

PO-CH/NL/0338

PART A

SECRET

(Circulate under cover and
notify REGISTRY of movement)



PO -CH /NL/0338



PART A

1988 AUTUMN STATEMENT
DEBATE

PO -CH /NL/0338

PART A

DDS 25 years NAGIS 10/11/95

3-3-88

APLWP
~~4.1~~



FROM: A P HUDSON

DATE: 16 December 1987

MR TYRIE

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Scholar
Mr Odling-Smee
Mr Turnbull
Mr Peretz
Mr R I G Allen
Mr Pickford
Mr Cropper
Mr Call
Mr N Forman MP

AUTUMN STATEMENT DEBATE

We are arranging a meeting for very early in the New Year to discuss the Chancellor's speech for the Autumn Statement Debate. I shall circulate a possible outline in advance.

2. In the meantime, the Chancellor would be grateful if you could start thinking about knock-about material, and if copy recipients could look out for any interesting points to make.

APH

A P HUDSON

BULL POINTS.

This is Nigel Part
Forman's material

- GROWTH. - Growth in U.K. more than 5% in year to third quarter of 1987 and broadly based, i.e. consumption, exports and investment.
- Manufacturing output growing at underlying rate of more than 6% a year, the fastest since 1973.
 - Whereas manufacturing output has grown under this Govt., it actually fell under Labour.

- UNEMPLOYMENT. - Adult unemployment fallen by half a million over the past year, the largest 12 month fall since records began.
- Now steadily falling in all parts of the country, and over past year has fallen faster than in any other major industrialised country.

- PROSPECTS FOR 1988. - Non-oil economy forecast to grow by a healthy 3% in 1988.
- Latest CBI surveys show that business confidence remains buoyant and that investment intentions in manufacturing have held up since Black Monday.

No. 1. William O'Brien (Normanton) What discussions he has had with Finance Ministers abroad concerning expansion targets for the OECD economies. (to be taken with 6 and 18).

This question provides an opportunity to make some positive points in Supplementaries about the economic performance of the U.K. in comparison with other countries (see attached list of positive points)

Positive

- (i) UK GDP growth since 1980 highest among major EC countries. Contrast with previous two decades when UK bottom of EC growth league.
- (ii) Over year to 1987Q3 UK had fastest growth of any G7 country. Also had fastest growth of manufacturing output.
- (iii) In 1960s and 1970s investment growth lower than EC average. Since beginning of upswing in 1981H1, UK investment grown substantially faster than EC average, and faster than any other major industrialised country.
- (iv) Since 1980 UK manufacturing productivity growth highest among major seven countries. UK bottom of league table in 1960s and 1970s.
- (v) Over the year to 1987Q3 UK manufacturing productivity growth fastest of G7 countries.
- (vi) In 1980s whole economy productivity growth in UK equal highest with Japan among major countries. In 1960s and 1970s UK near bottom of league table.
- (vii) Between 1983 and 1986, rise in total employment in UK greater than in rest of EC combined.
- (viii) UK proportion of people in work markedly higher than in Germany, France and Italy and one of highest in EC12.
- (ix) UK unemployment rate falling faster than any other major industrial country.

- (x) UK youth unemployment rate below EC average.
- (xi) UK's net external assets, as percentage of GDP, highest among major countries.

No. 4. Bill Walker (North Tayside) If he will make a statement on the latest outlook for inflation.

Suggested Supplementaries.

- Has not one of the major achievements of this Government been to reduce the rate of inflation to well under half the level it was in 1979 and less than a third of its average level under Labour in the 1970's?
- Will my RHF confirm that it remains the Government's objective to achieve stable prices and is not low inflation particularly beneficial to output, employment and competitiveness?
- Can my RHF say when was the last time that the rate of growth in this country exceeded the rate of inflation as it did in the third quarter of last year?
- Is it not worth noting that the lowest inflation rate achieved by Labour in the 1970's (7.4%) was above the highest rate of inflation since the 1983 election (7%)?

No 8. Ian Taylor (Esher) What estimate he has made of the relative benefit to British industry of 1% off interest rates as compared with 1% off pay rises.

Suggested Supplementaries.

- Does the answer given by my RHF not show the critical importance of controlling unit labour costs if we are to maintain our international competitiveness?
- Do these figures not show how important it is that the 3% or more real increase in average earnings which we have seen in recent years was met from increased productivity and improved industrial performance?
- Would not interest rates in the U.K. be lower if our rate of inflation could be brought down still further and does this not depend to a considerable extent on employers keeping a firm grip on their pay costs?

No. 9. Tim Smith (Beaconsfield) When he is next due to meet the Finance Ministers of the other major industrialised countries to discuss the international financial situation. (to be taken with No.11).

Suggested Supplementaries.

- Is it not very satisfactory that 1987 was the fifth successive year of growth in the Group of Seven major industrialised countries and doubly satisfactory that this country was at the top of that growth table last year?

- Is it not welcome that the policy changes in the G7 countries since last October have been broadly in the right direction with the US Federal deficit cut by over \$70 billion in Fiscal 87 and both Japan and West Germany having taken action to stimulate their economies?

- What further measures will my RHP be urging upon his counterparts when he next meets them in order to deal with the key problems of exchange rate instability and trade imbalances?

No.14. John Redwood (Wokingham) What responses he has received to his 1987 initiative to deal with the problem of developing countries debt.

Suggested Supplementaries.

- Is it not clear that substantial progress has already been made following my RHF's welcome initiative, notably on the conversion of loans to grants and the introduction of grace periods for repayment? Do we not now need to see further progress made in reducing interest rates or rescheduling official debt?

- Is it not welcome that agreement was reached at the IMF on the enhancement of the concessional Structural Adjustment Facility and could my RHF tell the House a little more about this?

- Is it not true that several of the Sub-Saharan countries assisted by my RHF's initiative, such as Ghana, are making major attempts to adjust their economies to market realities and are not such efforts a precondition for receiving assistance from the scheme?

PS/EST

cc. ~~Mr A Allan~~
pyp

Autumn Statement: Material for Chief Secretary's Wind-Up

Mr Allan's note refers. My suggested 'line to take' in relation to the infraction proceedings reflects the U.K.'s response to the Commission arguments, and was the line taken by the FSI at yesterday's TCSC hearing.

2. There was no suggestion that we could ignore the Court's judgement but until that judgement is received, my view was that we should simply reiterate the arguments offered to the Court, and not get drawn into any 'ifs and buts' of an adverse decision.

2. George Michie

14.01.88

A

Overheating implies that the economy is growing faster than can be sustained without giving rise to inflationary pressures.

15. The strength of the economy has given rise to concerns that we may face a problem of overheating. It is important here ^{not to confuse} ~~to distinguish between~~ possible early warning signs ^{with} ~~on the one hand,~~ and actual problems ^{of overheating.} ~~on the other.~~ For example, consumer credit may be expanding rapidly, but the rate of increase has not speeded up very much during 1987, and the growth of mortgage borrowing, which has been a feature for much of the 1980s, has proved consistent with achieving our inflation objectives. Or to take a different example, the fact that CBI surveys are showing that a historically ~~high~~ ^{high} proportion of firms are operating ~~at~~ ^{below} full capacity is in part a reflection of supply side improvements. Firms are now making better use of the capital stock, ~~and the~~ ~~Recent investment intentions surveys, including one taken after the stock market collapse,~~ suggest that businesses are planning a major increase in investment in 1988. And the CBI's special survey, ~~also taken after the stock market collapse,~~ ^{also suggests found that} ~~found that~~ ^{businessmen had no intention of cutting back on these plans.}



FROM: JILL RUTTER

DATE: 17 December 1987

MR TURNBULL

cc:
 Principal Private Secretary
 Sir Peter Middleton
 Mr Anson
 Mr Kemp
 Mr Monck
 Mr Scholar
 Mr D J L Moore
 Mr Odling-Smee
 Mr Burgner
 Miss Peirson
 Mr Pickford
 Mr R I G Allen
 Mr Gieve
 Mr C J Welsh
 Miss C Evans
 Mr Cropper
 Mr Call
 Mr Tyrie
 Mr Hudson -2

AUTUMN STATEMENT DEBATE: 14 JANUARY

The Chief Secretary will be winding up the debate on the Autumn Statement, scheduled for 14 January. He has been considering the main topics he will want to address.

