Royalist cause was centred, college plate and various other silver plate was melted down, they did not have the gold to make gold £1 coins and they produced these ones in silver. I do not think those would be very welcome in our pockets.

We hope that the actual model we produced will be much more useful and I am glad to have the opportunity of explaining that to you today.

QUESTION

You say £1 coins have increased in popularity since their introduction. I wonder how many people sitting here this afternoon have £1 coins on them. Could I ask the top table, disregarding those exhibits which have been brought along, how many of them have £1 coins in their pockets?

MR. STEWART

I have got one out of a selection of coins. The Deputy Master has got one. There are a couple down there.

I am not claiming that they are in widespread circulation as well-established coins are, but they are certainly now going increasingly into circulation. Perhaps I could just mention a statement made by the banks, through the Banking Information Service, today: they say that they welcome the end of the period of uncertainty about the future of the coin. They then go on to say: "There are obvious advantages in wider circulation of a coin with a very long life against a note which on average lasts only 10 months and becomes increasingly difficult to handle. The growing acceptance of the coin in general circulation has been particularly marked over the last few months."

QUESTION (MARK DOWDNEY, "DAILY MIRROR")

You were telling us about how long we have had a £1 coin. Can you tell us how long we have had a £1 note?

MR. STEWART

Yes, since the First World War. There was an absolute outcry at the time because everybody said you cannot possibly have pounds consisting of paper. A far greater outcry than there was when we introduced the new £1 coin last year.

QUESTION

This is a Government that believes in market forces. Can you tell us whether any other lobby, apart from the blind and the manufacturers of vending machines, have been pushing you to make this substitution.

MR. STEWART

"Pushing" is perhaps a strong word, but we have had quite a lot of favourable comments over recent months, particularly by stores which find the coin much easier, now that £1 notes are getting so dirty - easier and more convenient to handle quickly, and that produces change satisfactorily for customers, and I think that that has been general throughout the retail trade.

The point about vending machines: I do not think one should brush it aside too fast. It is actually a great convenience to a lot of people if meters and slot machines can take a coin with this sort of purchasing power.

QUESTION

Would it not be more convenient for both if you continued with both instead of removing the £1 note completely?

MR. STEWART

Well, I do not know that it would. In fact, one of the factors which has inhibited the increase of the £1 coin in circulation has been the uncertainty as to whether there will be a longer period of co-circulation between pound notes and coins and many people have said to us that we thought as soon as we announced a decision about ceasing to print new £1 notes there would be a greatly increased usage of the £1 coin and the conversion of vending machines and so on would then take place. While a familiar note is around it is not surprising that a lot of people will go on using it. What I think has been clear over the last year or two is that, regardless of the cost, it is going to become increasingly difficult actually to maintain £1 notes in clean, usable condition.

QUESTION

But is that just because they hang on longer, something to do with the fact that banks were given dirty notes instead of clean ones, that kind of thing?

MR. STEWART

The length of time - we have been replacing £1 notes during the last year or so at the same rate as we were replacing them before when the number of £1 notes in circulation was

actually greater, so relatively speaking, there has been an increase in the amount that have been replaced.

The difficulty is that £1 notes have tended now to be kept in tills and in pockets and not going back so regularly through the banking system for replacement, and so it is not actually practicable to keep all the £1 note currency in good condition any longer and that is a trend which has been gradually getting worse and as I said when I was mentioning these other countries, it is something in which we are not alone. It is a factor of purchasing power. The sort of purchases which people make for which they now use £1 are the sort of purchases where they tend to put their hand in their pocket to pay for it rather than to open a wallet for notes.

PETER HITCHINS ("DAILY EXPRESS")

Three questions, if I may.

First of all, why can you not coat them in plastic?

Secondly, you cited several countries where they have got rid of notes of similar value, but you did not mention the United States where the dollar which is still I think worth less than the pound circulates as a note, and

Thirdly, on current rates of inflation, how long before you abolish the fiver?

MR. STEWART

We have now got inflation down to very modest proportions and I hope we will get it down further, so I think the £5 note will be with us for a very long time. It is going

to be a feature of our currency for as far ahead as anybody can foresee, I am sure.

You asked me about the USA. I expect that they will come to a similar decision themselves. I cannot say when they will do it. Credit is used more widely in the United States than it is in this country and in the other countries which I have referred to. Certainly, with the exception of the USA, most of the major countries are doing the same thing as we are.

Plastic notes: the only countries - "countries" is perhaps rather a generous description - which have used plastic notes are the Isle of Man and Haiti. Haiti has already abandoned the attempt and, having looked at this very thoroughly and long before any decisions were taken about the £1 note being ceased to be printed, we considered various new materials from which notes could be produced and plastic does not meet our essential test of security against forgery, so that is the answer to that question.

ANDREW ARONS ("FINANCIAL TIMES")

Three questions as well.

Is this part of a complete rationalization? We have a little note on our press release saying that the £20 note will be subject to further press releases, but also, will we be seeing coins made lighter, smaller or subject to proportional weights.

Secondly, how many more coins will be minted to meet the new demand when you withdraw the notes, and the third is what is the Prime Minister's attitude now, given her Parliamentary answer to Marcus Harks last year and also the fact

What the coin's nickname is "the Maggie"?

MR. STEWART

The Prime Minister accepts that the time has come to make this decision. She was on record a year ago as saying that the coin was not very popular yet, and I think that was a fair assessment at the time, and she said that she had reason to believe that the ^{note} £1/would be retained. Well, that again, we have moved on a year. The two have circulated alongside now for over 18 months, I think it is. The £1 note will continue in circulation for a considerable further period and so there will have been a long time during which the two are available together.

There are plenty of stocks of the new £1 coin. They have been drawn down recently in increasing quantities, but there are a substantial number available from the Mint. I do not know whether the Deputy Master wants to say any more about that in a moment.

So far as the rationalization of the currency is concerned, the £20-note , there will be an announcement from the Bank of England about this in a couple of days time. It will be introduced later this week. We thought it would not be very candid for a further decision about the currency to be announced later this week, so it was mentioned today by the Chancellor, but it is part of regular updating of the currency to make sure that the most up-to-date means of security protection and so on are incorporated in the design and the Bank will be saying more about that in a couple of days time.

On the general structure of the coins, there has been a problem recently which I think you mentioned about the relative weight of coins. I mean, as over the last 10 or 15 years the purchasing power of those coins has declined, so the relative weight you have to carry in your pocket for the same purchase has increased and that, I think, was well demonstrated by the popularity of the 20p once people got used to it. To start with, they were not in favour of it because it was new and unfamiliar in shape and appearance. Once they realized that you could do away with two of those large 10p or two-shilling pieces for one rather small 20p, which is about, I suppose, less than a quarter of the weight, I think that was welcomed.

This is something which we will take into account in looking at the future development of the coinage. There are no immediate plans for further changes in the coinage, but we are always alert to the needs of keeping it up to date and that is certainly one of the factors which we will consider.

Perhaps the Deputy Master would like to add something.

DEPUTY MASTER

We have commissioned some research, as many people know. The "Financial Times" ran an article on that at Nottingham University and possible future specifications for coins. There are three rather complicated options which I can hardly describe now and within those options there are other options and we await the results of that research before taking a view on what might occur if it was considered necessary to make any changes.

QUESTION

Is the move going to lead to any unemployment among whoever prints £1 notes and did you identify any other disadvantages in the move?

MR. STEWART

Could I identify what?

QUESTION

Any other disadvantages in the change?

MR. STEWART

I cannot give you a comment about the employment implications. I would not want to give you a comment without checking it in detail.

I think you ask also about other possible adverse consequences. I do not think we have identified any. We have looked at this decision very carefully and had we done so, obviously we would have taken them into account.

ROBIN YOUNG ("THE TIMES")

Can you tell me how many £1 notes are still in circulation and do we know how many in total have been printed and issued since 1914 and thirdly, can you tell us how much it in fact costs to mint a £1 coin?

MR. STEWART

Yes, it costs about $2\frac{1}{2}$ p to mint a £1 coin, as against about $1\frac{1}{2}$ p for a note. The average expected life of a coin is about, say, 40 years, compared with about 10 months for a £1 note. So there is a significant difference in that.

I am afraid I cannot possibly give you the total of how many £1 notes have been printed since the First World War, but there are about 560 million £1 notes out and about at the present time.

There are about 560 million £1 notes and about 180 million £1 coins. That was at the last count, I expect it may be rising.

QUESTION

Can you say how many £1 notes we actually get and how many go out of circulation?

MR. STEWART

As I say, if the average life is about 10 months, we get through about 700 million.

QUESTION

What has happened to all the £1 coins, because we were told when the £1 coin was issued that there were 250 million prepared, that the Mint was making 8 million a week, and now they are down to 180 million. Who is stealing them?

MR. STEWART

It is 180 million in circulation. The Mint still have a substantial supply which I expect will be drawn down fairly soon.

QUESTIONER

Oh I see. I thought the 200 million were...was the figure actually put into circulation.

MR. STEWART

No, that was never the case.

QUESTION

How many £1 coins have actually been struck in toto?

DEPUTY MASTER

We have about just under 600 million, 570 million have actually been struck thus far. That was a few days ago. I do not know how many were struck today.

QUESTION

And where are the - my maths are not very good - 420 million that are not in circulation?

DEPUTY MASTER

They are waiting in store at the Mint for issue to the banks and we shall be talking to the banks later this week about

additional drawing.

QUESTION

I do not want to over-emphasize the unpopularity of the coin in the past, but is there any reason to believe that you have got so many in store because people preferred the notes and were asking shopkeepers for notes instead of coins or banks for notes instead of coins?

DEPUTY MASTER

No, not really. We have just maintained the planned production schedule from the word "Go", so everything has gone according to plan.

MR. STEWART

Perhaps I could just make a comment on that. There have been one or two customer surveys. One large store did it and the Post Office did it and the store found, I think, that only about 2½% - this is some time ago - of the public objected to taking the coin and the Post Office figure was I think about 1%. I did a bit of market research in my own constituency recently and I asked in a number of shops about this and they said...I said: "Could I have some £1 coins" to see whether they were in circulation locally, and frequently they would say: "No, we do not give out £1 coins. The public does not like them!", so I said "Well have you actually asked the public whether they like them and would accept them?" "Oh, no, we have not asked them!"

So my wife then went into these stores a little later and asked the same question and one of them said: "Funny thing! People keep on asking for £1 coins!"

QUESTION

Could I ask just one more question, which is what now happens in Scotland?

MR. STEWART

Yes, it is a good question. I mean, I do not know whether you know these handsome Scottish variants. There is one with a thistle on the back for the Scottish £1 coin. As far as the Scottish note issue is concerned, that is unaffected by this decision. There are two relevant bits of legislation. One is the Bank Note (Scotland) Act of 1845 and the other is the Currency and Bank Notes Act of 1954 and those relate to the issue of notes. They do not allow the issue of Scottish notes in England and Wales, but they permit the existing Scottish bank-note issues to issue in Scotland and it will be up to the Scottish banks themselves to decide how they want to carry on.

QUESTION

If they were to increase their issue and you were to turn out to be wrong about the unpopularity of the £1 coin, we could actually have a kind of Scottish invasion of bank-notes?

MR. STEWART

I do not know that you would have a Scottish invasion of bank-notes, because they cannot be issued in England. They creep over the border as it is and they have been doing that, and creeping back again, for many years, but it would be up to the Scottish banks to weigh the cost of any increase. They have to have it backed by Bank of England notes or £1 coins, so it is an expensive operation for them, and there has been a trend with the Scottish banks, as there has been with the Bank of England bank-notes, to move more towards the higher-denomination notes and away from the £1 denomination ones.

QUESTION

Can you tell us what the colour of the new £20-note will be?

MR. STEWART

I think I must leave that to Wednesday to the Bank of England because it is their issue.

QUESTION

Can I ask you what you think of the £1 coin yourself?

MR. STEWART

I like it. You would expect that I might have to say that because of my job, but I do actually. Personally, I rather like it.

MR. STEWART

Can I just say one thing. I particularly like the edge. You know, the English £1 coin has "Decus et Tutanim" (phon.) on it, which is a quotation from Virgil meaning "an ornament and a safeguard" which used to be on the early crowns and other milled coins and was also on Cardinal Richeleu's prayer book on the clasp and "ornament and a safeguard" was originally used about Ignatus suit of armour, I think, in the, but the Scottish one has "Nemo me impuni le kesset (phon)", "Nobody provokes me with impunity" and that again, like the ornament and the safeguard, was a reference to the fact that the milled edge preserved these coins against clipping and forgery and it now serves the purpose of course that it makes it ^{more} readily identifiable and easier for blind people and others to identify by feel.

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DRAFT

COMMONWEALTH BORROWER/LENDER CONSULTATIONS

Part of Speech by Economic Secretary, 13 November

The City of London is thus in one of the most exciting phases of its development. The changes I have described will lead, in the next few years, to great improvement in the services it can offer to its overseas customers. It is only to be expected that it will continue to exercise its customary ingenuity and inventiveness, in devising new and enterprising forms of finance for the countries represented here today. The main - but not the only - theme of your consultations in the next two days is of course the City's role in the provision of bank finance. You will hear far more on this theme this afternoon and tomorrow. I do not wish to anticipate the advice you will receive from the many experts whom the Secretariat has gathered to speak to you. But I want to pay tribute to the work of the Secretariat itself, ever since 1976, as part of its capital markets programme. This seems to me the sort of practical co-operation, at a technical but also crucial level, where the Commonwealth is at its best. We are all grateful to you, Mr Secretary General, and to your staff, for your valuable intermediary role in promoting these consultations.

X
One by-product of your work, which I was interested to read recently, has been the book on 'Sovereign Borrowers' issued by the Dag Hammarskjold Foundation, but largely based on work done here in London by the Secretariat. It is pleasant to see one of its editors here with us today.. [Dr Siddiqui.] That book contains a wealth of sound practical advice which I, as a former banker myself,

can appreciate to the full. It is however a sad reflection on the hard times we have passed through, that a significant part of that book is about techniques of rescheduling loans which have run into trouble. Indeed, it even goes so far as to advise you how to prepare for such disasters in advance. I note, too, that the whole question of rescheduling features largely on your agenda on the final day.

I don't want to underestimate the severity of the problems which have led so many countries to seek debt relief. A combination of falling commodity prices, reductions in world trade as the result of world-wide recession, and higher world interest rates have forced many LDCs to seek a measure of relief, out of sheer inability to service all their debts. Nor should you, if I may suggest it, underestimate the problems which this has caused, to the banks themselves, to their regulators, and to governments. It would be foolish to underestimate the scale of the problems we have been living through. As many speakers noted at this year's Bank and Fund meetings in Washington, we can now afford to be cautiously optimistic about the future. But it has been a tense and difficult time, and there remain problems on both sides. It is understandable, therefore, that many experts tried to devise global solutions to what appeared to be a global problem. Some of these solutions have been advocated in Commonwealth reports: for example, the very interesting one by Lord Lever which was presented to Commonwealth Finance Ministers in Toronto last month. But the British Government remains sceptical about global solutions. The more we are forced to look at the individual debt problems of particular customers, which include several Commonwealth countries, the more each of them seems to have its own unique characteristics and to demand its own unique solution. It is this which has led us to advocate the

case by case approach. Of course this can have several features in common. And there are some where Britain has been particularly prominent in promoting solutions. First, as a major government creditor, we have been ready to agree to generous rescheduling terms, as part of a multilateral operation, where this was supported by an IMF agreement and an adjustment programme initiated by the borrower country and approved by the Fund. In addition, following up the references in the London Summit Communique, we have been developing, with our creditor partners, the techniques of multi-year rescheduling agreements, now known as MYRAs. These are government actions. Our banks have been equally fertile in devising new solutions. They have not sought to evade their responsibilities, and have been content to see their essentially short-term loans remain in place for several years ahead as part of a comprehensive solution of banking problems for each individual borrower.

But, as these problems illustrate, over-reliance on bank finance in the past has not helped the developing countries. A combination of short-term loans and floating rates has made the borrowers and the lenders alike vulnerable to changes in world conditions. There is a pressing need, therefore, to preserve a balance between bank finance and other sources.

In this forum, I need not dwell for long on the multilateral sources of finance. They include the IMF for short-term liquidity purposes, which in problem cases helps to replace and supplement finance from banks. There is the IBRD for longer-term development finance, soundly based upon agreed development plans. Britain has been glad to support the innovation of structural adjustment lending, as a useful supplement to the World Bank's traditional role of funding major projects. There is the IDA for

concessional aid on a multilateral basis to the poorest countries. Also in the World Bank family there is the IFC, providing funds on a commercial basis for profitable investment, often in partnership with the private sector. We in the Commonwealth can recognise affinities here with the work of the CDC. Supplementing all these is the work of the regional development banks.

Britain also takes its part through its membership of the European Community. The Community provides developments and food aid both through its budget and, by national contributions, through the European Development Fund covering the 64 developing countries - soon to be 66 - who are members of the Lome Convention. We look forward to the early, successful conclusion of the present negotiations on the renewal of the Lome Convention. In particular we believe that the liberalisation of trade, which unfortunately causes difficulties for some of our partners, is the way in which the Community can give most help to ACP countries. This important relationship between the European Community and two-thirds of the world's developing countries is a valuable contribution to ties between developed and developing countries. The aid we provide through the Community thus has a political as well as developmental importance. In our view however, our own bilateral aid, and indeed that of the World Bank, is developmentally a more effective instrument than EC aid and a large proportion of our aid resources must be retained for this. We shall continue to press in Brussels for ways of improving the development value of Community aid.

There is of course a balance to be struck between multilateral aid institutions and bilateral aid. Both compete for scarce resources, and the aid budget as a whole must find its place among all the other competing

calls on our national budgets. [~~Yesterday's Autumn Statement~~
~~by the Chancellor of the Exchequer indicates the amounts~~
~~which we have been able to make available for the next~~
~~year/3 years ahead. One could wish it had been more: but]~~
the overriding imperative, in the interests of world
development as a whole is to rein back inflation in the
industrialised countries, and this requires continued
control of public spending.

*and since priority
must be given to
urgent needs like Ethiopia*

But

If ~~then~~ public funds are inevitably limited, the best
way forward must be to make the most use of existing
available resources. This means gearing them up with
bigger flows of private capital. In the context of
multilateral institutions, for example, that means more
co-financing by the World Bank, and more joint ventures
by the IFC, the EIB, and at home, by the CDC.

There is nothing new in all this. Historically, developing
countries have naturally run balance of payments deficits,
balanced by inward investment. Indeed, until the 1939
war, almost all inward capital flows for development
purposes, in the Commonwealth as elsewhere, took the form
of direct or indirect inward private investment. The
indirect investment often took the form of bond finance.
Bank lending, of the kind and certainly on the scale we
are now considering was virtually unknown.

Bond finance has the advantages of longer-term commitment
and, of course, of less volatility of interest rates.
Such inward investment was not just needed to cover a
balance of payments gap. Indeed the whole concept of
such a gap is a new and somewhat dubious concept: apart
from the very poorest countries there is no such thing
as an absolute gap between necessity and availability.
There may be a gap between what governments would like
to do, and what they can afford. Borrowing for balance

of payments purposes came later. Investment, in the period I am describing, was used to fund development. It contained the seeds of its own repayment. The need now, I suggest, is to find more ways of encouraging more such direct investment, especially but not entirely in the form of equity finance. I do not, incidentally, rule out the sale of stakes in existing assets. This can be a quick way of raising finance in the short term to help with a balance of payments problem. If it releases resources for other purposes, it seems to me entirely justified. It is what any company would do, faced with a short-term financial squeeze. But it is far more important to encourage fresh flows of new direct investment, which will contribute directly to future growth. The advantages to the borrower are fourfold. He gets an inward flow of funds across the exchanges. This is directly linked to future earnings, so that investment appraisal is, so to speak, built in. It brings with it management and technical skills which may not readily be available to the borrower at present. And the return flow across the exchanges is linked to new production, when the plant thus financed comes on stream, so that the immediate burden on the borrowing economy is deferred.

Clearly the initiative for such investment must come from the potential investor. But Governments on both sides have a role to play. Governments of capital exporting countries must encourage such developments, and help promote the flow of information about investment opportunities. Our Embassies and High Commissions have an important role to play here. But more important, they can remove obstacles to the flow of funds. Britain has tried both these. It provides advice, and information, to potential investors. On a small scale, it funds project studies of potential investment opportunities. It offers guarantees, in a scheme run by ECGD. We shall, incidentally, be studying

with great interest proposals by the World Bank for a multilateral investment guarantee scheme. The test will be whether it is likely to generate additional flows of funds, or simply to divert them from other channels. Above all, Governments can remove artificial obstacles to the flow of funds. To my mind, the most important single action we have taken to help investment in developing countries has been the removal of exchange control in this country.

On the borrowing side, importers of capital must welcome and facilitate investment. They too must remove artificial obstacles. In their case, this may mean such things as removing the limit to the maximum holding which may be owned by overseas investors. If they are to induce profitable investment, which I have suggested is in their own long-term interest, they must reduce the threat to future profitability. This may mean limiting the use of price controls, and guaranteeing freedom to remit profits once earned. A friendly, though not of course an over-generous tax regime is essential. It is a mistake to kill the goose which lays the golden eggs. Often, these favourable conditions can be embodied in an investment protection and promotion agreement (IPPA). These friendly instruments are like more war-like deterrents: more valuable if they never have to be invoked. But they do afford considerable reassurance to the potential investor.

In the longer-term, we should also encourage some shift back to bond markets. Here I am thinking only of the largest and furthest advanced borrowers. But I submit that it is a development worth considering. Initially, perhaps, it may be easier for public utilities, with a solid and guaranteed revenue base and the need for heavy inward investment, to come to this market again. In the longer-term, there may be some governments who could find

long-term money from this source. Eventually, it could provide a way of funding the present overhang of bank finance. It may be even that, in suitable cases, where rescheduling of existing bank loans is inevitable, new obligations could take the form of bonds, helping in the maturity transformation process.

I do not want to sell the idea of bond finance, or indeed of direct investment, as universal panaceas. As I said earlier, the British Government's approach, to the debt crisis at present, to the long-term development process, is "case by case". We must seek tailor-made solutions to individual problems. The great merit of the London market is its versatility, flexibility, and ingenuity in developing new forms of finance. It is therefore entirely appropriate that the Secretariat should organise these consultations, in the historic heart of the Commonwealth, which is also its financial centre. On behalf of her Majesty's Government in Britain, I am delighted to welcome you all to London and to wish these consultations well.

13/11/84.

Conference on "Monetary Conditions for Economic Recovery",
University of Amsterdam and De Nederlandsche Bank,
14th-16th November 1984

WHAT ROLE FOR MONETARY POLICY TODAY?

by

Alexandre Lamfalussy

Introduction

The conference organisers have given me the challenging assignment of presenting, by way of introduction to this conference, a paper on the rôle of monetary policy in a "disequilibrium situation". I have taken the liberty of interpreting this as a suggestion that I reflect on the rôle of monetary policy in today's world. I do this not simply because, in a narrow technical sense, we permanently live in a situation of disequilibrium - the "state of tranquillity" of economic theory is a theoretical construction which may, or may not, help us to understand what is happening in the real world but which never corresponds to an actual situation. More important, to my mind, is the fact that the signs of disequilibrium in more meaningful terms are more numerous and more disturbing today than they have been for some time.

Let me mention some of the most obvious manifestations or causes of imbalance in the world economic situation: the continued coexistence of unemployment and inflation; high real interest rates, with their possible adverse implications for capital formation; major shifts in the international division of labour and, consequently, in domestic industrial structures; massive capital inflows into the world's wealthiest country; major departures from purchasing power parity and the wild gyrations of the dollar in the foreign exchange markets; the international debt situation; signs of domestic financial fragility; and, last but not least, the potential impact of innovation and deregulation on financial markets.

How should practitioners of monetary policy respond to such a situation? On a strategic level, should they pursue a policy of monetary targeting, on the assumption that this is their best, and in fact only, possible contribution towards controlling inflation and promoting the smooth working of the markets? From the tactical standpoint, should they adjust their policy stance and/or their operational control techniques? Finally, in a longer-term perspective, and in terms of financial regulation and change, what is the optimum financial structure towards which they might wish to strive?

The 1979-80 consensus view on the rôle of monetary policy

Let me begin by trying to put these questions into some historical perspective. Once upon a time - around 1979-80 - a remarkable consensus emerged among the policy-makers of the western industrial countries on the use of monetary policy in the fight against inflation. The main components of this consensus might be summed up in the following three propositions:

- (a) among the major policy objectives, priority should be given to the fight against inflation;
- (b) by taking a restrictive stance, monetary policy should play a crucial rôle in achieving this objective;
- (c) restrictive monetary policy should be implemented by exercising firm control over the growth of the money supply which, in turn, should lead to, or coincide with, the re-emergence of positive real interest rates.

It is worth reminding ourselves that this consensus did not imply a genuine conversion to the creed of "pure" monetarism; it could more appropriately be called (as it was by the then Governor of the Bank of England) "practical" monetarism. Qualifying the monetarism practised by central bankers at that time as "practical" was well-founded for two sets of reasons.

First, on the theoretical level. While clearly acknowledging that money (and even the money supply) mattered a great deal indeed when fighting inflation, practical monetarists did not share without substantial qualification any of the basic premises underlying monetarist reasoning, namely:

- (a) that in the medium term money is "neutral" with regard to the level of real economic activity;
- (b) that the private economy is basically stable;
- (c) that the demand for money is a stable function of a few variables, primarily income and interest rates;
- (d) that there is a predictable functional relationship between the targeted money supply figure and the stock of high-powered money; and
- (e) that, on the assumption that authorities adhered strictly to publicly announced money supply targets, rational expectations would drastically reduce the inevitable social costs associated with disinflation.

On a more practical level central bankers never failed, even during this period of happy consensus, to express their concern about several possible developments. Firstly, they warned us that a policy mix combining expansionary fiscal policy with restrictive monetary policy could drive interest rates to excessive levels - an assertion that, quite clearly, does not fit into the monetarist frame of thought. Secondly, they insisted on the need for moderation in wage settlements, arguing that without such moderation the deceleration in the growth

of nominal expenditure would lead to rising and lasting unemployment. Thirdly, in particular in the United States, they voiced their concern that financial innovations might blunt the efficiency of monetary control techniques. Fourthly, more a European concern, the idea of excluding interest rates from the range of intermediate or even operating targets prompted fears that the implementation of a restrictive monetary policy might lead to undesirable exchange rate developments.

However, despite these practical concerns and the misgivings about the theoretical foundations of monetarism, there was still a firmly held belief that restrictive monetary policies, implying a gradual reduction in the rate of growth of monetary aggregates and positive real interest rates, should play a decisive rôle in fighting inflation.

It is against the background of this "historical consensus" that I should like to examine some of the problems that the monetary authorities of the western industrial countries are facing today. I propose to touch upon three sets of problems: the question of the appropriateness of the current stance of monetary policies in those countries - mainly in Europe - in which inflationary pressures have diminished considerably but where, at the same time, unemployment is high and still rising; the problems relating to the current level of real interest rates within the framework of increasing international integration of financial markets; and the problems arising for monetary control and the stability of financial institutions from the tide of innovation and from deregulation.

Monetary policy at a time of declining inflation rates and stubborn unemployment

The best starting-point is to ask ourselves whether the major shift towards restrictive policies that occurred in 1979-80 has achieved its objective and, if so, at what cost and whether this achievement is likely to be of a lasting nature.

There can be no doubt that the last four years have witnessed a substantial decline in inflation rates. The rate of increase of consumer prices in the G-10 countries as a group peaked some time during the winter of 1980-81 at close to 12 per cent. It is now running at something below 5 per cent. And it may be noted that the extent of the decline was fairly similar in all the G-10 countries, although it was naturally somewhat smaller in those whose currencies depreciated in effective terms. There is, therefore, strong evidence that the monetary policy objective has been achieved. What is perhaps even more encouraging is that during the whole period there

was only one year - 1982 - in which the group's combined GNP actually declined. Small positive rates of growth were recorded in both 1980 and 1981; after the setback in 1982 recovery began in 1983 and is now proceeding at a relatively fast pace. From 1980 to 1984 the group's GNP expanded in real terms by about 9 per cent.

Admittedly, this positive but relatively modest expansion was unable to prevent a considerable increase in unemployment, which rose from about 6 per cent. of the labour force in 1980 to a peak of 8½ per cent. in 1983. It then started declining, but only as a result of favourable developments in North America. In Europe, on the other hand, the unemployment rate continued to worsen. Moreover, all forecasts point to still higher unemployment, even under relatively optimistic assumptions about Europe's future growth.

If one adds to this the gradually deteriorating structural pattern of unemployment - the fact that the unemployed remain out of work for longer and longer periods, the heavy concentration of unemployment among the young, major regional differences - it is easy to understand why, with inflation apparently more or less under control, many are beginning to wonder whether it is still right to give first priority in economic policy to the fight against inflation. Would it not be justified to relax the stance of monetary policies in Europe, thus abandoning their medium-term perspective, in order to accelerate the pace of recovery, particularly in those countries in which the fiscal policy stance is itself relatively restrictive?

Several reasons can be advanced for answering this question in the negative. Firstly, on the assumption of a further deceleration in price/wage inflation, these policies already allow for a reasonable potential rate of economic growth. Moreover, doubts remain as to the lasting nature of the success achieved in the fight against inflation. A battle, or even several battles, may have been won, but not the war. Current rates of inflation are still substantially positive and would have been considered alarmingly high in a number of countries during the golden 1960s. Who can be confident enough to say that inflationary expectations have been eradicated? One does not need to be a pure monetarist to fear that a visible relaxation of monetary policies might revive them - in other words, that the recent favourable shift of the Phillips curve might prove to be short-lived. Monetary-policy-induced demand stimulation would then be equally short-lived and current inflation rates could rise without any lasting improvement in the labour market.

Secondly, even if this argument could be cast aside - i.e. even if it were possible to accelerate economic recovery through active demand management - the recent OECD study on unemployment suggests that a substantial part of European

unemployment is not of the Keynesian variety. That part cannot be cured by faster growth of nominal demand; the solution lies in active micro-economic policies, the main ingredients of which are education, increased labour mobility, the dropping of minimum wage requirements for young entrants into the labour market, and so forth. Some might object that the current US experience, in which fast growth goes hand in hand with an unexpectedly speedy drop in unemployment, warns us not to overstate the case for "structural" unemployment. I have some doubts about the relevance of the US example in this particular instance. The comparison of unemployment figures across the Atlantic is a notoriously risky exercise from a statistical point of view. Moreover, a large part of the impressive employment performance of the US economy can be explained by the transfer of labour from the internationally traded goods sector to the sector of non-tradables - mainly services. This may be a possible, though not necessarily advisable, route for a country with an overvalued exchange rate and a weak balance-of-payments constraint. But to what extent could European countries afford to follow this model for absorbing unemployment?

This leads me to exchange rate considerations, which present a third reason for giving a negative answer to the question I have just raised. The "decoupling" of European (specifically DM) interest rates from those of the United States has, to some extent, been successful - but at the cost of accepting a decline in exchange rates. This has so far been a tolerable cost. Booming exports at the expense of the US economy have given a helping hand to a modest revival of domestic demand. At the same time, the weakness of dollar-denominated commodity prices has partially offset the cost-push inflationary impact of the fall in the effective exchange rates of the European currencies. But such a trade-off has its limits: unless there is a marked shift in exchange rate expectations against the dollar, a renewed widening of the interest rate differential could well put the European currencies under unacceptable external inflationary pressure.

So far, so good. I am ready to defend this line of reasoning against any relaxation of monetary policies with a fair degree of conviction. But how does this view stand up against the obvious need to consider monetary policy options in a wider framework? And by "wider" I mean both geographically, looking at the western industrial world (or perhaps even the world) as a whole, and taking account of fiscal policy stances as well.

The level of real interest rates in a financially integrated western world

The need for a geographically enlarged horizon seems to me overwhelming in view of the extensive integration of

financial markets in the western industrial world. This integration is one of the most striking facts of recent economic history and presents a considerable challenge to policy-makers, perhaps the greatest that they have faced for some time. It also presents an intellectual challenge to economists, who are desperately trying to catch up with the changing international scene: witness, for example, the turmoil into which the theory of exchange rate determination has been thrown in the wake of the large and enduring movements in the dollar's real effective exchange rate.

Measuring financial integration is no easy matter and the significance of individual indicators is open to debate. Helpfully, all of them point towards greater integration. The volume of capital flows has increased considerably - a recent spectacular example is provided by the large-scale capital imports into the United States. There has been a dramatic growth in turnover on the foreign exchange markets, not to mention the more recent expansion of trading in foreign currency and interest rate futures. Banks' balance sheets have become more and more internationally oriented, whether looked at in terms of cross-border claims and liabilities, of assets and liabilities denominated in foreign currencies, of profits originating from international transactions, or of reliance on international interbank funding. The large banks' liquidity management is integrated on a worldwide basis; and these banks offer similar services to corporate treasurers. The technology of communications is developing at a rapid pace. Financial innovations are spreading more and more quickly from one country to another: look at the speed with which currency and interest rate swaps have become common practice in international banking.

More significantly, all current studies of which I am aware confirm that interest parity is almost instantaneously observed in the Euro-markets, even in periods of swift interest rate fluctuations. Finally, and even more significantly, interest rate variations in the United States have had an appreciable impact on interest rates elsewhere. As I have noted, exchange rate developments have limited this influence but have not offset it completely. In other words, a transmission mechanism is operating between domestic financial markets even in a system of fairly generalised floating - just as there is a cyclical transmission mechanism through the flow of goods and services despite the existence of the same floating system.

As a result of this advanced integration of financial markets, it has become difficult - perhaps even meaningless - to assess the stance of the monetary policy or monetary/fiscal policy mix of any large country without looking at the group of industrial countries as a whole. Let me try to approach some of our "global" problems by hanging them on a common peg, namely that of real interest rates. Are these interest rates too high today? If so, why? Because of the US policy mix or

for other reasons? Answers to these questions, it seems to me, follow four schools of thought - and I apologise for this inevitably arbitrary classification. May I also add that these schools of thought do not necessarily lead to mutually exclusive conclusions but can, in fact, be regarded as complementary.

Firstly, there are the agnostics, i.e. those who express doubts about the feasibility of measuring the level of real interest rates and, therefore, of forming meaningful views about the appropriateness of their current levels. A minor (and probably not insurmountable) practical problem underlying such doubts relates to the complexity of fiscal systems, which makes it difficult to compare the after-tax interest burdens of individual market participants, in particular when they belong to different countries. A more fundamental reason for doubt lies in the difficulty of measuring inflationary expectations, which may well (indeed, are likely to) differ from actual inflation rates. It is on this second count that not a few economists refuse to pass judgement on the current level of real interest rates. While I have some sympathy for such scepticism, I nevertheless cannot help but feel that when observed inflation rates have been declining for some time, with nominal interest rates remaining unchanged and in some instances even rising, something is likely to have happened to the level of real interest rates, and this "something" was surely not a decline. In the same way, I do not deny that tax advantages reduce in many cases the burden of high interest charges - except when a business corporation has no taxable income.