2 The Chief Secretary would like to concentrate on two public expenditure themes. The first is that of the Government's ability to "prioritise" in public expenditure within the envelope provided by the declining GGE/GDP share. He would like this to be a fairly meaty chunk of the speech and it should highlight the increases on specific priority services (health, education etc). The Chief Secretary has discussed this with Mr Anson and you may like to discuss ideas with him.

3 The second point the Chief Secretary would like to underline is the healthy state of public finances overall. This need not be long - a couple of paragraphs. The Chief Secretary would, if possible, like to make the point that the public finances are in a better state than in many years.

4 In this connexion we may need some defensive material on privatisation proceeds - both their contribution to present

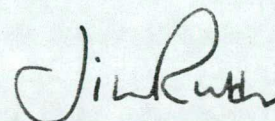
PS/CSI
 7
 TURNBULL
 17/12

finances and their course over the Survey period. Could Mr D J L Moore produce a suitable piece? (The Chancellor may want to say something on this; if he does the Chief Secretary might need less).

5 Mr Anson suggested the Chief Secretary ought also to bring in value for money into the discussion of the state of public finances. The Chief Secretary would like to use this occasion to emphasise the new monitoring arrangements for health authority spending/services etc which have been agreed as the condition for this year's supplementary financing. Perhaps you could discuss with Miss Peirson how that might best fit in with the other material requested in this note.

6 Since Lord Young will be publishing his White Paper in advance of the Autumn Statement debate, the Chief Secretary might need to respond to points made on that in the debate. Could Mr Burgner consider what material the Chief Secretary might usefully have.

7 I will commission other material nearer the debate when the Chancellor has decided on the key points he wishes to cover. The Chief Secretary would be happy to have this material in note or narrative form. It would be very helpful if the main blocks could arrive in this office by close on Thursday, 7 January with Mr Burgner's material arriving, if possible, by close on Friday, 8 January.



JILL RUTTER

Private Secretary



~~6 Feb 12.1~~
PHW

FROM: A P HUDSON

DATE: 4 January 1988

MR TYRIE

cc Miss Simpson
Mr Cropper
Mr Call
Mr N Forman MP**LABOUR STATEMENTS ABOUT TAX CUTS**

The Chancellor recalls that during the General Election, there were a number of statements by Labour spokesmen to the effect that the 1987 tax cuts would have to be reversed.

2. He would be grateful if you could let him have any good quotations from Messrs Kinnock, Hattersley, Smith, and Gould. I think I can put my hand on some remarks to that effect by Mr Hattersley from before the Election, but do not have any from the campaign itself.

3. The Chancellor has not set any particular deadline, but good quotations clearly might be useful for First Order Questions and the Autumn Statement Debate on 14 January.

A handwritten signature in dark ink, appearing to be "A P HUDSON".

A P HUDSON

PHJ

APH
→
CHEX
5/1

FROM: A P HUDSON
DATE: 5 January 1988

CHANCELLOR

cc Chief Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Turnbull
Mr Odling-Smee
Mr Peretz
Mr H P Evans
Mr R I G Allen
Mr Pickford
Mr A C S Allan
Mr Cropper
Mr Tyrie
Mr Call
Mr N Forman MP

SPEECH FOR AUTUMN STATEMENT DEBATE, 14 JANUARY

We are meeting tomorrow to discuss your speech for the Autumn Statement Debate on Thursday 14 January.

Background

2. Apart from the "philosophical" speech at the Centre for Policy Studies, this is your last speech before Purdah. You have First Order Questions the same day, and NEDC the day before.

3. The unemployment figures are published that day, and the RPI for December the following day. The DTI White Paper will be out, and the Public Expenditure White Paper will be published the following week.

The Debate

4. You open the Debate, and we have to decide on the terms of the Government motion. Last year, we decided to stick to exactly the same form of words as the year before:



"That this House approves the Autumn Statement presented by Mr Chancellor of the Exchequer on 6 November; welcomes the prospect of continuing low inflation and steady growth as the basis for maintaining the trend of rising employment; and congratulates Her Majesty's Government on the continuing reduction in the share of national income pre-empted by public expenditure."

There is a case for sticking with this, perhaps replacing "rising employment" with "falling unemployment". Do you want to expand it in any way?

- ... 5. I attach a possible outline for the speech, together with a couple of other points which you may want to put in. I do not think this has any problems of overlap with the topics the Chief Secretary wants to cover (Miss Rutter's 17 December minute).

A handwritten signature in black ink, appearing to be "A P HUDSON".

A P HUDSON

OUTLINE OF CHANCELLOR'S SPEECH FOR AUTUMN STATEMENT
DEBATE, 14 JANUARY

Courtesies to TCSC.

2. Autumn Statement about 3 things: Public Expenditure; National Insurance Contributions; and economic forecast. Not surprising that the last has attracted the most attention.

3. Autumn Statement came two weeks after stock market collapse. Then considerable apprehension about outlook for world economy.

4. Worst fears of some have receded. Striking that most commentators and businessmen looking forward to 1988, have been fairly optimistic, certainly for the UK economy.

5. Figures published since Autumn Statement, for UK and other countries, show growth if anything stronger than was then thought.

6. And right policy measures have been taken to assist adjustment of world economy: US agreement to reduce budget deficit; Germans have reduced interest rates.

7. Problem is dollar undershoot.

- Worth recalling how far dollar had fallen by October.
- And substantial move in trade volumes.
- Need was for stability.
- Further fall brings uncertainty and risk of inflationary pressures.

8. Conclusions on outlook for world economy, prospects for dollar, and state of international cooperation.

[Need to consider carefully what to say.]

9. UK economy well placed at the start of 1988.

- 1988 very successful. Worth examining why.
- Not a pre-election boom, as opposition claimed.
- Growth if anything stronger after Election than before.
- In any case, consumer spending actually grew more slowly in 1987 than in 1986. Difference is that investment was flat in 1986 and strong in 1987; and that exports

were stronger in 1987. This reflects strength and confidence of British businesses.

10. Key point is that up-swing is soundly based, balanced, and therefore sustainable. 1987 above trend rate of growth. So though 1988 likely to be slower, still thoroughly healthy.

11. Unemployment falling fast, and likely rate of growth consistent with further falls.

12. Strong growth not achieved at the cost of runaway inflation, unlike in the past.

13. Strength of economy enabled Government to increase spending on priority areas, while reducing share of GDP and reducing borrowing. Opposition always keen to spend money. But with their policies, it would not have been available in the first place.

14. Conclusion

Subjects not covered in this outline

A. Monetary Policy

The TCSC Report starts to go into the 'awkward choices for monetary policy' (para 27). And it talks about the dangers of intervening in the foreign exchange markets. How far do we want to take up either of these points?

*left over 1.5
- 2 usavts
(but not
monetary policy)*

B. Scope for Tax Reductions

Around this time of year, you normally try to damp down speculation about the scope for tax cuts. As I recall, a lot of people refused to believe last year's warning, and wrote it off as a routine remark. That sort of reaction is all the more likely this year. Do you want to get in to the subject nonetheless?

no

C. Lessons from the problems in the USA

You mentioned this as a possible topic for the NEDC note. Do you want to cover it in the House?

Johnson

RESTRICTED

FROM: A G TYRIE *AWP*

DATE: 6 JANUARY 1988

PS/CHANCELLOR

cc PS/Chief Secretary
Mr Hudson
Mr Cropper
Mr Call**AUTUMN STATEMENT: LABOUR BASHING**

I attach a bit of Labour bashing material which might be of some use for the Autumn Statement Debate, found mainly by Guy Black in the Research Department.

2. The Hattersley quotations cover the point you were looking for on Labour's claims that we would be forced to reverse tax cuts. Kinnock says almost as much.

3. You might want to make some fun of Labour's "Labour lessons" campaign. I attach their press release on this. I see no harm in your repeating the jibe that Labour have chosen to repair to Brighton (a retirement home at Rottingdean?) to learn their lessons.

4. You might also be able to irritate Labour with a suitable quip about the Deputy Leadership race. It provides Hattersley and Prescott as targets. It could even be a vehicle for "the jobs for the Roys" quip.