Secondly, there are those who do not question that real interest rates (defined as the nominal rates minus actual inflation rates) are high by historical standards, but ascribe this fact to the incorporation into current interest rates of one or two kinds of premia. There would be, in this view, an inflationary premium due to the persistence of inflationary expectations which should be attributed either to the long historical experience of inflation, or to the lack of credibility attached to the monetary authorities' commitment to fight inflation (itself a result of these authorities' inability to keep the growth of money supply on a gradually decelerating, stable, course) or simply to the deficit spending of the fiscal authorities. There would also be a premium to cover the increased uncertainty derived from the high volatility of interest rates. For some observers, the culprit again is the lack of stability in the rate of growth of the money supply. For my part, I would be ready to acknowledge the existence of both these premia, although I do not believe that they tell the whole story; nor do I believe that they should be explained exclusively in terms of observed money supply behaviour.

A third set of answers is given by those who argue, much in the classical tradition, that the level of real interest

rates is governed by the "real" economy, i.e. by the rate of return on real assets, and not by monetary factors. Monetary policy is therefore unable to influence it, except perhaps in the very short run.

Applying this reasoning to current circumstances produces the following line of argument. Let us acknowledge that real interest rates in the United States are at present quite high by historical standards; let us further admit that this triggers massive capital flows into the United States which, in turn, keep the dollar at its present high level and at the same time bear some of the responsibility for also keeping real interest rates in Europe and Japan at levels that are somewhat higher than in the past, although less so than in the United States. The point is then made that this state of affairs has not much to do with respective monetary and fiscal policy stances, but is due to the marked increase in the rate of return on real assets in the United States, reflecting the much better response of the US economy to the challenge of the current economic environment. Europeans have themselves to blame rather than the US policy mix; the solution for Europe lies in improving the performance of its real economy, specifically in implementing policies that would lead to higher real rates of return on capital.

Anyone who has been brought up in the classical tradition is bound to feel some sympathy for this view. Whatever my sympathy, I nonetheless have some doubts. I am prepared to acknowledge that the rapid pace of the US recovery, despite what seem to be rather high real interest rates, lends plausibility to the argument; I can also imagine that many market participants outside the United States actually believe that prospective real returns are higher in the United States than elsewhere - to say this is almost tautology. However, the fast pace of the US recovery can also be explained in terms of the most conventional IS/LM diagram - as a matter of fact, the problem that neo-Keynesians encountered a few years ago was exactly the reverse: why was it that the take-off of the US economy occurred with such a delay? Moreover, one knows perfectly well that tax rebates on investment have helped to make capital quite cheap for US businesses: I would hardly call these tax concessions a "real" adjustment, however justified they may have been from a policy point of view. Last but not least, market sentiment is no proof that real returns are, or will be, in fact high. The ability of financial markets to adequately forecast future earnings is, to say the least, doubtful. As Prof. Tobin would say, their "fundamental-valuation efficiency" is questionable. Nor am I aware of empirical evidence showing that, in any systematic way, rates of return on real assets have increased much more sharply in the United States than in either Europe or Japan, or are today at a higher level. This, admittedly, does not preclude their out-performing European ones in the future, but to believe this I would need more evidence than current market behaviour.

This leads me to the fourth school of thought, which puts the responsibility for high real interest rates squarely on the shoulders of US policy-makers. Real interest rates are high in the United States, and also relatively high elsewhere, because of a US policy mix that combines an expansionary fiscal stance with restrictive monetary policy. An appropriate change in the mix would lead to a lower real rate in the United States and, indirectly, both to a lower dollar on the exchange markets and to lower real rates in the rest of the western industrial world.

But what would this "appropriate" change be? Broadly speaking, two contrasting answers are given to this question, with shades of opinion between them.

On one view - what one might call the "mainstream" view - the change should imply a tightening of the US fiscal stance, preferably by cutting expenditure but if necessary by raising taxes, while keeping US monetary policy on its present course, i.e. continuing the gradual reduction of money supply growth rates. By helping to lower nominal and real interest rates in the United States, such a policy would also contribute to lowering them in western Europe and Japan, and would at the same time bring exchange rates into better balance.

The second view questions the wisdom of tightening US fiscal policy without a corresponding fiscal stimulus elsewhere and advocates a concomitant relaxation of the US monetary policy stance, possibly with some tightening in Japan and Europe. It is argued that the fiscal policy of the western industrial world taken as a whole is not expansionary, since the positive fiscal impulse emanating from the United States is, to a large extent, offset by the restrictive fiscal stance of the other major western countries. The OECD has provided some statistical basis for this view, suggesting at least a partial offsetting of the US expansionary impulse by contractionary fiscal impulses in some other countries. On this view, therefore, the explanation for the high level of world real interest rates must lie in generally tight monetary policies, or perhaps in high real rates of return, but certainly not in excessively stimulatory fiscal policies in the western world as a whole. The conclusion drawn is that, other things being equal, a tightening of the US fiscal stance would lead to a worldwide economic slowdown. Hence the suggestion that the adoption of a tighter US fiscal policy should be accompanied by fiscal expansion elsewhere, while monetary policy should be relaxed in the United States and left unchanged (or perhaps somewhat tightened) in the rest of the world. Incidentally, the second part of this proposition would also be endorsed by some "international monetarists", who explain the strength of the dollar directly in terms of an excessively tight US monetary policy set against an insufficiently tight one in Europe and Japan.

It will come as no surprise to you that my own conclusions incline towards what I have called the "mainstream" view, although I must admit to an uncomfortable feeling that this view does not take full account of the international interdependence, financial and real, of the western world. For the sake of stimulating discussion, let me try to make clear the three reasons which nevertheless prompt me to support it.

The first is that I regard the rapidly developing imbalance in the US external position, which, rightly or wrongly, I link to a large extent to the US fiscal policy stance, as a potential threat to international financial stability. A part of this imbalance was, and still is, welcome - otherwise the US economy could not have acted as the world locomotive, a rôle that the United States alone was, and is, able to perform. But the sharply deteriorating US international investment position - at an annual rate of \$100 billion -, combined with the crucial rôle of external financial flows in the financing of US domestic sectors, are unsustainable. At almost any time they could, in the event of a sudden shift in international portfolio preferences against the dollar, raise the spectre of financial shocks whose effects on both the United States and the rest of the world could quickly erode the currently beneficial "real" impact of US growth on the world economy. This is not, of course, a forecast, just a reminder of a possible scenario combining recession and high interest rates in the United States that policy-makers would be well advised not to rule out.

Secondly, we should not forget a principal lesson of the late 1970s, namely the importance of keeping inflation in the United States well under control not only for the sake of the US economy but also for that of the world as a whole. Hence my inclination to view any relaxation of the US monetary policy stance as a dangerous exercise.

Thirdly, I do not believe that either Europe or Japan has the same degree of freedom from external constraints as the United States. Even that of the United States is not complete; that of Japan and Europe is very limited indeed. There is no symmetry in the world economy. In other words, any relaxation of some importance of fiscal policies in Europe - quite apart from the fact that any such proposal is a non-starter since no major European government at present in power would be prepared to consider it - would carry with it major dangers for external balance, as the Germans well know from the experience of 1980-81 and the French from that of 1982-83, not to mention the dire consequences of further postponing the expenditure cuts needed to correct the over-extended position of the public sector. That this need for budgetary consolidation may exert a somewhat deflationary influence on the world economy must be accepted as a fact of life. The trouble is, of course, that for the two reasons just mentioned

any such influence can be compensated from the US side only up to a point - hence the difficult balancing-act of welcoming some fiscal and external imbalance in the United States, but not too much.

Financial innovations and deregulation

Let me turn finally to a third area of concern for monetary policy-makers - the implications of financial innovations and of deregulation for the conduct of monetary policy.

Two general observations - or suggestions for discussion - to begin with. The first is a plea for more extensive and more systematic analysis and information. As regards analysis, I find it disturbing that we seem to know so little about the driving forces behind financial innovations and why they seem to occur more extensively in some countries than in others. The list of factors contributing to innovations is of course reasonably well known: high and variable inflation rates; efforts to circumvent regulations or to reduce the burden of taxation - or, on the contrary, making use of opportunities offered by deregulation; the desire to limit risks associated with greater uncertainty (e.g. interest or exchange rate volatility); competitive pressure to meet customers' needs; the emergence of new technology. But do we really understand why some or all of these influences have led to such a sudden speeding-up of the process of innovation in recent years and why have they done so especially (or only apparently so?) in the United States?

It is at this point that factual information, or rather the lack of it, becomes important. As I already pointed out a few years ago, it is remarkable to observe that public discussion of innovation and deregulation is so much centred on the Anglo-Saxon world. What is the state of affairs in these respects elsewhere - in particular in some of the major continental European countries? Is it true that as a result of historical developments (such as the traditional interconnection between securities business, underwriting and commercial banking) the continental European practice of universal banking had led to a de facto state of deregulation well before developments currently observed in the United States or the United Kingdom? Or, on the contrary, is privately managed but officially encouraged financial cartelisation the real European way of life? Can it not be said that retail banking technology as applied to payment systems is far more advanced in some European countries than either in the United Kingdom or in the United States? More generally, in what respects is Europe financially more, or less, "backward" than the Anglo-Saxon countries? And why?

My second observation calls for an equally ambitious programme of research in the field of normative financial

economics. In his 1984 Fred Hirsch memorial lecture, Prof. Tobin offered us four criteria of efficiency of the financial system, while confessing to "an uneasy Physiocratic suspicion" that a global cost-benefit analysis would not necessarily come down in favour of complete financial deregulation. The heart of the matter, to my mind, is that, since we have never experienced completely free financial markets, no convincing empirical testing is possible. And I stress the word "completely": to observe what may actually happen during a period of transition from more to less regulation, or vice versa, can provide misleading information on the merits, or demerits, of a fully deregulated financial world. In general terms, lopsidedness in regulations can lead to situations which are difficult to assess. In a well-known recent case a bank which was free to compete for its assets, but not for its liabilities, got itself into trouble. Was there too much regulation on one side of the balance sheet or too little on the other? Or was it just an isolated case of mismanagement? And so it is left to pure theory to tell us whether the observed inefficiencies of financial markets (on any of Tobin's four criteria) are due to regulation or other types of government interference or are an integral part of the functioning of even completely free financial markets. Any such theorising is bound to be influenced by social or political philosophy or simply by personal bias and prejudices.

Be that as it may, in the present world of rapid innovation and progressive deregulation monetary policy-makers face two major problem areas. One relates to the implementation of monetary control in its broadest sense, i.e. not only the choice of the appropriate control targets or intermediate policy objectives, but also the modus operandi of the transmission mechanism from monetary variables - aggregates or interest rates - to prices and real output. The identification of operational or intermediate targets may be seriously disturbed by the process of financial innovation and the blurring of institutional boundaries resulting from deregulation. As to the transmission mechanism, it is bound to be affected by the generalisation of floating interest rates and by the spreading use of financial futures. But how? An answer to this question is needed not simply to provide central bankers with intellectual or moral comfort, or to establish rules of accountability, but also to preserve the usability of monetary policy as the main macro-economic policy instrument. At a time when the practical or fundamental limitations of fiscal policy have become so obvious, loss of effectiveness of monetary policy would surely have to be counted as a social cost to be set against the benefits of deregulation in any global cost-benefit analysis.

The same applies to the second area of problems generated by innovation and deregulation, which might be grouped under

the heading of the stability of the financial system. The question here is not the theoretical one of whether financial crises are or are not part and parcel of a completely free financial system. This is an interesting question but one that has little practical relevance. We do not, and shall not in the foreseeable future, live in a financial system completely free of government interference or of "distortions" of other kinds. What I have in mind is the very practical question of how central banks are supposed to discharge their duty to preserve the stability of financial markets, i.e. to prevent and/or to manage crises, in an environment characterised by an ongoing process of deregulation and innovation - with the emphasis on the word "process". To act as lenders of last resort or as supervisors at such a time of transition in financial markets is no easy business.

And their task is being dauntingly complicated by the concurrence of two other developments. The first is the process of worldwide financial integration I mentioned earlier in connection with the appropriate stance of the policy mix. The fact that innovation is taking place in such an environment renders much more arduous the task of bank management, auditors and supervisors alike. Let me just name one example: the assessment of the risks implied by such off-balance sheet items as financial futures contracts, which in some cases substitute for international interbank funding. The second development brings me back to where this paper has started: the process of disinflation, but this time seen from the prudential angle. Not unexpectedly, high real interest rates, slower growth and disinflationary price developments have produced casualties among bank customers, domestically and internationally, not to mention banks themselves; and the casualties have in some cases been multiplied by large and unexpected exchange rate movements, changes in energy prices and shifts in the international division of labour. Such casualties are continuing to occur even today, in the midst of a recovery, which clearly shows that the process of adjustment is still very much under way. I doubt that we have seen the end of the story, especially since cyclical upswings do not last for ever.

Concluding observations

By way of conclusion let me try to pull together the threads running somewhat loosely through my argument into a few propositions - which is perhaps also a way of confessing to having a few preconceived ideas, such as a basic disbelief in most of the premises of monetarist theory (but not in all of its policy conclusions).

The first is that one should not expect too much of monetary policy. Given the widespread disenchantment with incomes policy and the inflexible orientation of fiscal policy

on both sides of the Atlantic, there is a danger that monetary policy may be required to perform more than it can deliver. Central bankers have always tried to avoid falling into this trap, and their natural instinct of survival has been right. Restrictive monetary policy can lead to noticeable results in the fight against inflation. But, when the labour market is rigid, the social cost will be high and lasting unemployment; and when a public-sector deficit pulls the policy mix in the opposite direction interest rates may become stuck at a dangerously high level. At least, when restrictive monetary policy is applied with sufficient vigour, inflation will decelerate. But it is hard to see monetary policy of any kind leading to a sustainable, well-balanced, non-inflationary recovery without the help of other policies. There is no monetary policy trick that can undo the potentially disruptive influence of a strongly expansionary US budgetary policy (or, for that matter, of a structural budget deficit anywhere else); nor can European monetary policy be expected to speed up real capital formation and lastingly alleviate unemployment without a shift in income distribution in favour of profits, greater mobility in the labour market and improved entrepreneurial performance.

By emphasising these limits to monetary policy I do not mean to underrate its indispensable contribution to the fight against inflation, a task that seems to me to be still unfinished. It can make this contribution both directly, by restraining spending, and indirectly, by helping to defuse inflationary expectations. This second objective is best served, to my mind, through the implementation of a medium-term targeting policy, the targets being either monetary aggregates or the exchange rate tied to the currency of a large non-inflationary country or to a basket of currencies in which non-inflationary countries have a large share. Either of these targets will make plain the monetary authorities' commitment to the cause of eradicating inflation. In this way central banks can provide market participants with at least one element of stability in an otherwise highly uncertain environment. But even here some modesty is in order. The implementation of either of these targeting techniques may well create instability of another kind - in particular in the context of a wrong policy mix - of which the prime example is, of course, interest rate misalignment or volatility. There will be no general financial stability simply by sticking to monetary targets.

Last but not least, I should like to stress the importance of carrying out monetary targeting in a medium-term perspective. As I have already mentioned, the financial systems in many western industrial countries are, to varying degrees, caught up in three interconnected evolutionary processes: one of innovation and deregulation; one of growing internationalisation; and, lastly, one of disinflation. And as a result of advanced international financial integration, even those

countries where innovation is less buoyant and/or where the end of the disinflationary process is (perhaps) in sight, cannot isolate themselves from the rest. I am aware of no historical precedent that could serve as a satisfactory guide for the short-term conduct of monetary policy in these circumstances. Nor do I know of any credible theoretical contribution that could enlighten monetary policy practitioners in carrying out their day-to-day business in such a fluid environment - and this is just another way of saying that I do not regard as a credible advice the monetarist recipe of disregarding the practicalities of a rapidly changing world. To navigate in these uncharted waters, central bankers will have to apply a great deal of pragmatic flexibility which, on occasion, will have to temper the strict adherence to targets. They will run into criticism both from academics and politicians, but this is just a professional risk to take. Applying rules in our world without discretionary judgment is a pipedream bordering on irresponsibility.

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Director: PETER CROPPER

PJC/CR

13th November 1984

Dear Margaret

... Herewith some thoughts on the bundle of CGT papers, which are returned for safe keeping.

I have not copied this around: the Chancellor may or may not wish to do so.

Peter

PETER CROPPER

Miss Margaret O'Mara
The Chancellor of the Exchequer's Private Office
H M Treasury
Parliament Street
LONDON SW1

*c/ Do you want to circulate?
mom 14/11
Dec
mom 19/11*

CONFIDENTIAL



FROM: MISS M O'MARA
DATE: 15 November 1984

CHANCELLOR

SPEECH COMMITTEE

Peter Makeham had just produced a note on outstanding invitations today (Mark I) when we called a meeting of Speech Committee at your request. As a number of invitations have come in during the last couple of days since the official Speech Committee last met, he has produced a further note (Mark II).

2. Robert Culpin has also put in a note which refers, inter alia, to a Newspaper Conference speaking invitation. We have copied it to other members of the Committee so tomorrow's meeting could cover that too (copy flagged below).

3. On forthcoming speeches, we had asked Michael Portillo to produce drafts by this weekend for the next two occasions - Glasgow (next Friday) and the Portcullis Club (the following Monday) - as they are both Party events. But he has been so pressed this week that he will not be able to meet the deadline. Peter Makeham has suggested that Michael might put up skeleton speeches by tomorrow evening but he and Tony Battishill have also proposed that you might recycle much of Tuesday's speech for Glasgow, since the coverage given to Francis Pym meant that you were not reported in detail.

4. You also need to settle the travel arrangements for Glasgow (flagged below).

5. Looking further ahead, you agreed to have a drink with Mr Jacomb to discuss the speech for the Parlour. You would need to have that early next week if it is to influence the drafting but Donna has put a note in your diary folder tonight



showing that the timing looks virtually impossible. Would you prefer to have a word with him on the telephone?

6. Speech Committee might also discuss topics for your December speeches. It would be helpful to get someone working on the Stock Exchange Christmas lunch as soon as possible.

Mom

MISS M O'MARA

CHANCELLOR

To be delivered tonight. A more honest call on Superpower code (rather than Disraeli) than usual, & many carefully chosen bases - e.g. the Employment w.o. jibe at the 17 on p. 14. I have submitted previous & 4 on not want to glue.

M 20/11

Release Time: 18.30hrs Tuesday
20th November 1984

The Harold Macmillan Lecture by the RT. HON PETER WALKER MBE., MP., Secretary of State for Energy and National President of the Young Conservatives, to an audience invited by the national officers of the Young Conservatives at St Ermins Hotel, London S.W.1.. on Tuesday 20th November 1984.

PARLIAMENT HAS JUST COMPLETED ITS DEBATE ON THE QUEEN'S SPEECH. IT WAS DURING SIMILAR DEBATES EXACTLY FIFTY YEARS AGO, THEN ON THE KING'S SPEECH, THAT THE YOUNG MEMBER OF PARLIAMENT FOR STOCKTON, HAROLD MACMILLAN, SPOKE OF THE ASPIRATIONS OF HIS CONSTITUENTS AT A TIME WHEN MASS UNEMPLOYMENT HAD BROUGHT SUFFERING AND SQUALOR TO SO MANY.

HE TOLD THE HOUSE OF COMMONS:

"THE ORDINARY MAN OF TODAY WANTS FREEDOM, RESPONSIBILITY AND STATUS. HE REJECTS AT ONE THE OLD INDIVIDUALISM WHICH, BEGINNING WITH THE REFORMATION AND GOING ON WITH THE INDUSTRIAL REVOLUTION, DID NOT QUITE DESTROY BUT FATALLY INJURED THE OLD ORGANIC CONCEPTION OF SOCIETY. HE WANTS TO SEE IT REBUILT. HE DOES NOT WANT SOCIALISM OR INDIVIDUALISM. HE WANTS NEITHER THE JEKYLL NOR THE HYDE. HE WANTS AN ORGANISED SYSTEM OF SOCIETY IN WHICH HE HAS A PLACE, IN WHICH NEITHER THE RIGHTS OF THE COMMUNITY NOR THE RIGHTS OF THE INDIVIDUAL ARE OVER EMPHASISED, AND IN

WHICH HE CAN FEEL HIMSELF TO BE SOMETHING DIFFERENT FROM WHAT HE HAS BEEN IN THE PAST."

HOW DELIGHTED WE ALL ARE THAT FIFTY YEARS LATER HE HAS JUST DELIVERED HIS MAIDEN SPEECH IN ANOTHER PLACE.

NO APPEASEMENT

IN THE 1930'S HAROLD MACMILLAN WAS UNWILLING TO SUPPORT APPEASEMENT AT HOME OR ABROAD. JUST AS HE WOULD SHOW NO APPEASEMENT TOWARDS HIGH UNEMPLOYMENT NOR WOULD HE ACCEPT APPEASEMENT TOWARDS THE GROWING THREAT OF FASCIST GERMANY AND ITALY. FEW POLITICIANS THIS CENTURY HAVE HAD SUCH CLEAR AND CORRECT CONCEPTS AS TO WHAT SHOULD BE THE NATURE OF BRITISH FOREIGN POLICY.

HE RECOGNISED THAT IT WAS ONLY BY FRANK AND UNMISTAKABLE DETERMINATION THAT WAR COULD BE AVOIDED, AND THAT THE CONDITIONS OF THIS CENTURY MEANT THAT THE ALLIANCE WITH THE UNITED STATES WAS AN ESSENTIAL COMPONENT OF THE DEFENCE OF WESTERN FREEDOMS. CHURCHILL HAD SHARED THIS VIEW: CHAMBERLAIN HAD NOT. DURING THE WAR HAROLD MACMILLAN TOOK OFFICE FOR THE FIRST TIME. HE OCCUPIED A POST IN WHICH HE WAS INTIMATELY INVOLVED IN THE EMERGENCE OF DE GAULLE AS THE UNDISPUTED LEADER OF THE FREE FRENCH. HE WAS INVOLVED IN SECURING ITALY FOR DEMOCRACY AFTER THE FALL OF MUSSOLINI. BUT AS THE WAR

WENT ON MACMILLAN WAS AMONG THE FIRST TO CONCEIVE THE REAL DANGERS OF THE WORLD DIVIDED BETWEEN THE SOVIET BLOCK AND THE WEST. HE RECOGNISED BEFORE OTHERS THAT IF A VACUUM WAS LEFT BY THE RETREATING GERMAN ARMY IT WOULD CREATE AN OPPORTUNITY FOR STALIN TO REPLACE ONE TYRANNY WITH ANOTHER.

PERHAPS HISTORY WILL REFLECT HOW TRAGIC IT WAS THAT ROOSEVELT VETOED THE PLAN OF GENERAL ALEXANDER, ENTHUSIASTICALLY SUPPORTED BY HAROLD MACMILLAN, TO STRIKE EAST IN JULY 1944. IF THIS HAD BEEN ALLOWED THE DESTINIES OF THE BALKANS AND EASTERN EUROPE MIGHT WELL HAVE BEEN DIFFERENT.

CHURCHILL AND MACMILLAN SHARED AN AWARENESS OF HOW COMMUNISM MIGHT WELL PREVAIL BUT OTHERS WANTED TO BE GOOD MANNERED TOWARDS THE COMMUNISTS IN THE SAME WAY AS MANY HAD BEEN GOOD MANNERED TO HITLER AND MUSSOLINI IN THE 1930'S. IN HIS AUTOBIOGRAPHY HAROLD MACMILLAN RECALLED A CONVERSATION WITH CHURCHILL DURING THE CAIRO CONFERENCE IN 1943 IN WHICH HE WROTE:

"CHURCHILL SUDDENLY LOOKED AT ME AND SAID, 'CROMWELL WAS A GREAT MAN WASN'T HE?' I REPLIED, 'YES SIR, A VERY GREAT MAN.' 'AH,' HE SAID, 'BUT HE MADE ONE TERRIBLE MISTAKE. OBSESSED IN HIS YOUTH BY THE FEAR OF THE POWER OF SPAIN HE FAILED TO OBSERVE THE RISE OF FRANCE. WILL THAT BE SAID OF ME?' THIS THOUGHT, MACMILLAN COMMENTED,

DOMINATED HIS STRATEGIC PURPOSE. ALAS, AT THE TIME OF THE YALTA CONFERENCE THERE WAS A DIMINISHING INFLUENCE OF BRITISH DIPLOMACY. ROOSEVELT, AN AGING MAN, PARTLY FROM VANITY, FELT THAT HE COULD BEND AND CHARM STALIN. ALAS ROOSEVELT'S ILLUSIONS WERE SOON SHATTERED AND IN THE SUBSEQUENT YEARS THE SOVIET UNION TOOK A FIRM GRIP OF EASTERN EUROPE."

A UNITED EUROPE

FORTUNATELY HAROLD MACMILLAN HAD SEEN THAT AGAINST SUCH A BACKCLOTH THE UNION OF WESTERN EUROPE AND THE WESTERN ALLIANCE WAS ESSENTIAL. A FEW DAYS BEFORE ALAMEIN CHURCHILL AND MACMILLAN CONCEIVED HOW VITAL IT WAS IF WESTERN CIVILISATION WAS TO SURVIVE TO CREATE AN ORGANISATION ECONOMIC, CULTURAL AND POLITICAL COMPRISING ALL THE COUNTRIES OF WESTERN EUROPE.

WITH ONE OF THE MOST DECISIVE BATTLES OF THE WORLD WAR ABOUT TO TAKE PLACE CHURCHILL SAID THAT HIS THOUGHTS WERE PRIMARILY IN EUROPE FOR HIS MAIN FEAR WAS THAT THERE WOULD BE THE MEASURELESS DISASTER IF SOVIET BARBARISM OVERLAID THE CULTURE AND INDEPENDENCE OF THE ANCIENT STATES OF EUROPE.

FORTUNATELY FOR WESTERN EUROPE THE DEVELOPMENT OF NATO, THE DETERMINATION TO BE STRONG IN DEFENCE, THE IMAGINATIVE

CONCEPTS OF THE MARSHALL PLAN AND THE DEVELOPMENT OF THE EUROPEAN COMMUNITY HAVE PROTECTED BRITAIN FROM THIS DISASTER.

THERE IS, HOWEVER, NO ROOM FOR COMPLACENCY. THE SOVIET THREAT IN MILITARY TERMS IS NOT JUST THERE BUT THERE IN FAR GREATER STRENGTH THAN AT ANY TIME. WE STILL HAVE THE NEED FOR EUROPE TO MEAN SOMETHING FOR EACH INDIVIDUAL CITIZEN. HAVING UNDERSTANDABLY HAGGLED OVER THE INJUSTICES OF THE BUDGET DISTRIBUTION WE NEED A LEADERSHIP IN EUROPE WHICH WILL NOW EXPLOIT THE COLLECTIVE, ECONOMIC, COMMERCIAL AND CULTURAL STRENGTH OF ALL OF THE NATIONS INVOLVED.

THE KENNEDY PARTNERSHIP

ALTHOUGH OF DIFFERENT GENERATIONS, BOTH THE DOMESTIC AND INTERNATIONAL IDEALS OF HAROLD MACMILLAN WERE SHARED ENTHUSIASTICALLY BY PRESIDENT KENNEDY. BOTH OF THEM RECOGNISED THAT WE NEEDED MILITARY STRENGTH TO DETER ANY SOVIET INTIMIDATION TO IMPOSE COMMUNISM BY FORCE. WHILST BOTH THESE LEADERS WERE IN AGREEMENT AS TO THE NEED TO STOP MISSILES GOING TO CUBA, TO INCREASE DEFENCE SPENDING, THEY ALSO WORKED TO ACHIEVE A PEACEFUL RELATIONSHIP WITH THE SOVIET UNION. THE TEST BAN TREATY, THE DIALOGUE WITH SOVIET LEADERS, AN ATTITUDE BEST EXPRESSED IN THE CLEAR MESSAGE OF PRESIDENT KENNEDY WHEN HE SAID:

"SO LET US BEGIN ANEW - REMEMBERING ON BOTH SIDES THAT CIVILITY IS NOT A SIGN OF WEAKNESS, AND SINCERITY IS ALWAYS SUBJECT TO PROOF. LET US NEVER NEGOTIATE OUT OF FEAR. BUT LET US NEVER FEAR TO NEGOTIATE."

TO THE SOVIET UNION HE SAID:

"TO THOSE NATIONS WHO WOULD MAKE THEMSELVES OUR ADVERSARY, WE OFFER NOT A PLEDGE BUT A REQUEST: THAT BOTH SIDES BEGIN ANEW THE QUEST FOR PEACE, BEFORE THE DARK POWERS OF DESTRUCTION UNLEASHED BY SCIENCE ENGULF ALL HUMANITY IN PLANNED OR ACCIDENTAL SELF-DESTRUCTION.

"WE DARE NOT TEMPT THEM WITH WEAKNESS. FOR ONLY WHEN OUR ARMS ARE SUFFICIENT BEYOND DOUBT CAN WE BE CERTAIN BEYOND DOUBT THAT THEY WILL NEVER BE EMPLOYED."

BOTH SAW MULTILATERAL DISARMAMENT NOT AS A DEBATING POINT BUT AS A POLITICAL PRIORITY. WHILE MAINTAINING A READINESS FOR WAR, THEY FOLLOWED EVERY AVENUE FOR PEACE. THEY BELIEVED THAT THE MAKING OF PEACE WAS THE NOBLEST WORK OF GOD-FEARING MEN.

THE NORTH SOUTH CHALLENGE

BOTH ALSO RECOGNISED THE NECESSITY TO MEET THE NORTH SOUTH CHALLENGE. IN RECENT WEEKS WE HAVE BEEN REMINDED OF THE HORROR OF STARVATION IN ETHIOPIA. IT IS, HOWEVER, A HORROR THAT HAS BEEN AND WILL BE REPEATED ON A CONSIDERABLE SCALE. IN 1959, THE TIME OF HAROLD MACMILLAN'S GENERAL ELECTION SUCCESS AND AT THE TIME WHEN JACK KENNEDY HAD EMBARKED UPON THE ROAD TO BECOME PRESIDENT, THE YOUNG SENATOR, REFERRING TO THE NORTH SOUTH CHALLENGE, SAID:

"THERE IS A NATIONAL PREOCCUPATION WITH THE MISSILE GAP. THERE IS AN EQUALLY CLEAR AND PRESENT DANGER TO OUR SOCIETY - THE GAP IN LIVING STANDARDS, INCOME AND HOPE FOR THE FUTURE BETWEEN THE STABLE, INDUSTRIALISED NATIONS OF THE NORTH AND THE OVER-POPULATED, UNDEVELOPED NATIONS OF THE SOUTH."

HE WENT ON:

"IT IS THIS GAP WHICH PRESENTS US WITH OUR MOST CRITICAL CHALLENGE TODAY. IT IS THIS GAP WHICH IS ALTERING THE FACE OF THE GLOBE, OUR STRATEGY, OUR SECURITY AND OUR ALLIANCES MORE THAN ANY CURRENT MILITARY CHALLENGE. AND IT IS THIS ECONOMIC CHALLENGE TO WHICH WE HAVE RESPONDED MOST SPORADICALLY, MOST TIMIDLY AND MOST INADEQUATELY."

IN THE YEARS SINCE NEITHER THE UNITED STATES NOR THE EUROPEAN COMMUNITY HAVE BEEN ABLE TO DEVELOP THE AGRICULTURE OF THE THIRD WORLD OR FIND WAYS OF MOVING THE FOOD SURPLUSES OF THE WEST TO THOSE WHO ARE STARVING. IT IS ONLY WHEN THE TELEVISION CAMERA BRINGS TO OUR SITTING ROOMS THE STARK HORROR OF THE SCENE THAT WE AROUSE OURSELVES TO TAKE SOME ACTION, ACTION MORE MOTIVATED AS A CONTRIBUTION TO OUR CONSCIENCE THAN ACTION ON THE SCALE REQUIRED TO SOLVE THE PROBLEM. IT IS A SITUATION WHICH CANNOT ENDURE. THE REVOLUTION IS COMING. THE WEST MUST PURSUE POLICIES THAT WILL SEE THAT IT IS A PEACEFUL REVOLUTION. WITH COMPASSION AND ORGANISATION IT CAN BE A REVOLUTION WITH BENEFITS TO THE WORLD. WE CAN AFFECT THE CHARACTER OF THE REVOLUTION. WE CANNOT ALTER ITS INEVITABILITY.

IN THE 1930'S HAROLD MACMILLAN FORESAW THE TYRANNY OF HITLER. IN THE 1940'S HE WAS FIRST TO SEE THE TERRIBLE DANGERS OF TWO EUROPE'S AND THEREAFTER THE DANGERS OF THE SOVIET UNION CREATING TWO WORLDS. IN THE 1950'S HE WAS THE FIRST OF THE WESTERN LEADERS TO SEE THE POTENTIAL FURTHER DIVISION OF THE WORLD BASED UPON RACIAL TENSION IF THE ASPIRATIONS OF THE AFRICANS AND ASIANS WERE NOT MET. WHEN AS PRIME MINISTER HE TOURED AFRICA MANY IN BRITAIN WERE NOT PLEASED WHEN HE SAID:

"WE HAVE SEEN THE AWAKENING OF NATIONAL CONSCIOUSNESS IN PEOPLE WHO HAVE FOR CENTURIES LIVED IN DEPENDENCE UPON SOME OTHER POWER - THE MOST STRIKING OF ALL IMPRESSIONS I HAVE FORMED SINCE I LEFT LONDON A MONTH AGO IS OF THE STRENGTH OF THIS AFRICAN NATIONAL CONSCIOUSNESS. IN DIFFERENT PLACES IT TAKES DIFFERENT FORMS BUT IT IS HAPPENING EVERYWHERE. THE WIND OF CHANGE IS BLOWING THROUGH THIS CONTINENT AND WHETHER WE LIKE IT OR NOT THIS GROWTH OF NATIONAL CONSCIOUSNESS IS A POLITICAL FACT. WE MUST ALL ACCEPT IT AS A FACT AND OUR NATIONAL POLICIES MUST TAKE ACCOUNT OF IT."

MACMILLAN REACTED TO TRENDS THAT MIGHT HAVE THOUGHT TO BE HOSTILE TO BRITAIN. HIS ATTITUDE WAS ONE THAT WE NEED TO APPLY TODAY. HAROLD MACMILLAN WOULD NOT TAKE A NARROW ACCOUNTANT'S VIEW OF LATIN AMERICA'S INDEBTEDNESS. HE WOULD NOT DISTANCE HIMSELF FROM THIRD WORLD DEVELOPMENT. HE WOULD SEE IN THE DEVELOPMENT OF THESE COUNTRIES' DOMESTIC MARKETS THE SAME OPPORTUNITIES FOR EXPANDING TRADE WHICH MOTIVATED PRESIDENT TRUMAN TO AUTHORISE MARSHALL AID. HE WOULD SEE IN THE THREAT OF WIDESPREAD POVERTY AND DESPAIR NOT ONLY A CAUSE, WHICH CALLED FOR HUMAN RESPONSE, BUT HE WOULD ALSO SEE THE SAME POLITICAL THREAT TO WESTERN INTERESTS AND INTERNATIONAL STABILITY WHICH HE SAW IN THE DESPAIRING FACES OF HIS CONSTITUENTS IN STOCKTON.

IN "THE MIDDLE WAY" HE ENDEAVOURED TO SHOW WHAT COULD BE DONE AT HOME TO CREATE ONE NATION. IN HIS LATER CAREER HE SHOWED THAT ONE NATION WAS NOT ENOUGH. WE ALSO NEEDED ONE EUROPE, ONE ATLANTIC ALLIANCE AND, WHENEVER POSSIBLE, TO AIM TOWARDS ONE WORLD.