AGS

A G TYRIE

Hattersley

SPEECH BY THE RT HON ROY HATTERSLEY MP, DEPUTY LEADER OF THE LABOUR PARTY AND SHADOW CHANCELLOR OF THE EXCHEQUER, AT A MEETING OF THE INTERNATIONAL EQUITY DEALERS ASSOCIATION, BUTCHERS' HALL, BARTHOLOMEW CLOSE, EC1 ON THURSDAY 15 JANUARY 1987 AT 6.15 PM

The Government's present economic policy is unsustainable and the Government knows it. The Government is promoting policies which will do the economy long-term harm in the hope that they can win short term popularity for the Conservative Party. The damage will be increased by the tax cuts which will certainly be part of the pre-election budget. Today I want to make clear the Opposition's view on those tax cuts and on the economic crisis which the Government is promoting.

Tax cuts are quite the wrong prescription for the British economy. Indeed they are neither economically nor socially the right choice for this country. The Government hopes that a cut in the standard rate will both win votes and obscure the underlying danger of an impending crisis. I believe that it will do neither. Indeed, it will bring the crisis nearer. What is more, a tax cut made this March would inevitably lead to compensating action immediately the election is over. That necessity would face whatever Government was in post. Even were the Tories to win, they would reimpose higher taxes and make public expenditure cuts so deep that even the Conservative Party would be reluctant to support them. The

[Mr. Roy Hattersley]

offer some cheer to those Tories who wanted a party political Budget and felt that they were not getting it. It was, of course, exactly what they got. The Budget was intended to buy votes, but the Chancellor has carefully targeted the voters whom he hopes to buy. The men and women who have been written off as potential Tory converts were ignored. There was nothing for pensioners without a second income, nothing for families living on poverty wages, and nothing for the unemployed. By neglecting the people who need help the most, the Chancellor has widened the desperate and destructive divisions within our society.

Mr. Eric Forth (Mid-Worcestershire): Will the right hon. Gentleman explain how the fall in interest rates, which has already begun and will inevitably continue as a result of my right hon. Friend's long-term Budget—for that is what it is—can fail to benefit the business community and therefore employment in the long run?

Mr. Hattersley: Everyone agrees—the Tory's own model agrees and every economist and institution of every point of view agrees—that if the first priority is to reduce unemployment, spreading money about in tax cuts is the slowest, least effective and least economic way of achieving that.

Mr. Forth: What about interest rates?

Mr. Hattersley: If the hon. Gentleman will bear with me for more than a couple of minutes of my speech, I shall be developing exactly that point.

Before the hon. Gentleman's wholly irrelevant interruption, I was referring to the fact that the desperate and destructive divisions in our society have been intensified and deepened by the Budget. They have been intensified in the name of prudence. The price for the reputation of prudence that the Chancellor thinks it expedient to promote is to be paid by the families on the dole, those living in houses unfit for human habitation, the sick waiting for hospital beds and the pensioners unable to pay their fuel bills. No Budget every relied so heavily on the dictum that no one with a conscience votes Conservative.

Prudence is the word that Conservative spokesmen have been advised to put into their speeches, but this is not a prudent Budget. It is not prudent to spend £20 billion per year holding unemployment at more than 3½ million. It is not prudent to sacrifice the £30 billion per year that this country would earn if those 3½ million men and women were back at work. It is not prudent to allow our housing stock, our hospitals our schools and our roads to decay to the point of disintegration. It is not prudent to squander our oil revenues. It is not prudent to encourage the reduction of manufacturing output and the collapse of manufacturing investment and to escalate the deficit in our balance of manufactured trade. It is not prudent to refuse to secure the homes of the old and the weak against the disastrous rise in burglary and robbery over which the Government have presided. I repeat, this is not prudent Budget.

Mr. Nigel Forman (Carshalton and Wallington): If the right hon. Gentleman is so converted to the merits of genuine prudence, which I take to be the burden of his

argument, what is so prudent about the Labour party's spending plans which would increase public expenditure by £28 billion at the minimum estimate?

Mr. Hattersley: "All this and more", as they say. If the hon. Gentleman and his colleagues will bear with me, they will find that I deal with exactly that point on page 78 or 79 of my speech.

I repeat, this is not a prudent Budget. More important, it is generally irrelevant to our economic needs. It is built around income tax cuts which cannot be sustained and will worsen the growing deficit in our balance of payments—a danger that the Chancellor at present finds it convenient to ignore. Even if the prospects were as rosy as the Government pretend, the Chancellor's choice of spending priorities would be wrong. It is not simply the economic outlook which demands that available funds should be invested in our future rather than used to fuel the credit and consumption boom. Short term or long term, the extra resources at the Chancellor's disposal should be concentrated on the reduction of unemployment, the alleviation of poverty and the improvement of essential services. They should have been used to build a united country; instead, they have been used to finance a failed publicity stunt.

The public expenditure White Paper, which was the curtain raiser to the Budget, was described by the *Spectator* as having fallen off the back of a lorry. The simile is now continued. We are in the middle of one of those closing-down sales that advertise their bargains with whitewash messages painted on grubby shop windows: "Everything must go. Buy while stocks last. Amazing reductions." Customers who fall for such blandishments find, when they return to complain about the shoddy character of the goods, that the hucksters have cut and run. So will it be with this Government. That is their clear intention, and that is the message of the Budget.

The tax cuts that the Chancellor announced yesterday, intensifying as they do both the credit boom and the pressure on imports, cannot be sustained. Were the Government to be returned in the general election, for which the Budget is no more than a trailer, value added tax would be increased to fill the gap left in the revenue and to reduce the consumption of imported goods. We would be left with tax cuts that help the rich the most, and those cuts would be replaced by tax increases that hit the poor the hardest. An increase in VAT is the Prime Minister's clear intention. On television in January 1984 she was absolutely explicit. She said:

"It is the balance between indirect and direct taxation which we want to switch."

It is the pattern of Tory behaviour to cut direct taxation before elections and, given the chance, to increase indirect taxation afterwards.

Yesterday, my right hon. Friend the Member for Islwyn (Mr. Kinnoch) referred to the history of Conservative tax duplicity, notably the behaviour of Mr. R. A. Butler. Hon. Members shouted then, as some are shouting now, for more recent examples. An hon. Gentleman, whom I am afraid I cannot identify as I do not know his constituency, has asked for such an example. Let me give him one. I suspect that the occasion of his election in 1979 was such an example. Before that election, the Prime Minister promised that there would be no increase in VAT. Immediately the election was over, VAT was increased from 8 per cent. to 15 per cent.

Budget Resolutions and Economic Situation

AMENDMENT OF THE LAW

Motion made, and Question proposed,

That it is expedient to amend the law with respect to the national debt and public revenue and to make further provision in connection with finance; but this Resolution does not extend to the making of any amendment with respect to value added tax so as to provide—

- (a) for zero-rating or exempting any supply;
- (b) for refunding any amount of tax;
- (c) for varying the rate of that tax otherwise than in relation to all supplies and importations; or
- (d) for relief other than relief applying to goods of whatever description or services of whatever description—*[Mr. Lawson.]*

[Relevant documents: European Community Document No. 10155/86, Annual Economic Report 1986-87 and the unnumbered document, Annual Economic Report 1986-87 (final version as adopted by the Council).]

4.35 pm

Mr. Neil Kinnock (Islwyn): May I begin with the usual facilities and congratulate — [HON. MEMBERS: "Felicities."]—the usual facilities of offering the usual felicitations and congratulate the Chancellor of the Exchequer on his Budget speech and, indeed, on yet another record-breaking short speech? I am sure that hon. Members on both sides of the House will have reason to be grateful for the fact that he was economical with his words—I use the term in its very best sense—and that he was able to produce such a remarkable anticlimax towards the end which, for those of us with a poetic turn of mind, will be all the more gratifying. The Chancellor may have lost his place in the speech, but with this Budget he has lost his place in history as well.

The Budget is, as we and almost everyone else anticipated, a bribes Budget. It is a Budget that almost entirely ignores the national need for efficiency in the production of wealth and the national demand for fairness in the distribution of wealth. It is a Budget that has little to do with the general good, and everything to do with the general election.

The approach of the Budget to the problems of this country starkly defines the difference between the values and priorities of Her Majesty's Government and the values and priorities of the British people as they express them whenever they are asked. Those priorities are to fight unemployment, to help the old, to help the weak and to reunite the country. Those priorities are held all over the country, except on the Government Front Bench.

The Government have chosen a Budget that produces a short-term consumption spurt, but we and the British people want long-term investment to build up foundations for future strength. The Government choose across-the-board cuts in taxes. We and the British people want across-the-nation cuts in unemployment, but the Chancellor, in his Budget, has again done absolutely nothing to mount any form of serious attack on the 3 million level of unemployment in this country. All that he has done is to continue with the Government's efforts to beautify the figures of unemployment, while doing nothing to deal with the facts of unemployment.

There are elements in the right hon. Gentleman's speech with which we concur. I select particularly the

simplification and improvement of the business expansion scheme, and also the corporation tax changes, which appear, certainly at first sight, to be welcome, if with some necessary minor reforms. The improvements in taxation incentives to encourage training are all the more welcome. Indeed, the right hon. Gentleman might have felt disposed to go further than that, given the very sad and inadequate record of investment in training, which is all too typical in this country.

Changes in the system of payment and in the administration of VAT for small businesses is particularly welcome. I think that this will be greeted on both sides of the House, but I must say to the right hon. Gentleman that many people who have small businesses—the vast majority of whom are entirely reputable—will want him to ensure that there will not be an abuse of those changes, which would inflict disadvantages upon honest traders and small producers.

The reliefs on the VAT liabilities of charities are naturally welcome and, indeed, as the Chancellor will be aware, they have been pressed for by hon. Members on both sides of the House. The subsidies to ensure against different and disadvantaged prices for non-leaded oil are also welcome. We commend all these measures and give an easy passage to them, although, naturally, the detail of them must be explored in the appropriate way.

The Chancellor took it upon himself in the Budget to make a drum-banging announcement about the abolition of the Exchange Control Act 1947. I think that that is unlikely to be resisted, as it is a somewhat academic, even otiose, exercise at the present juncture. Indeed, the incoming Labour Government have a much better system for encouraging the return of much needed capital investment. *[Interruption.]* The repatriation scheme that we propose and will implement has received accolades from many independent observers who consider that the advantages that it will afford to those who move money will provide us with ready and plentiful resources to stimulate just the kind of investment that this country desperately needs. Much of such investment has been lost as a consequence of the huge increase in the outflow of capital investment since the Prime Minister and her colleagues removed capital exchange controls at the beginning of their period of office. This represents a loss in our already under-invested country of about £70 billion net in the past eight years.

The Chancellor has claimed that investment decisions have improved since he made his changes in 1984. He must explain how those investment decisions manifest such an improvement when this year the level of investment in manufacturing in Britain is 20 per cent. lower than it was in 1979 when the Government came into office.

As we listened to the Chancellor today, many of us, on both sides of the House, must have felt a certain familiarity with his Tory themes and the tactics that he is plainly seeking to implement. We recall the dilation of the economy before the election of 1983 and the subsequent action by this Chancellor to reverse the extremely modest expansion that was prompted by his right hon. and learned Friend the former Chancellor of the Exchequer.

The Chancellor's actions in 1984 were part of the Tory tradition that stretches back through Reggie Maudling and Heathcoat-Amory to the Chancellorship of the late lamented R. A. Butler, a much respected and endearing man in many ways, but he was also the father of the congenital Conservative practice of making concessions

[Mr. Neil Kinnock]

before an election and, if successful in buying votes, taking those concessions back after the election. [Interruption.] That, indeed, is precisely what R. A. Butler did in 1955 when he presented the April Budget. I am sure that you, Mr. Deputy Speaker, will recall that Budget, as you were active in the engineering business at that time.

In 1955 Rab Butler took 9d off the standard rate of income tax and raised tax thresholds. Just three months later, after the election, he introduced special measures. In October he brought in a special emergency Budget to reverse all the tax changes. [HON. MEMBERS: "Oh."] Those actions are memorable, not only because of the cynicism that they engendered, but because of the unforgettable appeal that the late Lord Butler made to the nation to respond in pursuit of his demands for stringency. I am sure you will recall, Mr. Deputy Speaker, as I do, that Lord Butler said that the nation should

"not drop back into easy evenings with port wine and over-ripe pheasant."

In our prefab I clearly recall that my mother and father gave up port wine and over-ripe pheasant for the duration. As I recall, they even gave up dressing for dinner.

Even more memorable from that period was the fact that that Budget marked the onset of the "stop-go" era in the British economy—an era that has cost our country so dear. There was the periodic "go" for consumption and mainly "stop" for investment. As we listened to the Chancellor today, that is exactly what we heard all over again — "go" for consumption, and "stop" for investment. Of course, it was wrapped up in a great deal of talk about "recovery", "strength", "buoyancy" and "prudence", as if the Budget was a carefully compiled climax to all the years of prudence and planning undertaken by the Government. The trouble is that, for the Government, all the facts belie any claims of prudence, buoyancy, recovery and care.

The fact is that we have a Chancellor who, just three months ago, in December, was saying that he doubted "very much whether there will be much scope for reductions in taxation in next year's Budget."

For once, the right hon. Gentleman absolutely meant it. It was not part of a disinformation campaign to persuade people that there was nothing much coming so that there would be great delight when something did come. The right hon. Gentleman meant his publicly expressed doubt about the prospect for income tax reductions. It was the confession of a man who knew very well that the reality of unplanned public expenditure overruns and an oncoming balance of payments deficit, together with his mismanagement of both interest and exchange rates, was catching up with him. There was no talk then of "lucky Lawson", and that was only 12 weeks ago.

It is no wonder that there was no such talk, because the Chancellor was also aware of the fact that, after nearly eight years of Conservative rule, the economy was still not back, as represented by all the important indicators, to the performance standards that were inherited in 1979.

We have had nearly eight years of oil-rich Conservative rule—some seven and a half years—with £60 billion net oil revenues and all the immense advantages of the savings

on the balance of payments because we were an oil-producing, oil-exporting country. With all those advantages, the Government still blew all the great opportunities that went with being oil rich.

As I said earlier, manufacturing investment is now 20 per cent. lower than it was in 1979. The manufactured trade surplus that the Government inherited in 1979 was £2.7 billion. This year the manufactured trade deficit is approaching £7.5 billion, even on the Chancellor's admission. In the years from 1979 manufacturing exports have certainly gone up by 15 per cent., but manufactured imports have gone up by 48 per cent. in volume over the same period.

In the early part of his speech the Chancellor spoke of a great productivity surge that has taken place under the Government—unbeatable, unrivalled by other countries. The Chancellor forgot to tell us about the starting point. He also forgot to say how that productivity surge has been achieved under the Government. It has been achieved by fewer people making fewer things. Indeed, 28 per cent. fewer people make 4 per cent. fewer things, because manufacturing output in Britain is still, in 1987, 4 per cent. lower than it was in 1979. So much for productivity Tory style.

What of taxation, the centrepiece of today's Budget? The tax burden as a proportion of the national income was still, in 1986, 18 per cent. greater than it was under the previous Labour Government. As a consequence of today's changes, that figure will not have altered significantly. To bring down the level of the tax burden, as a proportion of national income, to the 1979 figure the Government would have had to cut tax today by £15 billion.

The tax burden on the average household—the people who are supposed to concern the Prime Minister very much and who are said to want additional sums net of tax to be able to look after themselves, which is an instinct that I well understand—under this so-called tax-cutting Government has gone up by 10 per cent. To bring their tax burden down to 1979 levels there would have had to be a cut in the standard rate to 23.5p in the pound. [Interruption.] I realise why those figures make Conservative Members so agitated. They represent the shattering of every one of the central promises that they made to the people in 1979 and in 1983.

The Prime Minister says that she wants the citizen to be able to keep the lion's share of his earnings, but it is obvious that the Government have never practised what they have preached, except for the top 10 per cent. of earners. For the other 90 per cent. of British earners and pensioners, national insurance contributions, rates rises and VAT increases have all ensured that they have kept less of their incomes post-tax than they did in 1979.

The Government are not only the biggest taxers in modern British history, but the biggest job destroyers and biggest poverty spreaders. They have presided over an increase of 2 million in unemployment and of 2¼ million in the number of men, women and children in poverty. That is the Government's record. The real state of our economy and society is that after eight years the country is more divided and more impoverished with higher taxes, higher unemployment, and higher crime rates as well under this Government of law and order. In the middle of all that mess, along comes the Chancellor of the Exchequer with a Budget that completely ignores each of those

Campaign Briefing

From the Policy Directorate

Issue Number 67

November 1987

In this issue

EDUCATION: Reaction not Reform.....	1
HOUSING: A False Prospectus.....	2
HEALTH: Cutting where it hurts...3i+ii	3
POLL TAX: Tories' Shambles.....	4
ECONOMY: More Shocks on the way.....	5
ENVIRONMENT: Tory Muck.....	6

LABOUR LISTENS

"Labour Listens" will be launched in the New Year - with activities at all levels of the Party. Its aims are to reinvigorate our campaigning work, reshape our relationship with the community and to encourage contributions from a wide range of individuals and organisations to the Policy Review process.