ONE NATION

IT WAS HIS ONE NATION APPROACH WHICH WAS THE FOUNDATION OF HIS REMARKABLE BOOK "THE MIDDLE WAY". MACMILLAN BELIEVED IN ECONOMIC EFFICIENCY. MACMILLAN SOUGHT SOCIAL COMPASSION. HE ARGUED THAT THE ESSENCE OF RADICAL TORYISM WAS TO SEARCH FOR THE CORRECT BALANCE BETWEEN BOTH. MACMILLAN RECOGNISED THAT A VIBRANT LIBERAL SOCIETY DEPENDED ON INDIVIDUAL ENTERPRISE AND INITIATIVE. BUT HE ALSO RECOGNISED THAT IT WAS THE JOB OF THE STATE TO ENSURE THAT ALL THE PEOPLE BENEFITED FROM THAT ENTERPRISE. IN HIS CONSTITUENCY HE SAW THE TRAGIC HUMAN CONSEQUENCES OF THE COLLAPSE OF THE LAISSEZ-FAIRE SYSTEM OF UNCONTROLLED CAPITALISM. ELSEWHERE IN EUROPE HE RECOILED FROM THE TOTALITARIAN ALTERNATIVES FROM BOTH THE LEFT AND THE RIGHT. AT HOME AND ABROAD HE SOUGHT TO PROMULGATE ANOTHER ALTERNATIVE: THE MIDDLE WAY.

IN 1938 THESE WERE THE DREAMS OF A BACKBENCH REBEL. IN 1948 THEY BECAME THE AUTHENTIC POLICY OF MODERN TORYISM.

BY 1958 THEY WERE THE CLEAR VISION OF A MOST SUCCESSFUL
POST-WAR PRIME MINISTER.

SPEAKING AS PRIME MINISTER HE SAID:

"THE LONGER I LIVE AND THE MORE I TRY TO READ AND STUDY,
THE MORE CERTAIN I AM THAT WE ARE THE HEIRS TO THE
FINEST AND MOST ENDURING TRADITION OF BRITISH POLITICAL
THINKING. I BELIEVE, AS SURELY AS I BELIEVED TWENTY
YEARS AGO, THAT THE ONLY POSITION IN POLITICS THAT WE
CONSERVATIVES CAN OCCUPY WITH HONOUR IS THE MIDDLE GROUND,
AND THE ONLY PATH IN OUR INTERNAL POLITICS THAT WE CAN TREAD
IN TRIUMPH IS THE MIDDLE WAY. I DO NOT SAY THIS BECAUSE
I HAVE A SPECIAL TASTE OR TEMPERAMENT FOR TRIMMING. MATTERS
OF PRINCIPLE CANNOT BE COMPROMISED, BUT ECONOMIC AND SOCIAL
PROBLEMS ARE MATTERS OF JUDGMENT AND PRACTICAL APPROACH,
AND INDEED THE MIDDLE OF THE WAY APPROACH SQUARES WITH
THE MOST FUNDAMENTAL TRADITIONS AND HABITS OF MAN THAT HAVE
BEEN PASSED DOWN TO US FROM THE PAST, AS WELL AS WITH THE
MOST URGENT NEEDS OF THE DAY."

NO DOGMA

THROUGHOUT HIS CAREER HAROLD MACMILLAN HAS SPURNED DOGMA:
"LET SLEEPING DOGMAS LIE" HAS BEEN HIS SLOGAN. IN RECENT
YEARS HE REFLECTED:

"ECONOMICS HAS NOW USURPED THE PLACE HELD ONE HUNDRED YEARS AGO BY THEOLOGY. THE ODIUM ECONOMICUM HAS TAKEN THE PLACE OF THE ODIUM THEOLOGICUM."

THROUGHOUT HIS LIFE HE HAS REFUSED TO ALLOW THE HIGH PRIESTS OF THE NEW THEOLOGY TO DISTRACT HIM FROM PRACTICAL MATTERS. WHEN THE ECONOMIC THEOLOGIANS OF THE 1930'S ARGUED THAT THE CAUSES OF UNEMPLOYMENT LAY BEYOND THE POWER OF GOVERNMENT TO SOLVE, HE DISMISSED THEIR VIEWS AS "ECONOMIC CALVANISM".

"ARE WE TO ACCEPT ECONOMIC DETERMINATION OR HAVE WE FREE WILL? CAN WE APPLY HUMAN INTELLIGENCE TO MAKE A SOLUTION OF SOME OF THESE PROBLEMS OR ARE THEY INHERENT IN EVERY SYSTEM?"

MACMILLAN BELONGS TO THAT RADICAL TORY TRADITION, ONCE DESCRIBED BY AN AMERICAN HISTORIAN AS THAT "FRETFUL AND TROUBLESOME COMPANY OF THOSE WHOSE IMAGINATION, HAVING ONCE BEEN SHOCKED INTO A SENSE OF FINER POSSIBILITIES IN SOCIAL ORDERING, CANNOT THEREAFTER WALK PEACEABLY ALONGSIDE COMPLACENCY."

THE HORROR OF UNEMPLOYMENT

IN STOCKTON, AS HE WATCHED THE DESPAIRING FACES OF THE MEN WHO TRAMPED UP AND DOWN THE HIGH STREETS OF STOCKTON AND THORNABY HE KNEW THERE WAS NO ROOM FOR COMPLACENCY. TRUE, THERE WAS RELIEF AND ASSISTANCE AVAILABLE, THOUGH ON A MODEST SCALE. BUT IT WAS NOT CHARITY, WHETHER FROM THE NATION AS A WHOLE, OR FROM THEIR NEIGHBOURS, THAT THESE MEN REQUIRED. IT WAS WORK: THAT WAS THE FINER POSSIBILITY" MACMILLAN STRUGGLED TO BRING THEM.

TODAY, THE SPECTRE OF HIGH UNEMPLOYMENT HAS NOW RETURNED TO STOCKTON AND MANY OTHER PARTS OF BRITAIN. THE LABOUR EXCHANGE HAS BECOME THE JOB CENTRE. NATIONAL ASSISTANCE HAS BECOME SUPPLEMENTARY BENEFIT. THE DOLE IS BETTER THAN ANYBODY COULD HAVE DREAMED IN THE 1930'S. TODAY WE ARE ABLE TO CUSHION THE HARSH EST ECONOMIC HARDSHIPS OF THE UNEMPLOYED. BUT THE SOCIAL WASTE IS STILL THE SAME, THE HUMAN DEBILITATION JUST AS BAD. THE AFFRONT TO DIGNITY JUST AS TRAGIC AS IT WAS IN THE 1930'S.

INDEED, IN SOME WAYS, THE DANGERS TO OUR SOCIAL COHESION ARE EVEN GREATER. SOME OF BRITAIN'S BLACKEST UNEMPLOYMENTS ARE WHERE THE BRITISH ARE BLACK. A GENERATION OF BLACK YOUNGSTERS IS GROWING UP, MOST OF WHOM HAVE NEVER KNOWN WORK. WHAT PROBLEMS WE ARE STORING UP FOR THE FUTURE. PROBLEMS HAROLD MACMILLAN RECOGNISED:

"THE PRESERVATION OF FREEDOM," HE WROTE ABOUT HALF A CENTURY AGO, "IS INTIMATELY RELATED TO ECONOMIC AND SOCIAL PROGRESS. WHEN SOCIAL EVOLUTION SLOWS DOWN THE TIDE OF REVOLUTION RISES. WHAT MODERN MAN FAILS TO ACCOMPLISH BY REASONED INTELLIGENCE AND BY THE VOLUNTARY ACCEPTANCE OF INEVITABLE CHANGE, OTHER MEN WILL SEEK TO ACHIEVE BY THE BLUDGEON OF VIOLENCE."

IN OUR STRUGGLE TO DEAL WITH TODAY'S MASS UNEMPLOYMENT, NEW ATTENTION HAS BEEN DRAWN TO THE OBJECTIVES AND PRESCRIPTIONS OF THE 1944 EMPLOYMENT WHITE PAPER. REMEMBER WELL THE FIRST SENTENCE OF THAT DOCUMENT:

"THE GOVERNMENT ACCEPT AS ONE OF THEIR PRIMARY AIMS AND RESPONSIBILITIES THE MAINTENANCE OF A HIGH AND STABLE RATE OF EMPLOYMENT."

THE 1944 WHITE PAPER WAS A GREAT TRIUMPH FOR MACMILLAN FOR IT EMBODIED MUCH OF HIS MIDDLE WAY. WHAT HE HAD CAMPAIGNED FOR PRE-WAR BECAME THE GUIDELINE FOR ALL GOVERNMENTS POST-WAR. FOR A QUARTER OF A CENTURY MACMILLAN'S MIDDLE WAY BECAME THE BASIS OF BRITISH ECONOMIC POLICY, A QUARTER OF A CENTURY WHICH SAW THE LOWEST RATES OF UNEMPLOYMENT, THE HIGHEST RATES OF GROWTH AND THE LOWEST RATES OF INFLATION IN OUR HISTORY.

THE AUTHORS OF THE 1944 EMPLOYMENT WHITE PAPER UNDERSTOOD THAT THE KEY TO FULL EMPLOYMENT LAY IN A FLEXIBLE AND GROWING ECONOMY. TODAY'S GENERATION OF POLICYMAKERS CAN ONLY ENSURE FULL EMPLOYMENT IN THE 1980'S AND 1990'S THROUGH ECONOMIC GROWTH IF THEY FACE UP TO THE NEW CHALLENGES OF INTERNATIONAL TRADE AND TECHNOLOGICAL ADVANCE.

THE NEW CHALLENGES

LET NOBODY UNDER-ESTIMATE THE SCALE OF THESE CHALLENGES. IN INTERNATIONAL TRADE WE FACE FAST-EMERGING COMPETITORS IN THE PACIFIC BASIN, SOUTH AMERICA AND SOUTH AND SOUT-EAST ASIA. BUT WE SHOULD NOT SCURRY BEHIND PROTECTIONIST WALLS TO HIDE FROM THIS CHALLENGE. IF THESE COUNTRIES ARE DEVELOPING FAST WE SHOULD TREAT THEM NOT AS THREATS TO OUR TRADITIONAL MANUFACTURING INDUSTRIES, BUT AS GREAT OPPORTUNITIES FOR BRITISH EXPORTERS OF BOTH MANUFACTURED GOODS AND SERVICES. NOR SHOULD WE SHRINK FROM HIGH-TECH. THE MICROCHIP AND THE INFORMATION REVOLUTION GENERATED BY THE ALLIANCE OF THE COMPUTER WITH TELECOMMUNICATIONS SHOULD NOT BE SEEN AS A THREAT TO JOBS, FOR IT IS NOT, BUT AS AN OPPORTUNITY TO IMPROVE OUR INDIVIDUAL LIFESTYLES AND END THE DRUDGERY OF INDUSTRIAL SOCIETY. WE STAND ON THE BRINK OF BETTER LIVING STANDARDS, SHORTER, MORE FLEXIBLE WORKING HOURS AND ALL MANNER OF NEW LIFESTYLES. THOSE SOCIETIES WHICH HAVE GRASPED THE NEW TECHNOLOGY

BETTER THAN US - SUCH AS AMERICA AND JAPAN - ARE THOSE WITH THE FASTEST FALLING DOLE QUEUES.

THE KEY TO OUR SUCCESS WILL BE OUR ABILITY TO IDENTIFY AND EXPLOIT THOSE SECTIONS OF OUR ECONOMY WHERE WE HAVE GREAT NATURAL ADVANTAGES. WE HAVE THEM IN MANUFACTURING AS WELL AS SERVICE INDUSTRIES AND OUR OBJECTIVE MUST BE TO BUILD A BALANCED ECONOMY ON THE BASIS OF NEW AND EXPANDING INDUSTRIES WHICH ARE ABLE TO HOLD THEIR OWN AGAINST INTERNATIONAL COMPETITION.

WHENEVER POLITICIANS TALK OF NEW INDUSTRIES AND INTERNATIONAL COMPETITION THEY HAVE A GREAT TENDENCY TO TALK ONLY OF THE PRIVATE SECTOR, AND OF INFORMATION TECHNOLOGY. BUT WE MUST MAINTAIN A MANUFACTURING CAPACITY, JUST AS WE HAVE MAINTAINED AND ENHANCED AN EFFICIENT AGRICULTURAL SECTOR. AND WE MUST NOT FORGET THAT BRITAIN IS THE ONLY MANUFACTURING COUNTRY IN THE WORLD WHICH IS A NET EXPORTER OF ENERGY. WE HAVE WITHIN AND AROUND THESE ISLANDS A FULL RANGE OF ENERGY-RELATED ACTIVITIES WHICH CAN BE INTERNATIONALLY MARKETED ON A MASSIVE SCALE. WE ARE WORLD LEADERS IN THE EXPERTISE NEEDED FOR OFF-SHORE OIL AND GAS EXPLORATIONS. WE ARE WORLD LEADERS IN MINING TECHNOLOGY. WE HAVE ONE OF THE MOST SOPHISTICATED SYSTEMS OF GAS AND ELECTRICITY DISTRIBUTION IN THE WORLD TOGETHER WITH THE ASSOCIATED CAPITAL GOODS INDUSTRIES, JUST AT THE TIME WHEN MANY

DEVELOPING COUNTRIES ARE NEEDING TO INSTALL EXACTLY THESE TYPES OF SYSTEMS. IN FOOD PROCESSING AND MANUFACTURE WE HAVE A REPUTATION FOR QUALITY WHICH WILL ALLOW US TO DEVELOP NEW MARKETS. BRITISH AGRICULTURE, AFTER ALL, IS THE MOST EFFICIENT IN WESTERN EUROPE.

NOR SHOULD WE WRITE OFF SOME OF THE TRADITIONAL MANUFACTURING INDUSTRIES WHICH ARE REGARDED AS PERMANENTLY AT A DISADVANTAGE COMPARED WITH LOW LABOUR-COST COUNTRIES. IN INDUSTRIES LIKE FURNITURE, TEXTILES AND CLOTHING BRITAIN CANNOT COMPETE SOLELY ON THE BASIS OF PRICE, AND MUCH OF THE MASS PRODUCTION OF THESE INDUSTRIES HAS MOVED PERMANENTLY TO THE PACIFIC BASIN. I BELIEVE, HOWEVER, THAT WE CAN DEVELOP A GROWING MARKET FOR BRITISH GOODS BASED ON A REPUTATION FOR QUALITY AND SERVICE AGAINST WHICH THE LOW-COST COUNTRIES, REMOTE FROM THE MARKET, WILL FIND IT DIFFICULT TO COMPETE.

LOOK AT THE REVIVAL OF JAGUAR SALES IN AMERICA, OR WALK DOWN THE BEST SHOPPING CENTRES OF PARIS AND NEW YORK TO SEE QUALITY BRITISH GOODS ON SALE.

COMMERCIAL REVIVAL

NATIONAL REVIVALS HAVE ALL BEEN RELATED TO RECOGNITION OF THE BASIC IMPORTANCE OF SEEING THAT COMMERCIAL SUCCESS IS GIVEN ITS TRUE PRIORITY. BRITAIN NEEDS A DRIVE IN WHICH WE WILL IMPROVE ALL OF OUR COMMERCIAL AND INDUSTRIAL ASSETS: THE HUMAN ASSET BY MEANS OF TRAINING PROGRAMMES AND AN EDUCATIONAL SYSTEM THAT RECOGNISED THE REQUIREMENTS OF THE FUTURE. FAR TOO MANY OF OUR FACTORIES ARE OUT-DATED, BADLY ARRANGED, MASSIVELY WASTEFUL IN ENERGY AND INAPPROPRIATE FOR MODERN INDUSTRIAL REQUIREMENTS. IN MACHINERY WE HAVE SEEN THE VIRTUAL DESTRUCTION OF THE BRITISH MACHINE TOOL INDUSTRY. BRITISH INDUSTRY MUST INVEST IF IT IS TO SUCCEED.

THE INFRASTRUCTURE, TOO, IS IN NEED OF RENOVATION. AS AN ISLAND WE NEED TO SEE THAT WE HAVE THE FACILITIES TO MOVE GOODS AND MERCHANDISE SPEEDILY NOT JUST THROUGHOUT OUR NATION BUT THROUGHOUT THE WORLD.

GOVERNMENT AND INDUSTRY IN PARTNERSHIP

IN ALL OF THIS WE NEED AN ENTHUSIASTIC COLLABORATION BETWEEN GOVERNMENT AND INDUSTRY. LET IT BE RECOGNISED THAT THE THREE GREAT ECONOMIC REVIVALS OF THE PAST FIFTY YEARS WERE ACHIEVED BY GOVERNMENTS BELIEVING IN FREE ENTERPRISE BUT RECOGNISING THE NEED FOR THE GOVERNMENT TO COLLABORATE

WITH FREE ENTERPRISE IF IT WAS TO SUCCEED. THE RECOVERY OF THE UNITED STATES UNDER ROOSEVELT, THE REVIVAL OF GERMANY UNDER ADENAUER, AND THE TRANSFORMATION OF FRANCE UNDER THE LEADERSHIP OF DE GAULLE ARE THE GREAT WESTERN WORLD EXAMPLES OF GOVERNMENT LEADERSHIP AND INDUSTRIAL LEADERSHIP WORKING AS PARTNERS TOGETHER.

THE NEED FOR BRITAIN TO IMPROVE ITS MANUFACTURING PERFORMANCE IS CLEAR TO SEE. IN TWENTY YEARS OUR SHARE OF THE WORLD MARKET IN MANUFACTURED GOODS HAS VIRTUALLY HALVED. WHERE ONCE THE SURPLUS OF OUR MANUFACTURING EXPORTS PROVIDED US WITH THE MONEY NECESSARY FOR OUR IMPORTS OF FOOD AND RAW MATERIALS, RECENTLY WE HAVE MOVED TO A SUBSTANTIAL DEFICIT IN MANUFACTURED GOODS. IN 1966 WE EMPLOYED TWELVE MILLION PEOPLE IN MANUFACTURING. TODAY WE EMPLOY FOUR MILLION LESS. IN THE SAME PERIOD JAPAN HAS INCREASED THE NUMBER OF MANUFACTURING JOBS BY FOUR MILLION WHILST IN NO WAY REJECTING THE NEW TECHNOLOGIES. IN THE COMING DECADES THE GREAT WEALTH OF NORTH SEA OIL IS GOING TO GO DOWN. IT WOULD BE DISASTROUS IF IN THOSE DECADES OUR WEALTH FROM INDUSTRY AND COMMERCE DID NOT GO UP.