- * Every fortnight, from January until June, there will be a nationally organised Listening event in one part of the country. These will be supplemented by events targetted to attract women, youth, pensioners and black people. The Policy Review groups will also be listening to evidence given directly to them by experts.
- * At regional and CLP level the Party will be using "**Labour Listens**" as a means of drawing local people into a debate about how they see Britain today and how they'd like to see it in the 1990s. Local activities will run alongside nationally organised events in each region and will continue way beyond June 1988.

A full-time team has been established at Walworth Road and it will advise regions and CLPs on the types of activity to be organised. And very soon a "**Labour Listens**" kit will be sent to all CLPs.

But don't wait for the kit to reach you. Start now by thinking about the people in your community to whom you should be **Listening**. When was the last time you, as a Party, spoke to the local religious groups, the Chamber of Commerce or 'tenants' and residents' associations? Draw up your plans now so they are ready to coincide with the national "Labour Listens" launch in January.

Campaign Briefing is prepared by The Labour Party Policy Directorate,
150 Walworth Road, London SE17 1JT.

One copy of Campaign Briefing is sent free to secretaries of CLPs, affiliated organisations and Labour Groups and to party spokesmen. Additional copies to the same address may be ordered for £2.50 per annum. Other individuals and organisations may subscribe for £3.50 per copy, per annum, additional copies as above.

Labour



News Release

18 December 1987

PR/314/87

"LABOUR LISTENS" - NATIONAL MEDIA LAUNCH

"Labour Listens" - a major new development in political communication and campaigning - will be launched by Labour leader NEIL KINNOCK at :

11.00AM MONDAY 18 JANUARY 1988
TRANSPORT HALL, TRANSPORT HOUSE
SMITH SQUARE, LONDON SW1

Mr Kinnock will be joined by Labour campaign coordinator, Frank Dobson MP, Joan Lestor MP, and NUPE deputy general secretary and Labour NEC member Tom Sawyer.

"Labour Listens" is a major new initiative by the Labour Party, through which the views of all in the community will be channelled into the Party's policy review programme and used to strengthen the Party's local campaigning.

The "Labour Listens" programme will cover all regions of the country, with large meetings in regional centres complemented by smaller local listening activities. There will be national listening events centred on key issues such as health and education, and a programme of events designed for listening to young people, pensioners, women and ethnic minorities.

Ends

Note

Full details will be released prior to the national launch, and a complete press pack will be available on 18 January

For further details contact Colin Byrne on 701 6564

PL1,1a,2,5 (Political),5 (Women & Youth),7,19 (Ethnic)

Issued by the Campaign and Communications Directorate
150 Walworth Road London SE17 1JT
Telephone 01-703 0833 night 01-701 6564

Director Peter Mandelson

All news releases are issued on a check against delivery basis and any portion of the speech not actually delivered should be regarded as private and confidential



Public opinion consultation

273
Labour sets up camp in enemy Sussex

By Philip Webster, Chief Political Correspondent

The Labour Party is to move deep into the heart of enemy territory to launch its national programme of consulting public opinion, part of its review of policy in the wake of its third successive election defeat.

It has symbolically chosen Brighton, in the South, where Labour has signally failed to make any impression in recent elections, to stage next month the first of the nationwide series of "Labour listens" events.

Senior Labour politicians will hear the views of people from a wide range of representative and community groups about Labour policies and philosophy.

Mr Roy Hattersley, deputy leader, shadow Home Secretary and joint head of the policy review group considering demo-

cracy for the individual, Mr Bryan Gould, shadow Secretary of State for Trade and Industry and joint head of the economy policy group, and Miss Joan Lester, a member of the key policy group considering defence, are expected to form the panel facing an invited audience of up to 300 people at the Brighton conference centre.

They will give an introduction consisting of Labour's basic approach in main policy areas, an assessment of the effects of Tory policies in key areas, and likely changes in society by the 1990s and then invite contributions from the floor in what party chiefs are hoping will be a well publicized exercise.

A special unit at Labour's headquarters in London, drawn

from different staff departments, is busily planning similar events for the early months of next year at big cities across the country.

At the same time, there will be specially targeted events, where Labour leaders will meet and hear the opinions of specific groups, such as teachers, white-collar workers, low-paid women, pensioners, the disabled and young people.

Although the centrally organized and regionally and locally operated events may gain the most attention from the media, Labour leaders regard it equally important that constituency Labour parties and trade union branches up and down the country should play their part by generating their own

listening and community-based approach to opinion seeking.

They will be given guidance on how to stage meetings, approach interest groups, engage in doorstep canvassing and compile reports.

The activity will inform the seven policy groups covering the economy, people at work, economic equality, consumers and the community, democracy for the individual, Britain in the world, including defence, and the physical and social environment.

But it is also regarded as central to the party's campaigning activities for at least the next nine months and will go on beyond the April deadline for the first reports back to the leadership.

E33



FROM: A P HUDSON

DATE: 6 January 1988

MR DYER

cc Chief Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Turnbull
Mr Odling-Smee
Mr Peretz
Mr Culpin
Mr H P Evans
Mr R I G Allen
Mr Pickford
Mr A C S Allan
Mr Cropper
Mr Tyrie
Mr Call
Mr N Forman MP

GOVERNMENT MOTION FOR AUTUMN STATEMENT DEBATE, 14 JANUARY

Thank you for reminding me about the need to consider the motion for the Autumn Statement debate.

2. The Chancellor has decided that the motion should be the same as last year, as follows (I have changed the date):

"That this House approves the Autumn Statement presented by Mr Chancellor of the Exchequer on 3 November 1987; welcomes the prospect of continuing low inflation and steady growth as the basis for maintaining the trend of rising employment; and congratulates Her Majesty's Government on the continuing reduction in the share of national income pre-empted by public expenditure."

3. Please could you point out to the business managers that the motion is the same as last year, and indeed as the year before. The Chancellor commented that if they suggested a change, he would, of course, consider it.

A handwritten signature in black ink, appearing to be 'A P HUDSON'.

A P HUDSON



PLW

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

7 January 1987

P R C Gray Esq
10 Downing Street
LONDON SW1

Dear Paul,

GOVERNMENT MOTION FOR AUTUMN STATEMENT DEBATE, 14 JANUARY

... I attach a minute I have sent to Brian Dyer recording the Chancellor's decision on the Motion for the Autumn Statement debate. Since this is formally in the name of the Prime Minister, Brian reminded me that we need to clear it with you.

Please could you let me know if you are happy? I don't think David Norgrove used to bother the Prime Minister herself with these - ~~but~~ I am sure we can sort out any changes between ourselves.

Yours ever,

Andrew

A P HUDSON



cc Mr B. Dyer PWP

We can now go ahead
and put the motion
down.

AMH

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

8 January 1988

Dear Andrew,

Government Motion for Autumn Statement
Debate, 14 January

Thank you for your letter of 7 January.
I am sure it is right to keep to the same
wording of the Motion as in earlier years.

Yours,
Paul

(PAUL GRAY)

Andrew Hudson, Esq.,
HM Treasury.

(A)

[If the Rev Am Munk for Shonpon
 had ~~been~~ ^{placed} an agent ^{deep in} ~~the~~
 The ~~several~~ Alliance merger talks
~~disrupt~~ with the mission of
 wreck the merger, shattering
 the links - discrediting their leaders,
 he could have done better than
 to have done with his long time
 Munk for Carthus & Suttler.]

In my Budget Statement last March, I warned the
— and I quote —

"The biggest risk to the excellent prospects I have outlined is that of a downturn in the world economy as a whole. There are still serious imbalances affecting the three major economies — the United States on the one hand, and Japan and Germany on the other — which, if not handled properly, could lead to a simultaneous downturn in all three. And this in turn could be exaggerated by renewed turmoil in the foreign exchange markets, whose tendency to overshoot is as notorious as it is damaging."

Recent events have brought those concerns very much to the fore, and I therefore propose to devote most of my remarks today to the prospects for the world economy — not least because this may be my last opportunity to do so before the Budget Statement, which, I can now tell the House, will be on 15 March. The important ~~issues~~ issue of public expenditure will be dealt with by my Rt Hon the Chief Secretary, when he comes to wind up this debate.

[4. So in my speech today, I want to put recent events into perspective, and explain what I see as the way forward for the world economy and in particular the importance of achieving a renewed period of exchange rate stability. I shall then say a few words about the position of British economy.]

5. I presented my Autumn Statement to the House ~~in~~ *a bare two weeks after the collapse of the* November, ~~barely two weeks after the collapse of the~~ *(that has come to be known as Black Monday.)* world's stock markets. At that time, there was naturally ~~considerable~~ *A* apprehension about the prospects for the world economy, ~~The professional peddlers of doom and gloom, and some more rational analysts as well,~~ *was at its most acute. It was widely* predicted that the ~~stock~~ *equity* market collapse would ~~lead to~~ *instantiate* a world recession in 1988. ~~And those who did not go as far as that were also apprehensive about the outlook.~~ *this year.*

major

6. Two months on, it is ~~now~~ *sharp* easier to put the ~~(fall in~~ the stock market ~~itself~~ *in October)* into perspective. ~~It has~~ *Although since then the markets have been very much steadier,* certainly increased uncertainty, and will tend to reduce ~~the rate of growth of world economic activity.~~ ~~But~~ *A* although the scale and suddenness of the fall were unprecedented, it has increasingly been seen as ~~(in large measure)~~ a correction, following the rapid rise in the early part of 1987. In the three main markets - London, New York, and Tokyo - in spite of the sharp falls in October, ~~(prices~~ *sharp* levels ~~are at much the same levels as a year ago.~~ *have not fallen any further since the end of October, and* The impact on consumer spending - the so-called "wealth effect" - should therefore be limited.

that

levels have not fallen

But a shock

readily

7. ~~Shocks~~ such as the stock market collapse can ~~easily~~ damage business confidence. ^{quite serious.} Most of the major countries therefore acted ~~quickly and wisely~~ ^{promptly} to reduce interest rates, which ~~met demands for greater liquidity~~ ^{both to deal with the immediate risk of a lack of liquidity & business} and has helped to sustain confidence. ^{I am sure that, in the circumstances of that time, that was right.}

8. ^{A further} ~~other~~ reason why ^{business} confidence has remained ^{pretty well} intact is that ^{all the} economic evidence published since October, so far from implying that ^{would} recession is imminent, suggests that

^{market's stronger than had earlier been apparent} the world economy ^{is actually stronger than had previously been thought.} ~~is actually stronger than had previously been thought.~~ ^{Most of the talk of recession}

came, of course, from pundits in the financial world, some of whom have a very blinkered outlook. When their own sector shows signs of overheating, they assume the whole economy is doing the same. When stock markets tumbled, they therefore assumed the world economy was heading for recession.

^{So any slowdown that may be this year will be from a pretty vigorous maintenance of growth. It is now clear that}

9. ~~In fact,~~ activity picked up ^{markedly} in the course of 1987. Taking the seven industrialised countries as a whole, output in the third quarter of the year was over 3 per cent higher than a year earlier, with industrial production in October over 4 per cent up. ^{in 2} The United States, ~~continues to grow strongly,~~ ^{was} with industrial production in the third quarter of 1987 ^{reached} 5 per cent up on a year earlier, and unemployment ~~at~~ the lowest level since 1979. Japan, the world's second largest economy, ~~has picked up momentum,~~ ^{what had earlier been a little sluggish, began to move ahead briskly, with} and industrial production ~~is~~ some 8 per cent higher than a year ago. The United Kingdom,

at no later
crisis

As I indicated in the Autumn Statement,

^{looks to have} of course, enjoyed 4 per cent growth last year, ^{over} with the third quarter stronger than the first two. And the Canadian economy, ^{too,} is buoyant. It is only the performance of continental Europe, and particularly Germany, which remains disappointing, though even there modest growth is ~~expected.~~ ^{continuing.}

Thus, overall,

10. World growth has thus been proving extremely robust. But ~~there remain~~ ^{the} serious imbalances in the world economy. ^{remain.}

11. ^{At the heart} ~~The most serious~~ of these ^{imbalances lies} is the huge budget deficit in the United States. This is peculiarly damaging, not just because of the enormous size of the United States economy, but because the Americans, with their low propensity to save, ^{they have proved} have proved wholly unable to finance the deficit from domestic ^{savings.} sources. This means, inevitably ^{The United States requires} that there had to be large capital inflows from overseas, ^{with no counterpart, so long as this state of affairs persists, or} and, equally inevitably, a large current account deficit.

12. For years, there were calls for the United States to reduce the budget deficit. ^{But not nearly enough} progress was made, not least because of the difficulty of reaching any sort of agreement between the Administration and Congress on how to go about this. President Reagan himself said, earlier this week:

"That deficit is an embarrassment and a shame - most dangerous, perhaps, because it signals the complete breakdown of one of the most basic functions of the United States Government."

↳ Except, I have to say, from the opposite, which might be considered.

13. There has now been some encouraging progress. The legislation passed just before Christmas to reduce the deficit, relative to the level it would otherwise have been, by \$30 billion for 1988 and \$45 billion for 1989. But these steps will not be sufficient, by themselves, to reduce the deficit to a ~~manageable~~ ^{tolerable} level, ~~or indeed below the 1998 out-turn~~ and I urge the US authorities to look for further reductions.

14. It has been clear for some time that the reduction of the other set of imbalances - the current account imbalances - will depend on domestic demand in the US growing more slowly than that in Japan and Germany for some years. And one of the prime objectives of the major industrialised countries, meeting together in the Group of Seven, ^s ~~has~~ been to achieve this in an orderly way. The United States action, and the decision of the German authorities to reduce their key discount rate from 3 per cent to 2½ per cent, the lowest rate ~~fall~~ ^{since the war,} for nearly ~~30 years~~, are helpful steps, and paved the way for the G7 communique issued on 23 December.

15. That communique also re-emphasised the agreement to ~~co-operate to foster~~ ^{co-operate to foster} exchange rate stability, following a period of turbulence on the foreign exchanges which had seen a further slide in the dollar.

16. Wild gyrations in exchange rates ^{can} create uncertainty, and damage ^{business} confidence. ~~Businesses~~ ^{Companies} in all ^{grow}

countries find it more difficult to plan for the future, and have to ~~waste time~~ and ~~energy~~ on insuring themselves against exchange rate risks, when they should be concentrating on the real job of improving company performance. That is why the CBI, for example, has stressed the importance to its members of a stable exchange rate.

17. It is thus natural that countries should seek to act together to prevent excessive volatility. Moreover, ~~I am~~ ~~convinced~~ ~~that~~ ~~a~~ ~~readiness~~ ~~by~~ ~~countries~~ ~~to~~ ~~recognise~~ ~~and~~ ~~commit~~ ~~themselves~~ ~~to~~ ~~more~~ ~~stable~~ ~~exchange~~ ~~rate~~ ~~is~~ ~~the~~ ~~best~~, indeed the only, feasible way of securing wider international cooperation on economic policy.

(Spand) pucras (monny) pygenults
Each to rate
economic history has shown
to
(some form of
stability

18. If countries are indeed prepared to accept such commitments wholeheartedly, they will find themselves obliged to pursue ~~the broad~~ ~~objective~~ ~~of~~ ~~stable~~ ~~exchange~~ ~~rates~~. They will have to ~~give~~ ~~that~~ ~~objective~~ ~~full~~ ~~weight~~ - and ~~sometimes~~ ~~give~~ ~~it~~ ~~priority~~ - in formulating their domestic policies. This applies particularly to monetary policy, though fiscal policy also has a role, particularly over the medium term.

domestic
then exche of
rate objectives.
most obviously
Supports

18A. ~~This approach is the only way of bringing international cooperation to bear on domestic policies.~~ It is an academic dream, ^{IMAGINE} ~~to think~~ that sovereign countries will be persuaded into consistent ^{domestic} ~~policies~~ by a process of careful international analysis and discussion.