ATHENS WITHOUT THE SLAVES

WE SHALL ALSO NEED IMAGINATION IN EXPLOITING THE OPPORTUNITIES PROVIDED FOR US BY NEW LABOUR-SAVING MACHINERY. WE LIVE IN A SOCIETY WHERE THE TRADITIONAL OBJECTIVE HAS BEEN TO PROVIDE WORK FOR HUMAN BEINGS FROM THE AGE OF 16 TO 65. PERHAPS THE NEXT GENERATION WILL NOT BE SATISFIED BY A GUARANTEE THAT THEY WOULD BE ABLE TO WORK IN AN UNATTRACTIVE FACTORY, MINE OR OFFICE FOR FIFTY OF THE REMAINING FIFTY-FIVE YEARS OF THEIR LIVES. PERHAPS THEY WILL SEE IN THE NEW TECHNOLOGY THE OPPORTUNITY TO EMANCIPATE WORKING PEOPLE FROM THE RELENTLESS GRIND OF THE PRODUCTION LINE. PERHAPS THEY WILL BE THE FIRST GENERATION WHO ARE NOT OBLIGED TO SPEND THE GREATER-PART OF THEIR WORKING HOURS DOING WORK OF LITTLE MENTAL OR SPIRITUAL SATISFACTION. WHEN MACHINES CAN PRODUCE AT GREATER SPEED AND WITH GREATER EFFICIENCY THAN IN ANY OTHER ERA, WE SHOULD EMBRACE THE OPPORTUNITY WHICH THAT CREATES WITH BOTH HANDS, FOR NOW IT IS THE MACHINE WHICH WILL WORK TWENTY-FOUR HOURS A DAY, SEVEN DAYS A WEEK, FIFTY-TWO WEEKS OF THE YEAR, WHILE MAN IS ALLOWED MORE LEISURE TO PURSUE HIS OWN SELF-FULFILMENT. WE SHALL THEN HAVE TRULY REALISED THE OLD DREAM OF HAROLD MACMILLAN: ATHENS WITHOUT THE SLAVES.

WE FACE GREAT AND FUNDAMENTAL CHANGES IN OUR ECONOMY, JUST AS WE DID WHEN MACMILLAN WROTE HIS MIDDLE WAY. MANY ARE NERVOUS ABOUT THE IMPLICATIONS OF THESE CHANGES FOR BOTH OUR ECONOMIC AND SOCIAL ORDER. THE EXAMPLE OF HAROLD MACMILLAN, HOWEVER,

BECKONS US FORWARD. THE CHANGES WE NOW CONTEMPLATE ARE NO GREATER THAN THE CHANGES HE CONTEMPLATED IN THE 1930'S AND BROUGHT ABOUT IN THE 1950'S. HISTORY HOLDS NO COMFORT FOR THE FAINTHEARTED. IT IS THE MORAL RESPONSIBILITY OF POLITICIANS TO FACE THESE CHALLENGES AND TO SEE THAT THEY ARE MET; IT IS THE MORAL IMPATIENCE OF YOUTH WITH ENQUIRING MINDS AND OPTIMISTIC SPIRITS THAT SHOULD BE THE CONSTANT SPUR TO POLITICAL ACTION.

ONE OF HAROLD MACMILLAN'S GREAT CONTEMPORARIES WAS CHARLES DE GAULLE. THEY WERE COMRADES IN ARMS IN NORTH AFRICA DURING THE WAR AND CONTEMPORARIES IN OFFICE FIFTEEN YEARS LATER. LIKE MACMILLAN, DE GAULLE BELIEVED THAT FUNDAMENTAL SOCIAL AND ECONOMIC CHANGES COULD BE EASED WHEN GOVERNMENTS PURSUED THE MIDDLE WAY.

"THE ECONOMIC TRANSFORMATION OF THE COUNTRY WAS INFLICTING WOUNDS UPON IT," HE WROTE. "THE LAISSEZ-FAIRE SYSTEM WOULD HAVE IGNORED THEM LEAVING THEM TO BLEED. A TOTALITARIAN DISCIPLINE WOULD HAVE CAUTERISED THEM WITH A REDHOT IRON. THE POLICIES OF MY GOVERNMENT WERE INTENDED TO HEAL THEM."

PEOPLE'S PARTICIPATION

PRESIDENT DE GAULLE RECOGNISED THAT IF CAPITALISM WAS TO SURVIVE AND SUCCEED A FAR GREATER SPREAD OF OWNERSHIP NEEDED TO BE ATTAINED. HE INTRODUCED PROFIT SHARING SCHEMES BUT PRIOR TO HIS DEPARTURE AS PRESIDENT HE WAS DESPERATE TO SEE THAT THE PARTICIPATION OF ALL OF THOSE INVOLVED IN INDUSTRY WAS SUBSTANTIALLY EXTENDED. HE WAS DEFEATED. HE REFLECTED THAT HE HAD BEEN DEFEATED BY THE DETERMINED OPPOSITION OF ALL OF THE VESTED INTERESTS, ECONOMIC, SOCIAL, POLITICAL, JOURNALISTIC, MARXIST, LIBERAL AND DIE-HARD. BUT IN HIS AUTOBIOGRAPHY HE WROTE:

"THAT WHICH IS LEGITIMATE WILL ONE DAY BE LEGALISED AND THAT WHICH IS RIGHTFUL WILL IN THE END BE PROVED RIGHT."

WE DO NEED RADICAL AND POSITIVE PROGRAMMES SO THAT CAPITAL AND PROFIT SHARING BECOMES A REALITY FOR THE MAJORITY OF THOSE WORKING IN FIRMS AND CORPORATIONS WHOSE ACTIVITIES ARE BASED UPON THE PROFIT MOTIVE, FOR THE MOTIVATION OF PROFIT MUST BE A MOTIVATION SHARED BY ALL WHO DEVOTE THEIR LIVES TO COMMERCIAL ACTIVITY.

WE MUST SEE THAT REDISTRIBUTION OF WEALTH TAKES PLACE. THE NEED IS NOT TO REDISTRIBUTE WEALTH FROM THE INDIVIDUAL TO THE STATE. WE SHOULD NOW EXPLORE MORE THE REDISTRIBUTION OF WEALTH FROM THE STATE TO THE PEOPLE. WE SHOULD FIND WAYS OF CONVEYING THE VAST BUREAUCRATICALLY CONTROLLED COUNCIL HOUSING STOCK TO THE INDIVIDUAL FAMILY AND END THE SITUATION IN WHICH ONE THIRD OF SOCIETY IS THE PERMANENT TENANT OF THE STATE. WE SHOULD SEEK WAYS OF SEEING THAT NOT JUST EMPLOYEES IN THE PRIVATE SECTOR BUT THOSE IN THE NATIONALISED INDUSTRIES AS WELL HAVE A PARTICIPATION IN THEIR INDUSTRIES.

THE MIDDLE WAY

LIKE DE GAULLE, MACMILLAN BELIEVED THAT THE FREE ENTERPRISE SYSTEM PRODUCES GREAT BENEFITS FOR THE COMMUNITY AS A WHOLE BUT CARRIES WITHIN IT THE SEEDS OF A GIGANTIC AND PERENNIAL DISSATISFACTION. LIKE DE GAULLE HE SET OUT TO BRING ABOUT A DEGREE OF ORDER AND CENTRAL DIRECTION TO THE MARKET SYSTEM, WITHOUT DESTROYING THE INDIVIDUAL ENDEAVOUR AND ENTERPRISE THAT IS THE WELL SPRING OF THAT SYSTEM.

IN "THE MIDDLE WAY" MACMILLAN WROTE:

"THERE CAN BE NO DOUBT THAT IT IS WITHIN THE POWER OF MEN TO ARRANGE THE FULL EMPLOYMENT OF THEIR EFFORTS TO INCREASE THE PRODUCTION OF WEALTH - SOCIETY HAS NOT THE RIGHT TO ABANDON THE INDIVIDUAL BECAUSE, AS A RESULT OF FAULTY ORGANISATION THE LABOUR WHICH HE IS STILL WILLING TO EXPEND CANNOT TEMPORARILY BE UTILISED."

PRIOR TO HAROLD MACMILLAN'S GREATEST ELECTORAL VICTORY IN 1959 HE SAID, "OF COURSE WE IN THE CONSERVATIVE PARTY DO NOT WANT TO RETURN TO THE LAISSEZ-FAIRE DOCTRINAIRE LIBERALISM. TOO OFTEN THAT MEANT THE DEFENCE NOT OF FREEDOM BUT OF PRIVILEGE".

HAROLD MACMILLAN POSED THE QUESTION, "WHAT DO THESE GUIDING PRINCIPLES, THE DIGNITY OF MAN AND THE CONSEQUENT NECESSARY LIMITS OF POLITICAL POWER, THE VALUE OF OUR INSTITUTIONS AS THE CEMENT OF SOCIETY MEAN IN TERMS OF POLICY?"

HE ANSWERED, "MODERATION SHOULD BE THE KEYNOTE OF POLICY. EXTREMES ALWAYS THREATEN THE FAMILY OR THE INDIVIDUAL IN ONE WAY OR ANOTHER. TOO MUCH STATE CONTROL ENDANGERS FREEDOM AND INITIATIVE. BUT A FREE FOR ALL EXALTS RIGHTS OVER DUTIES AND MEANS THAT THE WEAK GO TO THE WALL. EXTREMES UNDERMINE NATIONAL UNITY WHICH IS OUR CONSERVATIVE TRADITION TO FOSTER. OUR AIM IS TO HARNESS DIFFERENT AND CONFLICTING INTEREST, NOT TO SET THEM AGAINST EACH OTHER WITH THE STRIDENT ACCENTS OF THE CLASS WAR. WE AIM TO BALANCE THEM SO THAT ALL CAN CONTRIBUTE AS ONE NATION TO THE COMMON GOOD."

THESE SURELY NEED TO REMAIN THE AIMS OF OUR CONSERVATIVE PARTY - THE ONE PARTY THAT HAS PERSISTENTLY THROUGH THE CENTURIES SOUGHT TO UNITE OUR NATION.

ENDS

(my)

PPS

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EXTRACTS FROM A SPEECH BY
THE RT HON PETER REES QC., MP.,
AT THE NINTH MEETING OF THE NATIONAL UNION INDUSTRY AND TRADE FORUM:
WEDNESDAY 21 NOVEMBER 1984

PUBLIC INVESTMENT: THE FACTS

"The Subject of public investment seems to come for many people under the heading "This is a Good Thing". Images are conjured up of the fabric of the national rotting away".

"The Government is indeed determined to control public spending. That is my job. The Autumn Statement, published last week, showed that for the third year running the public expenditure total has been held to the level set in earlier plans."

"Within this total, there is no "right" level of public capital spending. Just as in the private sector, each capital proposal must be justified on its merits - its rate of return".

"What does this approach mean in practice? The facts are these. Aggregate capital spending by the public sector has been maintained broadly in real terms at the level of 1978-79. In 1984-85 it is planned to be £24 billion - about one-fifth of the expenditure total:

"This is not the whole story. The Government believes in reducing the role of the public sector. Through privatisation, for example, it has taken major steps in this direction. The position in the whole economy, public and private, is important."

"Fixed investment across the whole economy in 1984 and in 1985 is expected to reach post-war record levels."

"Construction output is estimated to have risen 5½ per cent in the first six months of this year compared to the same period a year earlier."

"Investment in private dwellings was at its highest ever level in 1983"

"Manufacturing investment is estimated to have risen by about 15 per cent in the first half of 1984."

"Investment in construction and services was up by nearly 13 per cent in the first half of 1984."

"This is where the real answer to unemployment lies - a more vigorous and enterprising economy, competitive and able to sustain real jobs."

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*It is the logic of the post-
Budget position, the Revenue
has been a different fig,
I still remember that in
New.*

PS/CHANCELLOR

FROM: HIC GOODMAN
21 November 1984

*c/ See also record of PM's
meeting below.*

*MSM
22/11*

cc PS/Chief Secretary
Sir Peter Middleton
Mr Cassell
Mr Monck
Mr Battishill
Mr Monger
Mr Lovell
Mr Allan
Mr Haigh
PS/IR

*2. What does
the PS have in
mind re short
term assets?
is
PS. Paper
found in X.
M.*

CBI VIEWS ON CAPITAL ALLOWANCES

As you know, the Financial Secretary met with Sir James Cleminson on Tuesday to discuss Unitary Tax.

2. At the end of the meeting Sir James raised the question of the revenue implications of the changes to allowances effected in the 1984 Budget. This has been discussed in the President's Committee of the CBI. Sir James acknowledged that the Committee were biased towards manufacturing industry but said that there was strong pressure within the CBI for some relief and he would be grateful for help from Ministers in dealing with this. Apparently, the CBI had reworked the figures for the 1984 Budget and found that there was a serious cash flow through, even if the figures 25 per cent straight line route was taken. He wondered whether any relief could be offered for that period.

3. The Financial Secretary made it plain that this was not in the offing, but that on short life assets where there was a legitimate logical point the Government were considering application of the CT changes. The Financial Secretary promised to write to Sir James explaining the figures which enabled the Government to argue that over the four years package as a whole was revenue neutral. Mr Corlett is drafting.

PS/FST
→
PS/JCX
21/11

HIC
H C GOODMAN

CONFIDENTIAL

Pwp

3/12/84

CH/EXCHEQUER	
REC	05 DECEMBER
ACTION	MR UNWIN
COPIES TO	MR LITTLE
	MR FITCHEW
	MR LAVELLE
	MR MOUNTFIELD
	MR HOPKINSON

EUROPEAN COUNCIL, 3-4 DECEMBER: PARLIAMENTARY STATEMENT BY
 SIR THE PRIME MINISTER

SIR THE PRIME MINISTER

MR MORTIMER
 MR BONNEY

C. Final version. Draft below with Brian Vaux's comments marked, as passed to No 10 by David. *Pwp 5/12*

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WITH PERMISSION, MR. SPEAKER, I SHOULD LIKE TO MAKE

A STATEMENT ON THE RESULTS OF THE EUROPEAN COUNCIL OF
 3/4 DECEMBER. I WAS ACCOMPANIED AT THIS MEETING BY MY
 RIGHT HONOURABLE AND LEARNED FRIEND, THE SECRETARY OF STATE
 FOR FOREIGN AND COMMONWEALTH AFFAIRS.

THE COUNCIL COVERED FOUR MAIN SUBJECTS. FIRST, WE
 EXAMINED THE ECONOMIC SITUATION IN THE COMMUNITY. THE
 COMMISSION HAD SUBMITTED AN EXCELLENT REPORT. I AM
 PLACING A COPY OF THIS REPORT AND OF THE CONCLUSIONS OF THE
 EUROPEAN COUNCIL IN THE LIBRARY OF THE HOUSE. IN
 PARTICULAR, WE DISCUSSED THE CREATION OF MORE JOBS
 BY OPENING UP THE INTERNAL COMMUNITY MARKET FOR ALL GOODS,
 SERVICES AND PROFESSIONS AND THROUGH ADVANCED INDUSTRIAL

TECHNOLOGIES. THIS HAS TO BE ACHIEVED IN THE CONTEXT OF -
AND I QUOTE - "MODERATION IN THE EVOLUTION OF REAL WAGES"
AND "A PAUSE IN THE GROWTH OF CURRENT PUBLIC EXPENDITURE AND
A DECLINE FOR SEVERAL YEARS IN ITS SHARE OF GDP". THE
COUNCIL AGREED TO SET UP A REVIEW OF MANPOWER POLICY WITH
THE AIM OF DIRECTING TRAINING TO SECTORS WHERE LABOUR WILL
BE NEEDED, OF ENCOURAGING JOB MOBILITY AND OF FOSTERING
ENTERPRISE, ESPECIALLY AMONG YOUNG PEOPLE.

SECONDLY, THE EUROPEAN COUNCIL REACHED AGREEMENT ON THE
COMMUNITY'S POSITION IN THE ENLARGEMENT NEGOTIATIONS WITH
SPAIN AND PORTUGAL. TWO MAJOR ISSUES HAD BEEN OUTSTANDING:
WINE AND FISHERIES. BOTH WERE SATISFACTORILY SETTLED.
UNFORTUNATELY, GREECE RESERVED HER POSITION ON ENLARGEMENT,
LINKING IT WITH A BID FOR MORE MONEY FOR MEDITERRANEAN
PROGRAMMES. HOWEVER, THE ENLARGEMENT NEGOTIATIONS WITH
SPAIN AND PORTUGAL WILL NOW GO AHEAD ON THE OUTSTANDING
ISSUES AND, WE HOPE, BE BROUGHT TO AN EARLY CONCLUSION, WITH

A VIEW TO THEIR ACCESSION ON 1 JANUARY 1986. THE OUTCOME WILL HAVE TO BE BROUGHT BACK TO THE COUNCIL OF MINISTERS, ESPECIALLY IN VIEW OF GREECE'S POSITION.

THIRDLY, WE GAVE PARTICULAR ATTENTION TO FURTHER MEASURES TO RELIEVE FAMINE IN AFRICAN COUNTRIES, PARTICULARLY IN ETHIOPIA. WE AGREED THAT THE COMMUNITY AND ITS MEMBER STATES SHOULD PROVIDE 1.2 MILLION TONNES OF GRAIN IN 1985. THIS IS A REALLY MAJOR EFFORT WHICH THE UNITED KINGDOM STRONGLY SUPPORTS. WE APPEALED TO OTHER DONOR COUNTRIES TO MATCH THIS EFFORT.

FOURTHLY, WE HAD A PRELIMINARY EXCHANGE ON REPORTS FROM TWO GROUPS ESTABLISHED AFTER THE FONTAINEBLEAU MEETING. THESE GROUPS ARE DEALING WITH COMMUNITY INSTITUTIONS AND WITH PRACTICAL MEASURES SUCH AS EASIER MOVEMENT OF GOODS AND FRONTIER FORMALITIES. THE FINAL REPORTS WILL BE

SUBSTANTIVELY DISCUSSED AT THE EUROPEAN COUNCIL IN THE FIRST HALF OF NEXT YEAR.

THE EUROPEAN COUNCIL ALSO URGED THE ENVIRONMENT MINISTERS TO REACH AGREEMENT AT THEIR MEETING TOMORROW ON GUIDELINES FOR THE REDUCTION OF LEAD IN PETROL - A BRITISH INITIATIVE WITHIN THE COMMUNITY - AND ON VEHICLE EMISSIONS.

WITHIN THE CONTEXT OF POLITICAL CO-OPERATION THE COUNCIL ENDORSED THE SET OF PRINCIPLES FOR DEALING WITH TERRORISM AND THE ABUSE OF DIPLOMATIC IMMUNITY, WHICH WAS ADOPTED IN SEPTEMBER AND IS NOW BEING PUT INTO PRACTICE. WE DISCUSSED EAST-WEST RELATIONS AND THE MIDDLE EAST AND STRESSED THE IMPORTANCE OF REACHING SATISFACTORY ARMS CONTROL AGREEMENTS. IN THE DISCUSSION ON CENTRAL AMERICA WE REAFFIRMED OUR SUPPORT FOR THE CONTADORA PROCESS.

FINALLY, THE FOREIGN AFFAIRS COUNCIL ADOPTED THE TEXT ON BUDGETARY DISCIPLINE, INCLUDING THE STRICT FINANCIAL GUIDELINE FOR AGRICULTURAL EXPENDITURE. IT IS THE RESULT OF CONSIDERABLE EFFORTS OVER A PERIOD OF YEARS BY BRITAIN TO ENSURE THE BETTER CONTROL OF COMMUNITY EXPENDITURE AND A BETTER BALANCE IN THE COMMUNITY BUDGET.

From: THE PRIVATE SECRETARY

pprs today pl.



HOME OFFICE
QUEEN ANNE'S GATE
LONDON SW1H 9AT

5 December 1984

✓
pprs

Dear Philip,

C/ To see.

Pms 6/12

HOME SECRETARY'S SPEECH TO THE BOW GROUP

Thank you for your helpful comments on the Home Secretary's speech. I attach a copy of the final text which is being released to the press today, *by central office.*

I am sending a copy of this letter and the speech to Andrew Turnbull (No 10).

*Yours sincerely
H H Taylor*

H H TAYLOR

P Wynn Owen, Esq. *Mr Monds,
Mr Watson,
Mr H. Evans, Mr Scholar,
Mr Byatt, Mr Kitcath,
Mr Folger, Mr Burgher,
Mr Cropper, Ms. Seaman,
Ms Conn, Mr Ridley,
Mr Robson.*

CH/EXCHEQUER	
REC.	05 DEC 1984
ACTION	Mr Battishill
COPIES TO	CST, FST, MST, EST, Sir P. Middleton, Sir T. Burns, Mr Cassell, Mr Littler, Mr Bailey

✓ 6/12

SPEECH BY THE RT HON LEON BRITTAN, QC., MP., HOME SECRETARY,
TO THE BOW GROUP IN A HOUSE OF COMMONS COMMITTEE ROOM ON
THURSDAY, 6 DECEMBER 1984

Release Time: 6.30 p.m., Thursday, 6 December

THE MORAL CASE FOR THE MARKET ECONOMY

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THE MORAL CASE FOR THE MARKET ECONOMY

Conservatives are, by instinct, practical people who do not wear their hearts on their sleeves. We prefer to do what is necessary than to prate about what is right. That is our strength - and our weakness. On the one hand, we have set about tackling vigorously and successfully deep rooted weaknesses in the British economy which previous Governments preferred to ignore. Yet, while doing so, and with some notable exceptions, we have not much troubled to explain why we think our vision of Britain's future is not just more practical but actually morally superior to the alternative.

Achievements are more eloquent than words. But achievements are not enough to win arguments. Recent criticism from the Bishops and others show how many thoughtful and conscientious people still misunderstand and distrust the Government's ultimate objectives.

Margaret Thatcher's Government is, thankfully, not populated by dreamers and visionaries: but we do have a vision of how we want our country to be. Nor is it a vision which makes exclusive appeal to those with cheque book mentalities and degrees in economics. Rather, it is a vision of society where a prosperous, free people live under the rule of law enjoying the widest scope for choice and the widest range of opportunity. This vision is not a plan: indeed it depends on the rejection of planning. It requires a system which, for convenience sake, can be called free enterprise capitalism. In it the customer - rather than the philosopher - is king. But its moral and philosophical justification is clear enough: for it liberates the individual and permits the values of freedom to flourish.

/The idea that the

The idea that the kind of Britain which we Conservatives want to see is somehow morally inferior to that preferred by our critics of the Left is, of course, nothing new. What is strange is that it persists when the failures of socialism and the successes of market capitalism stand in such sharp contrast at home and abroad.

Hayek has suggested one reason why so many people still regard with moral unease the market system upon which their livelihoods depend:

"Our inherited moral feelings constitute the stubborn obstacle to the moral approval of the market system to which we owe our wealth. They demand that we consciously aim at benefiting other known persons; in contrast, the beneficial effects of our efforts on other people in the market society are mostly unknown to us and cannot guide us. In order to do most good the individual must let himself be guided by abstract and impersonal signs. He cannot consciously aim at the most gain for others, but only at the most gain for himself and his associates". ("Unemployment and the Unions", page 43).

That pervasive moral unease is, in the case of this Government, usually channelled into three areas of criticism of our policies.

First, there is the attack on what our critics inaccurately describe as "monetarism", by which they mean that we are exclusively concerned with beating inflation and insufficiently so - or not at all - with beating unemployment.

/The criticism is

The criticism is based on a totally false premise. There is no trade-off - except, and then arguably, in the very short term - between inflation and unemployment. Governments can, through the pursuit of responsible monetary and fiscal policies, control inflation. We have. But they cannot by these means increase the number of real lasting jobs - although they may be able to do so over a period by encouraging the appropriate structural changes in the economy. Moreover, inflation itself and the expectations it arouses destroy existing jobs and abort new ones. So, the most important contribution any Government can make towards overcoming unemployment is to bring down inflation by means which do least transitional harm to the enterprise sector of the economy. That has been the whole purpose of the Medium Term Financial Strategy, launched in our 1980 budget and pursued since.

That strategy is one of curbing monetary growth and public spending and borrowing, so as to bring down inflation and allow interest rates to fall. And it is now pursued in differing degrees by responsible Governments throughout the free world - largely irrespective of their party political hue.

In Britain, too, our critics would do well to recall that the last Labour Government was forced to make, between 1976/77 and 1977/78, the sharpest ever cuts in real public spending. The lesson of their panic measures is clear. It is that the constraints under which Governments' monetary and fiscal policies are determined are not for the most part ideological or self-imposed. Rather, they are imposed by pressures from international markets which Governments can neither control nor ignore, except at their peril - and even if they try to act at their peril, they cannot do so for long.

Our strategy has been successful. Inflation is now only a quarter of what it was just four years ago. Lower inflation and lower inflationary expectations - through their effects on confidence and so on investment and consumer spending - have created the conditions for almost four years of steady economic recovery.

That recovery is no less real and no less impressive because it has not yet led to a fall in unemployment.

For today's high unemployment is itself the price we pay for yesterday's high inflation. And not just inflation - but yesterday's nationalisation, controls, over-spending, over-borrowing, over-taxation and restrictive practices - in short the accumulated legacy of misguided economic policy that has too often prevailed in Government, and Luddite attitudes in industry.

Today's unemployment is also yesterday's over-manning: and that over-manning grew up precisely because of the loose financial policies, Government intervention, subsidy, protection and horse-trading with over-powerful unions which our critics now urge on us.

There is no "political solution" to unemployment: there is only an "economic solution" which depends upon working with market forces rather than against them. It consists of winning and keeping increased market shares at home and abroad: it consists of unions and individuals pricing themselves and others into rather than out of work.

There are encouraging signs. Job vacancies are up. And a quarter of a million new jobs came into existence in the year to June 1984 - while,

/by contrast

by contrast, in France and Germany the numbers in work fell. Significantly, here as in the USA (where labour costs and the labour market are much more flexible), these new jobs are coming into existence in the least unionised, least collectivised sectors of the economy.

It may be a harsh, unpalatable, not to say unpopular, message for some of our critics to accept. But if they really wish to help reduce avoidable unemployment they should observe that over the last two years real labour costs in Britain have been rising at a rate of about three per cent. They should consider the unfairness and imbalance of those in work receiving higher real incomes at the expense of those without work. And they should then try to convince all concerned that labour market signals cannot be scorned or ignored if more jobs are to be created.

Finally, we should not forget that inflation itself is a great moral evil.

Long-term unemployment can induce hopelessness, frustration and bitterness: it erodes a person's dignity. But inflation introduces into the body politic a poison which is just as potent: distrust.

Groups of workers are driven by fear of the effects of price rises on their living standards to compete with ever greater ferocity for increased shares in the national economic cake. Long-term agreements are everywhere replaced by short-term fixes. Realism, truth and honesty about the value of goods and services and the reliability of undertakings by Government, employers and unions are early victims of inflation.

The value of savings is eroded. The unpredictable effects of inflation make all economic activity - and ultimately the whole of society - a sort of lottery. Wealth and security are more and more determined by chance rather than by talent. The black market flourishes, as Governments struggle to control the symptoms rather than the disease of inflation itself. Social tensions become explosive. As in the 1978 "Winter of Discontent", when patients went untreated and the dead lay unburied, it is the weak who go to the wall. If the inflationary disease remains untreated for long enough, democratic government and civil society themselves are endangered. These are just some of the reasons why the defeat of inflation is a worthy end in itself.

The second major criticism levelled against us is, in a word, that we "just don't care". We are not "compassionate". Or, at least, we are not "perceived" to be so. The criticism is confused: but its very confusion increases its effectiveness.

Our critics often have little idea of the commitment of resources we currently make to those in need. The social security budget has increased by more than a quarter in real terms since we took office. Real spending on the National Health Service has risen by 21 per cent since 1978/79, much faster than public expenditure in general. In our schools the pupil-teacher ratio is better than ever. No-one need be ashamed of that record.

Of course, one can always argue that more should be done. There are people - often people who do not fit simply into the Dickensian categories of children without shoes, beloved of some commentators - who badly need help. There is an almost limitless demand for

improved health care. There are tower blocks and council estates in need of repair. There are schools with special social and educational problems. Every member of the Government would wish to see improvements made. It is not because we do not care that we do not accept that increases in public spending should immediately occur to secure them. Rather, it is because we know that not all public expenditure is good; that not all good things require more public expenditure; and that even those which do, do not necessarily justify imposing heavier burdens on the wealth-creating economy today which will impoverish our children and grandchildren tomorrow.

The state has no monopoly on compassion - indeed it is not institutions but individuals who can truly be said to care. Those who imagine that it is difficult to spend other people's money on good causes and who judge a Government's moral worth by its willingness to do so could hardly be more wrong. Profligacy is not a sign of compassion, but of irresponsibility.

For ... Government is a trust - not just on behalf of today's citizens, but also on behalf of future generations. If we consume their seedcorn - so that tomorrow's pensions cannot be paid for, tomorrow's employees do not have jobs to go to, tomorrow's families are not defended - we betray that trust.

The third major criticism is perhaps the most central to our critics' case: it is that we are making society more unequal and strengthening divisions within it.

The fact is that Britain is still only slowly recovering from the

effects of years of egalitarianism. I do not deny that that experience has been a painful one. But the obsessive and unconditional pursuit of equality lies behind most of our country's relative economic decline. It has affected our tax system: it has left unreformed our labyrinthine social security system: it has perpetuated the under-use and physical decline of our housing stock: it has put at risk educational standards: it has prompted trade union leaders to pay more attention to socialist politics than to their members' legitimate interests: it has justified the extension of state ownership and control in large areas of British industry. Most deeply, it has left its scars on all too many people's attitudes towards wealth creation and success. If Britain is to enjoy prosperity and fuller employment, our instinctive reaction to other people's success must be to match it rather than decry it.

Equality under the law, recognition of the equal moral worth of every man or woman, and equality of opportunity: these kinds of equality we laud and uphold. But the pursuit of equality of reward and result, and the imposition of limits above which none may rise, is a sure path to poverty and discontent. For us, relative inequalities are always less important than absolute standards of living. Concentration on equality as the end of social and economic policy fosters envy and lowers standards. Moreover, even in the most highly regulated egalitarian societies inequalities persist. But there they take the form of special privileges obtained through influence and political power: in the sort of society in which we believe, inequalities flow from talent.

/For us, the wider

For us, the wider distribution of property is the way towards equality of opportunity. That is why, through the sale of council houses and the sale of shares in de-nationalised enterprises, we put such emphasis on the creation of a property owning democracy. The fact that some sixty per cent of the population now own their own homes is the best guarantee that the system of political and economic freedom in which we believe will last. Wider ownership leads to a wider dispersal of power within society, which can be exercised to the common benefit through the market. Irrespective of colour, creed, sex or social background, personal property and the market together guarantee the equality which liberates rather than enslaves: equality of opportunity.

Economic inequalities are bound to be starker in a period of swift economic change. Many point to regional inequalities in the level of unemployment as proof that our policies are divisive. But it has more often been past resistance to change rather than present attempts to respond to it which lie behind today's concentrations of heavy regional unemployment. That, of course, is no consolation to those whose jobs are lost. And we are right to focus a range of measures, including a sharper and more effective regional policy, on such areas to relieve the worst effects. But it does nothing but harm to the reputation, and so the prospects, of the regions affected to speak as if the North of England were a hopeless case of economic decline. Where companies and work forces adapt to and satisfy changing markets, new jobs are coming into existence. And becoming more market responsive, not less, is the way to more real jobs.

/It is equally

It is equally misleading to talk as if the international community were divided into two opposed and contrasting North/South blocs, inevitably condemned to grow apart, the former becoming richer as the latter grows poorer. I do not under-rate the value of humanitarian aid provided by Governments and individuals. But all experience suggests that trade and investment are far better tools for the promotion of prosperity in third world countries than unconditional transfers of resources. States which encourage investment by developing efficient market economies are much better able to withstand the shocks of natural disaster than are their inefficient, corrupt and collectivist equivalents.

The three major criticisms of our policies and of the system we uphold are, then, fundamentally false.

But those who criticise do so not just because they dislike free enterprise capitalism and the market approach, but because they believe that there is a superior alternative on offer. The clarity with which they spell that alternative out varies. But it is essentially collectivist. That is, it puts the emphasis on collective rather than individual decision-making; on central direction of the economy; on the redistribution of wealth; on collaboration between central government, federations of employers and a highly unionised workforce; on the overall pursuit by society of certain common ends which take precedence over individuals' personal preferences.

Of course, there is a wide range of possibilities. Socialist France is not as collectivised as was Labour Britain. And both are much less so than even the most market-orientated collectivist economies in the Eastern bloc, let alone that of the Soviet Union. Yet the

differences are essentially ones of degree.

The Labour Party itself shows how that is the case. In order to achieve its socialist goals in the face of suspicion abroad and resentment at home, it now believes that only a fortress economy, surrounded by a drawbridge of import controls, consolidated by sweeping nationalisation and state planning and unconditional surrender to trade union power would allow it to succeed.

For collectivism has its own momentum. Controls breed more controls, as human ingenuity finds new ways around them. Constraints on income have to be supplemented by limits on wealth and the confiscation of property. Protection for one industry leads to protection for another. Above all, the habit of dependence on the collective - whether the state, or the union, or some other group - grows. Individual responsibility wanes with the scope for individual choice. That is why economic freedom has proved so necessary - though not always sufficient - for political freedom - and why, as has been pointed out, the path to socialism in practice so easily becomes the "Road to Serfdom".

The miners' dispute is held by our critics to prove that the market brutalises and divides and that only a compassionate, interventionist government can avoid such problems. The diagnosis is precisely false: so is the suggested cure.

The miners' dispute is not "about unemployment", as some have claimed - except insofar as its continuation adds to it and insofar as the subsidies required to finance the NCB abort new jobs elsewhere. It cannot be about unemployment - because the NCB has repeatedly offered terms which require no compulsory redundancies. Nor is it about

whether the rigours of the market are ruthlessly to apply to the British coal industry. Rather, as has repeatedly been made all too clear, the sticking point for the NUM is whether any pits - no matter how costly the coal is to mine there - are to be allowed to close.

But the dispute is about whether the most extreme, Marxist style of collectivism is to be imposed, if necessary by force, on the rest of the community.

Mr Scargill is the standard bearer of that extreme collectivist society. He does not mince words. He does not have much time for democracy or freedom or the supremacy of the law. He does not even have time for free trade unions - at least in a totally collectivised state like Poland, where he regards "Solidarity" as just an 'anti-socialist organisation who desire the overthrow of a socialist state'.

His rhetoric is that of class war; and that - class war - is what his supporters undoubtedly think they are fighting when they injure policemen and intimidate working miners and their families.