19. Of course, countries may choose at any time to ignore the implications of the exchange rate arrangements they have entered into. Sovereign states cannot, in the end, be required to take particular courses of action. But if they are not prepared to play their part in an agreement with the visible, measurable, objective of broad ^{Exchange rate} ~~currency~~ stability, ^{within a framework of low inflation,} it is hopelessly unrealistic to imagine that a more general agreement on consistency of fiscal and monetary policy would stand any chance at all of working. ^{Those} ~~People~~ who suggest that ~~that should be the way to achieving stable exchange rates are,~~ ^{otherwise are} frankly, not living in the real world.

19A. Let me be quite clear. I am not suggesting a return to anything like the rigid exchange rate system that applied under Bretton Woods. But I believe there are clear advantages in a more managed approach which ^{designed to} ~~should~~ prevent the gyrations of recent years, ^{partially in the dollar, and in} and, ^{so long as there is} ~~over time,~~ ^{attracted in} bring greater cooperation on economic policy, ^{more gradually.}

20. The events of recent years ^{unlikely} ~~demonstrate~~ the point. It is ^{most} ~~very~~ unlikely that the ^{heady} ~~dizzy~~ rise in the dollar during 1984 would have taken place if there had been an

exchange rate agreement at the time, and the US authorities had given greater weight to the dollar in the conduct of monetary policy. Instead they were generally interpreted as being content with the rise in the currency, or even encouraging it.

(thus seen dollar is external value of it, and fiscal) And had that been so, no imbalance that plague us today, and no protectionist thrust that accompanies them, could have been seen developed to the extent that we have.

United States became in 1985

21. Since the Americans' becoming converted to the desirability of co-operation on exchange rates, we have had seen a much greater degree of co-operation on a more managed approach. The Plaza Agreement in September 1985, was designed to deal directly with the problem of dollar overvaluation, and over the following 15 months we saw an orderly, but substantial, depreciation. And the Louvre Accord, signed in February of last year, provided a period of broad stability, intended to allow the major economies to adjust to the changes that had taken place.

(massive exchange rate) already

22. A number of commentators have seized on the decline in the dollar that has occurred since October to suggest that the Louvre Accord was fundamentally flawed, and thus unsustainable, all along. I disagree. As Paul Volcker commented in a speech in Geneva in November,

from the outset

"The argument of some seems to be that the agreement sacrificed appropriate internal economic management to the requirements of a stable exchange rate. That seems to me a misreading of both the nature of the understanding and, more broadly, the need to accord the requirements of exchange rate stability more prominence in economic policy making."

(plans is I was present, note, too, that no Select Committee, a New report - a) I quote - "give weight to ensuring reasonable stability of exchange rates which was no original intention of the Louvre agreement."

23. It is ^{of course} clear, and this is implicit in both the Plaza and Louvre agreements, that stability of exchange rates cannot be achieved simply by wishing it. Appropriate domestic policies - fiscal, and in particular monetary - are needed. And for a period, the Louvre Accord brought the necessary results: stable exchange rates, greatly helped by the fact that interest rates in the United States rose, and those in Japan and Germany edged down.

24. What brought stability to an end was the perception in the market that the Americans were no longer committed to ~~it~~ ^{the Louvre agreement,} and were simply concerned to prevent any risk of domestic recession. The markets were also aware that ~~the~~ ^{after} ~~United States had been unable~~ ^{Commensurate progress in fiscal 1987} ~~to reduce its Budget deficit for the coming fiscal year~~ ^{no United States (official) includes} ~~by anything like the extent agreed at the Louvre.~~ ¹⁹⁸⁸⁾

25. During November and December, the dollar seems to have been given little weight in United States policy, ~~and we saw a good deal of nervousness in~~ ^{with no realistic prospect of turmoil on} the foreign exchanges, with the dollar falling and expected to fall further. Last week, however, the US authorities demonstrated a renewed commitment to supporting the ^{CENTRAL} ~~dollar, with the Federal Reserve Bank intervening~~ ^{can connect with other capital banks,} ~~to a~~ ^{very} much greater extent, and doing so in a deliberately public way. This ~~gives some grounds for believing that~~ ^{end of the a brief but dangerous} ~~the stability we saw following the Louvre can be restored, though there will undoubtedly be periods of turbulence along the way.~~

^{Phase of so-called "strong"}
reflects a step in no right direction. But it is not to suppose that official intervention on the part of the US, even when it is co-ordinated internationally, ^{AND INVOLVES} ~~is~~ ^{involves} full US participation, amounts to a coherent policy.

25A. ~~Achieving a steadier pattern of exchange rates will require co-operation on all sides. One feature of the period since the Louvre agreement is that there has been more substantial intervention by central banks than for many years.~~ ^{But} Intervention is an important tactical weapon, and it would be foolish not to use it, ^{when appropriate.}

In our own case, it has helped us achieve a remarkable degree of stability for sterling, particularly against the deutschmark - something ^{that is} widely welcomed by British industry, ^{and it has also enabled us, last year, to} ~~[and our foreign currency reserves have doubled in size].~~ ^{restore our foreign exchange reserves to an adequate level.}

NP) 26. The desire at the Louvre to allow time for the exchange rate changes to have their effect on the trade imbalances is equally important now. The markets were surprisingly slow to wake up to the imbalances in the world economy. But having done so, they have shown signs of impatience at the slowness of the adjustment. ^{important} In fact, changes are taking place. ^{published} Although the ~~nominal~~ US trade deficit has shown very little improvement so far, the volume figures have moved very substantially: in the year to the third quarter of 1987, exports had risen by 15 per cent, whereas imports were only 6 per cent up, according to the latest figures. ^{NP)} As many of us had warned, there was bound to be a lag before these developments fed through to the current account - this is the well known J-curve. And repeated dollar depreciations, so far from speeding up the adjustment of the current account, ^{can only} ~~will~~ add to the length of the J-curve. ^{This is particularly the case if, at the same time, domestic activity is not adequately restrained.}

No prospects for the year 1988,

27. Looking forward to ~~1988~~, it is clear that there remain very real risks in the outlook for the world economy. *While there is no immediate prospect of* ~~It is not simply a matter of avoiding recession,~~ *still* The substantial dollar depreciation could lead to serious inflationary pressures in the United States. And there *at any time* remains the threat of creeping protectionism, which could escalate into a trade war.

But 28. The current strength of the world economy, which I illustrated earlier, *does* gives us a breathing space in which to get the world economy onto a more sustainable footing. Some of the necessary steps have already been taken. More action needs to follow. We must get the right policies in place, and pursue them with patience and determination - because there are bound to be periods of difficulty which we shall have to ride out. Provided we can do that, *at* though there may be some slowdown in world economic growth, I *am confident* think we can avoid the twin dangers of inflation and recession.

UK Economy

29. ~~I said in my Budget Speech that the greatest threat to the continued progress of the British economy lay in events beyond these shores. That remains the case. We cannot~~ *Clearly, we in Britain cannot wholly* ~~insulate ourselves from developments overseas, and we should not pretend that we can.~~ *insure against.* But subject to those inevitable uncertainties, it is clear that the British economy is ~~very~~ well placed to continue the excellent progress of recent years, in spite of the problems faced by other countries and the turbulence in the financial markets.

30. Britain's strength is clear to the OECD, which forecasts that, in 1988, we shall *once* again be among the fastest growing of the major industrial nations. It is clear to the many thousands of companies from overseas which are coming to invest in Britain. It is clear to those who run industry - take, for example, the chairman of British Oxygen, who said last year:

"In the last half dozen years, Britain has done a pretty good job. If I was a company having to set up in Europe, it is Britain I would choose."

And it is clear, of course, to the British people, as they demonstrated in the General Election. *Eight months ago.*

It's clear that to T

31. In fact, the strength of the economy is clear to everybody except ^{to} ~~for~~ the Opposition in this House. ~~Their~~ ^{Their} problem is that they are so wedded to living in the past that they cannot accept that the policies we are following, which are precisely the reverse of those they followed when they were in office, can possibly have led to success.