Moreover, Mr Scargill's tools have been provided for him by past collectivism. He has the benefit of a heavily unionised workforce in a state owned quasi-monopoly industry. He can draw on a background of romantic myth about mining communities and the miners' special role in the "labour movement". He has ruthlessly excluded moderates from influence and obtained a firm grip on his union's policymaking bodies. Mr Scargill has read his history. He knows - or he thinks he knows - that the bourgeois state, that passing phase in history's long march towards socialism, lacks moral fibre and will crumble before a determined leader of the proletariat.

In fact, Mr Scargill is wrong. It is his hold, not the Government's will, which has crumbled. But that is no thanks to all those who refuse to see the truly evil nature of the collectivist system which he wishes to impose.

The Marxist state exemplifies only the worst kind of collectivism. But the tendencies which the ossified, oppressive, uniform Communist societies in Eastern Europe exemplify are present in some degree whenever collective decision-making comes to replace individual decision-making as the main means of determining society's future. The road to collectivism is paved with the very best of intentions. It is a constant source of dismay and surprise to social democrats and democratic socialists down the ages that good intentions, when combined with bad politics, economics and social theory, lead only to disaster.

If one looks at the world-wide historical balance sheet, comparing the contributions to progress and civilisation of liberal capitalism and collectivism, the former's superiority is beyond doubt.

Capitalist societies are generally prosperous, free, innovative, exciting and, though changing, have an inner stability. Collectivist ones are generally poor, more or less unfree, technologically backward, boring and riven with more or less repressed social tensions.

In the free West, successive socialist governments have had to abandon the policies in which they believed and on which they were elected and adopt policies of "monetarist", free enterprise capitalism. Right of centre parties are more committedly capitalist than in the past. And right of centre governments - most recently here, in Canada and in the USA - have won landslide victories.

By contrast, the failings of the most extreme collective economies have never been clearer. Indeed, so clear are they becoming to Communist governments themselves that these are, more and more, adopting capitalist techniques, importing capitalist technology and encouraging capitalist attitudes, while, with greater or lesser success, trying to resist capitalist political freedom. So stark has the trend become that beavies of Marxist historians are now employed by the governments concerned to explain it away.

Capitalism works - because it works with the grain of human nature rather than against it. It works with the natural desire of individuals to improve their and their families' conditions; and it then harnesses their ambitions to the general interest.

Life in capitalist countries is not only generally wealthier, longer and freer: its quality is different and better, too. It is hard to quantify: but those who have experience of the most highly collectivised societies tell us that life here is more varied, unpredictable, individualistic, a paradoxical mixture of the unorganised and the harmonious.

By contrast, life in Communist society has been described as:

"Grey and eventless. It consists of the repetition of the same primitive operations, and in part of the slow movement up the service ladder, which slightly changes and colours the daily routine.... Sometimes sparks of protest flash in people's souls, and it seems that they are about to break into flame. But the days and the months and the years go by. The sparks

go out by themselves or friends diligently stamp them out, or neighbours, or colleagues, or bosses, or subordinates, or altogether.

What is the use of sparks? Its quieter without them". (Zinoviev, "The Reality of Communism", page 53).

Life in a capitalist society is not quiet - and not intended to be. The answer to the critics of capitalism - and of the policies which we who believe in it pursue - is, ultimately, not just that the free enterprise, market capitalist system is efficient: it is that it is better - for it enriches life by liberating the individual spirit.

19

GRIFFITHS
10/12

Do you want a mtg?
Do so, do you want us to
ask Peter Hulley to go on then
at a couple of Party Speeches
in January.

Yks
JG
SM.
M.

FROM: H M GRIFFITHS
10 December 1984

- cc PS/Chief Sec
- PS/Financial Sec
- Sir P Middleton
- Sir T Burns
- Mr Littler
- Mr Odling Smee
- Mr Lavelle
- Mr Culpin
- Mr Folger
- Mr Cropper

Mon
12/12

[Ms Fallmer]

- MR BATTISHILL
- CHANCELLOR OF THE EXCHEQUER

SPEECHES IN JANUARY-FEBRUARY

You have a number of major speaking engagements early in the new year. So that we can set work in hand on the preparation of drafts, it would be helpful to have your views on the main subjects you will wish to cover.

Birmingham Chamber of Commerce - 15 January

2. You thought this might be the right occasion for a speech about unemployment. Mr Odling-Smee has prepared a draft outline text, and this is attached. It is deliberately rather long so as to give you an opportunity to choose which issues to focus on and which to omit or play down on this occasion. We ought to aim to let you have a first full draft by 4 January.

His quote
well used
retained EPR

Newspaper Society - 30 January

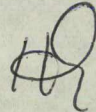
3 The Society - who represent local and regional newspapers - have been lobbying hard about VAT and recently came to see the Minister of State. There is no obvious subject for this occasion. Mr Culpin has suggested you might say something about open government; you could point to the large volume of information your Departments publish in White and Green Papers, Red Books, Autumn Statement etc. (This is likely to be only a few days after the PEWP is published.) Other possible topics might be local government reform and regional policy.

Purpose:
is deflat
/ Bridg
Capital
[Thoughts
on tax
reduction
or reform
policy]

We publish a lot but we don't have a very good record on being informative except when it's dragged out of us. Little to be said? But the old two subjects don't look too appealing either!

Overseas Bankers Club 4 February

4. You had set this aside provisionally as a suitable occasion for a speech on the international outlook, perhaps focussing mainly on the US economy in the wake of the President's Budget message. If you agree, we will ask OF to prepare an outline.



H M GRIFFITHS

Gregory Howen
John Lee

There are also a couple of Party occasions in January; and it might be best to arrange an early discussion so that we can tie up any loose ends before Christmas and get ahead with drafting in good time.

amb

11/12.

UNEMPLOYMENT

Outline of a Speech to Birmingham Chamber of Commerce

Introduction

Social and personal aspects of unemployment. Government very concerned.

Present Unemployment in Perspective

2. Historical comparisons. Rise in unemployment throughout post-war period, not just since 1979. Almost doubled 1966-74 (trough to trough), more than doubled 1974-79 (trough to trough).
3. Not so high now as in 1930s. Fell in 1930s by over 300,000 a year (1932-37). Probably fell even faster after recessions before 1914.
4. International comparisons. Rise in unemployment is common to most OECD countries. Less of a trend in Japan or the US.

Why is Unemployment High?

5. Need to look for explanations that are sufficiently general to explain pre-1979 period and other countries as well as recent years in UK. That is, cannot be attributed just to "Thatcherite" policies.
6. Can exclude two things:
 - a. rapid growth of labour supply. Not true of UK or Europe - US has had faster labour supply growth and smaller rise in unemployment;
 - b. information technology: too new to be quantitatively important.
7. Main explanations:

- a. shocks of 1970s (eg oil price increase of 1974, productivity slow down and rise of NICs) all required some slow down in growth of real wages, which occurred in few countries;
- b. policy response to the shocks of the 1970s was to accommodate the inflationary consequences rather than to try to offset them, with longer-term effects on unemployment;
- c. rising size of public sector, and failure of real wages to grow more slowly to pay for it;
- d. increasingly generous social security systems, and changing attitudes towards them, both making it less unattractive to be out of work;
- e. recent recession associated with second oil price shock and realisation by governments that they could not go on accommodating rising inflation;
- f. failure again of nominal wages to grow substantially more slowly in response to slowdown in money GDP growth.

8. Notice the prevalence of inappropriate wage behaviour in these explanations. Modern economies cannot operate efficiently unless all prices, including wages, adjust to changing circumstances. But real wages in Europe have been too rigid.

9. Notice also international nature of explanations. None applies to UK alone, and some (eg rising public sector, increasingly generous social security systems) ceased to apply in UK before they did in other countries.

10. Notice also that nearly all explanations go well back into 1970s and earlier. Indeed the attitudes in the labour market that cause the wage inflexibility were formed in the 1950s and 1960s when the rate of real wage growth was higher than the warranted (ie feasible) rate in the 1970s, there were few major shocks, and a new generation of labour leaders who had not known the 1930s was growing up.

Policy Towards Unemployment

11. People say that we are not doing anything about unemployment because we are not spending as much money as we can. But that will not solve the problem because it only tackles symptoms. On a small scale it could have a minor impact on unemployment, especially if it was concentrated on cost-effective schemes, but it would be short-lived because of crowding out, etc. On a large scale it would rekindle inflation and take us back to the bad old world.

12. The Government do have a policy towards unemployment. Unlike what most commentators think is necessary, it does not in general involve spending money. It also differs in that:

a. it is directed at the underlying problem, not at the symptoms only;

b. it will work.

13. The underlying problem is the labour market and real wages. Insufficient flexibility and adaptability. Hence policies towards trade union legislation, reductions in restrictive practices, competition in goods markets, low wage issues (eg YWS, wages councils), mobility (eg housing, pensions), training, etc.

14. How and why do these policies work?

a. trade union legislation: TUs tend to operate so as to keep up pay and employment of those in jobs at expense of unemployment. Legislation intended to reduce power of leadership in relation to that of membership as a whole and employers;

b. restrictive practices: barriers to entry reduce bargaining power of unemployed relative to those already in jobs; barriers to flexibility of working patterns raise costs of labour, reduce profits and hence reduce output and employment;

c. competition in goods markets: the more competition firms face in product markets the harder the bargains they will strike

in the labour market, which means better adjustment of wages and more jobs;

d. low wage issue: adjustment of wages towards lower end of income distribution is hampered by artificial factors setting a floor (eg wages councils);

e. mobility;

f. training: temporarily reduces youth unemployment; more importantly increases number of skilled workers and quality and adaptability of their skills, hence easing a traditional bottleneck to higher production and employment;

g. taxation: remove distortions, especially disincentives to employment

15. All this amounts to a substantial policy towards unemployment. And it will work. Employment is already rising: figures for last 12 months or so. But not quickly: changing the bad habits of generations (eg restrictive practices, role of trade unions, protected product markets) takes time. Even when legislation can be changed quickly, attitudes take longer to adjust.

Peroration

16. Important not to be defeatist. Just because our policy towards unemployment does not come in a package that can be announced at Budget time does not mean we are doing nothing. And just because it takes time to produce results does not mean that it is not working. (Examples.) They said that we could not bring down inflation; but we did. They said in 1981 that the economy could not recover from recession following the increase in taxes. But it did. They said we could not create more jobs: but we have. In time they will have to eat their words over unemployment too.



C
Following last Friday's meeting, I need to issue an edict about other Ministers' speeches.

It is hard to see how to do this tactfully, and I foresee problems. A possible draft is below.

But I'm sure it will be best for you to raise the subject first at prayers.

D.C.P.

20/12

DRAFT MINUTE TO:

PS/CHIEF SECRETARY
 PS/FINANCIAL SECRETARY
 PS/MINISTER OF STATE
 PS/ECONOMIC SECRETARY

Sir P Middleton
 Sir T Burns
 Mr Battishill
 Mr Griffiths
 Mr Culpin
 Mr Cropper
 Mr Lord

*Thank. I have
 (small) note @ pm
 I will go into
 press year. ~~Chairman~~ can then be
 in mind out. etc.
 H2 (21/12).
 M now detail at 1st page*

MINISTERIAL SPEECHES

The Chancellor has been considering how to get better value for effort from ministerial speeches. He is concerned that ^{The best way} ~~we are~~ ^{always be being made} ~~not making the best~~ of opportunities available to get across themes of Treasury Ministers' own choosing.

2. He has it in mind that it would, in general, be an improvement if:-

(a) there ^{were} ~~could~~ be agreement, in advance, ^{on} ~~as to~~ a small number of themes that ~~were~~ ^{are} particularly important to get across, and for most, if not all, speeches that ^{are} ~~were~~ publicly released to be addressed to these;

(b) on most occasions to concentrate on ^{press release consistency of a} ~~press releasing~~ a one-page summary or extract, rather than the complete text of the speech.

2. It would ~~also~~ mark a further improvement on present arrangements, if it could easily be arranged, for ^{now to be} ~~some~~ co-ordinated consideration ^{of} ~~it be given to~~ the acceptance of speaking ^{invitations} ~~engagements~~. Subject to your views, and those of your Ministers, do you think it would be possible in future for all important speaking invitations to be cleared centrally, with Central Unit and this office, before engagements are accepted? Unless there are any major difficulties, I should like to try to put ~~some~~ a procedure of this kind in place in the New Year.

D L C PERETZ

CONFIDENTIAL



FROM: DAVID PERETZ
 DATE: 17 December 1984

SIR P MIDDLETON

cc Sir T Burns
 Mr Battishill
 Mr Culpin
 Mr Cropper
 Mr Lord

PRESENTATION OF POLICY

The following points were agreed at the meeting the Chancellor held with you and copy recipients on 14 December.

(i) there was a need to counter the view that the best way to reduce unemployment was to increase public spending. The case needed to be put that cuts in tax, and keeping interest rates and inflation down, were important if the Government cared about jobs. There were opportunities to write a piece for publication in the "Sunday Times" on 30 December; and, at a later date, in the "Sunday Express". Both should be taken, and Mr Lord should produce a first draft for the former. (Action: Mr Culpin, Mr Lord)

(ii) a list of other themes for articles and Ministerial speeches should be drawn up. This would include the privatisation/wider share-ownership theme, the importance of supply side measures, (possibly) pay and jobs, and the unions. You agreed to draw up a list. (Action: Sir P Middleton)

(iii) Ministerial speeches. It was important to repeat these themes in speeches by other Treasury Ministers. The best format, for nearly all occasions, was a short one page press release. It was generally a mistake to press release the entire text of Treasury Ministerial speeches. It was also important for other Treasury Ministers to consult the Chancellor before speaking engagements were accepted. (Action: Mr Peretz)

(iv) The Chancellor's speeches. It would be helpful if the Chancellor could spend a short time with the official responsible for drafting a speech, on each occasion, before he sets pen to paper. (Action: Chancellor)

(v) Action should be taken, also, to get the chosen themes across to Government backbenchers. This would involve work by the PPS's, and the preparation of suitable CRD briefs. (Action: Mr Cropper)

A handwritten signature in dark ink, appearing to read 'DLP'.

D L C PERETZ

CP



RECORD OF A MEETING OF THE SPEECH COMMITTEE
HELD IN NO 11 DOWNING STREET
ON FRIDAY 21 DECEMBER 1984 AT 11AM

Those Present:

Chancellor of the Exchequer
Mr Battishill
Mr Folger
Mr H Griffiths
Mr J Monaghan
Mr Peretz
Miss O'Mara
Mr Baillie
Mr Lord
Peter Lilley MP

The meeting considered Mr Griffith's minute of 20 December.

2. In considering the speech programme for January/February 1985, the Chancellor made the following points:-

(i) He would give the speeches to businessmen in Sir G Howe's constituency on 11 January and to John Lee MP's constituency dinner on 23 January "off the cuff".

(ii) The speech to the Newspaper Society on 30 January, fell in the 'semi-purdah' period. As such, he would speak for 15 minutes with no question and answer session but with a press release (Mr Baillie to inform the Newspaper Society). The Chancellor suggested he might discuss the Government's tax strategy in general terms, based on the Treasury's recent paper to the NEDC. The speech would

Ch Ex
speeches



be designed to deflate expectations about the scale of tax reductions and reform in the 1985 Budget. It might cover the US proposals for tax reform and touch on public expenditure in the medium to long term by stressing that tax cuts had to be earned.

3. Turning to outstanding speech invitations the Chancellor decided to decline the following invitations:-

- (i) Cambridge University Conservative Association. ✓
- (ii) North West Industrial Council. ✓
- (iii) Society of British Aerospace Companies ✓
- (iv) Keynes Society (Eton College). ✓
- (v) Royal College of Defence Studies. ✓
- (vi) Sir Emmanuel Kaye's invitation ✓ to visit Lansing-Bagnall and Andrew Hunter MP's invitation to speak at Basingstoke Conservative Association AGM. ✓
- (vii) High Peak Conservative Association. ✓

(Mr Baillie to inform these bodies). ✓

4. The Chancellor agreed to accept in principle an invitation from Mr John MacGregor MP to speak at the Westminster Group Dining Club, but not on Monday 18 November. (Mr Baillie to arrange an alternative date.) ✓



5. The speech programme beyond the 1985 Budget was considered. The week beginning 25 March had been set aside as potentially within the purdah period. Now that the date of the Budget was publicly known, that week should be used to give a speech based on the 1985 Budget. Of the existing invitations, that from the American Chamber of Commerce (ACC) was identified as a likely platform for the Chancellor to make his first post-Budget speech, together with a press release (Mr Bailie to agree a date with the ACC). ✓

6. The Chancellor suggested that he might leave early for the Economic Summit in Bonn, so as to arrive on the eve of the Summit and thus fulfil his commitment to speak to DGAP. (Miss O'Mara to investigate whether the Chancellor could ask another Minister to chair NEDC on 1 May to allow an early departure.)

7. The Chancellor asked Mr Lilley to consider a suitable political theme for his speech to the Carlton Club in June.

8. The Committee considered a note by Mr Lilley (later circulated) on the Chancellor's speech programme. It was agreed that Ministers would consider the Chancellor's speech programme, alongside those of the other Treasury Ministers and their use of the media at the first meeting of Ministers and Advisers in 1985. A key element in this discussion would be the Treasury contribution to the briefing of backbenchers. The Chancellor stressed that those producing draft speeches for his use should focus their attention initially on the preparation of a suitable press release.

9. The Chancellor asked Mr Lord to sketch a plan, in consultation with Mr Lilley, indicating how sympathetic



backbenchers might ensure the Treasury's case got a fair hearing in the press.

10. It was agreed that there would be a meeting of the Speech Committee once the Chancellor had returned from the G5 meeting in Washington (Mr Baillie to arrange). This would cover among other invitations, the theme of the speech to the Overseas Bankers Club on 4 February.

11. There would be a further meeting of the Speech Committee immediately after the Budget to consider the theme of the Chancellor's speeches in the post Budget months.

DAVID M BAILLIE

7 January 1985

Circulation:

Those present
Mr Monger
Mr Unwin
Mr Cropper
Mr Lavelle