32. When it became clear that growth in 1987 was moving well ahead of the already strong trend of the past five years, the Opposition put it down to a ^{short-run} pre-Election boom. The HM for Dagenham spoke last February of the "irresponsible and profligate spending boom which the Chancellor hopes will sweep him to a General Election victory" (Hansard 18 February 1987, col.942). I have to tell him and his HFs that growth in the period since the General Election has, if anything, been stronger than before, ^{and faster growth - less rapid than in 1987, but} ~~And the fall in unemployment has accelerated,~~ ^{too. In fact of any, ever achieved under the last Labour Government - & seems likely in 1988.}

33. The Opposition put ^{the alleged} ~~their~~ so-called pre-Election boom down to higher consumer spending. Again, they are barking up the wrong tree. Growth in 1987 was stronger ^{than} ~~stronger~~ because investment growth picked up and exports ^{than in no previous year, in} ~~have~~ increased more rapidly ^{the aftermath of the oil price collapse.} ~~than in 1986, when our manufacturers were affected by the pause in world trade growth following the oil price shock.~~

34. The Opposition also ~~suggested~~ ^{claims} that ~~the~~ ^{this} so-called
~~pre-Election~~ boom would be instantly reversed. In the
last Autumn Statement debate, the RHM for Sparkbrook made
one of his justly ~~famous~~ ^{notorious} predictions:

"An election victory would be followed by a massive
increase in taxation",

he alleged. And he went on:

"There would be more public expenditure cuts".

He has now had his answer on public expenditure, in the
clearest possible terms, ~~with no ~~substantial~~ forecasts ~~or~~ announcements~~
~~to wait for the Budget.~~ ^{Autumn Statement. Whether he was}

^{right or wrong about taxation, of course, remains the}
^{story: he will have to wait until but he will only have}

36. But having warned of a boom, the Opposition have now
reverted to their normal cry that higher borrowing and
lower interest rates - an unlikely combination, if ever
there was one - are needed to stave off impending
recession.

Meanwhile,

dangers

to wait another two months now,
until 15 March, for ~~the~~
no massive increase in
taxation to so completely
predict.

37. It ~~is~~ ^{was once} ~~said~~ ^{has seen} that Wall Street has ^{correctly} forecast ^{thirteen} ~~six~~ out of the last ^{five} ~~four~~ recessions. The Opposition have done better. They have predicted recession in ^{fact} ~~every~~ one of the last six years, and it has not happened ^{once}.

38. The trouble is that all the old beliefs that they have clung to, in spite of the accumulating evidence, are being finally and definitively disproved. They believe that economic growth depends on ever higher public spending, paid for by higher borrowing and higher taxes, ~~and~~ ^{and} on easy money. They should look at what has happened in 1987. Public borrowing, even leaving aside privatisation proceeds, looks like turning out at the lowest level since 1970-71. ~~Real interest rates remain~~

~~around the average for the major industrial countries.~~ ^{as the Americans point out, Europeans are if anything about the interest average. And we have seen the strongest growth of ~~the~~ sustained growth [since the war].}

39. For ^{some time,} ~~a while,~~ the Opposition justified their attachment to higher borrowing by reference to the experience of the United States. The RHM the leader of the Opposition ^{ungrateful} ~~said~~ of the Government, ^{Howan passed on} ~~a massive scale, saying:~~

"They cannot even see the lesson of the United States economy when it is staring them in the face".

40. ~~Of course,~~ ^{ungrateful} it is now all too clear who learnt the wrong lesson. With his unerring instinct for backing a loser, the RHM made the keystone of his Party's economic

policy what ^{has} turned out to be the Americans' undoing - ~~the~~ ^{an} excessive budget deficit.

Rather a ~~has~~ ^{has} ~~Marble~~ ^{Marble} ~~opposite~~
41. ~~They~~ completely failed to appreciate the real reasons for the ^{rapid creation of new jobs in the US.} ~~rapid growth in the USA.~~ They ignored the role played by ^{the} ~~a~~ lower tax burden. They ignored the importance of labour market flexibility and stable wage rates, which contribute so much to the fact that unemployment in the United States is lower than in any major country in Western Europe, and has fallen so rapidly in recent years. They completely failed to appreciate the importance of deregulation, and the enterprise economy. As usual, they got the wrong end of every stick.

42. The short point is this. A successful economy cannot be created by the Government pumping in money. It depends on the performance of businesses and the individuals who work in them. That is what led to the outstanding performance in 1987. That is what has given us an upswing of unprecedented length and steadiness. And that is what enables us to look forward to the future with confidence.

43. The most telling example of the transformation in British industry is manufacturing. The Opposition, of course, paint a gloomy picture of British manufacturing, as an industry in terminal decline, in contrast to an ^{alleged} golden age under their stewardship. Nothing could be further from the truth.

44. The plain fact is that manufacturing output fell over Labour's period in office, whereas it has risen during ours. Contrast jobs for say's Nat. The But the underlying strength of manufacturing industry has been transformed. There is no point in having output for its own sake. Unless a business makes profits, it cannot possibly produce more goods and create jobs. Britain's manufacturers have increased their profitability for five years in succession, the best performance for a generation. And they have achieved this by making radical improvements in efficiency. Held back by restrictive practices and over-manning, manufacturing productivity increased by barely 1 per cent a year under Labour. Since 1979, it has risen more than four times as fast.

Britain

x 45. Last January, the RHM for ~~Mon~~ Midlands East said:

"We want increased productivity in an expanding industrial economy".

That is precisely what we have seen.

46. In the past, a spurt in growth, as we have just seen, would undoubtedly have quickly fed through into much higher inflation. In fact, although prices in 1987 rose smaller faster than in the previous year, as the one-off benefit of the oil price fall was lost, inflation has remained low throughout the year.

47. At the same time, unemployment fell rapidly. Today's figures show that, ^{during 1987 as a whole,} ~~in the year to November,~~ the number of people out of work fell by over half a million, the biggest fall on record, ^{with the rate falling far} ~~and far~~ faster than in any other major country. ^{to} ~~over the same period.~~

48. In the Autumn Statement, I forecast that growth in 1988 would be 2½ per cent for the economy as a whole, with the non-oil economy growing at 3 per cent.

49. I shall, of course, be making another forecast in the Budget, and I do not intend to make one today. But on the non-oil economy, which is ^{critical for} ~~the main source~~ of new jobs, let me just say this. The Labour Party frequently

present North Sea oil as the reason for the economic success of the 1980s after the lamentable failures of the 1970s. But the facts speak for themselves. Leaving aside the contribution of North Sea oil, the economy has grown at an average of 2¾ per cent since the trough of the recession in the first half of 1981. During the Labour recovery, such as it was, the non-oil economy grew by only 2 per cent a year.

50. Growth of 3 per cent for the non-oil economy in 1988 would ~~thus~~ be a thoroughly ^{credible} healthy performance. The Labour Government never ^{once} achieved 3 per cent growth, with or without oil. Indeed, it was only achieved once in the whole of the 1970s. But we have achieved that rate in four out of the last five years.

Indes, → sustains → See such Para 2, has
51. The strength of the economy has given rise to concerns that we may face a problem of "overheating". ~~Of course,~~ it is an oversimplification, and a hangover from ~~the days of "Stop-Go",~~ to imagine that there is a specific condition which can be identified as overheating, which warrants slamming the ~~breaks~~ ^{brakes} on an economy. This Government's aim has always been to keep the economy on a steady course which maintains downward pressure on inflation, and enables real growth to move ahead. That strategy has led to nearly seven years of steady growth, the last five of which have been combined with inflation averaging under 5 per cent.

No time
52. Keeping on track involves keeping a constant watch on all the indicators of how the economy is developing, and then taking action as necessary. I have never hesitated to act in the past when I have judged that there was a risk to our inflation objectives. I can assure the House that I shall not hesitate to do so in future. It is ^{only} (by acting promptly that ~~you~~ ^{we have seen this} avoid the need for drastic and destabilising lurches in policy. ~~And the~~ ^{Our} track record speaks for itself. // Part of the job of keeping the economy on track involves maintaining a stable exchange rate, particularly against the Deutschmark. ^{not only} That means ^{that} businesses know where they stand: ^{also} ~~And~~ it acts as a firm anchor against inflation. For much of 1987, this meant resisting upward pressure on sterling. But as I explained to the CBI Annual Dinner

last May, and as the Governor reaffirmed last week, it would equally mean resisting significant downward pressure, if that were to emerge.

Conclusion

53. Mr Speaker, we enter 1988 with the British economy in good shape, and the public finances ~~sound~~. *Sounder than they have ever been at any time since the war. This is, of course, no coincidence.*

54. When we came to office in 1979, we gave the highest priority to restoring the public finances to a sound and sustainable condition. That is one of the rocks on which the new strength of the economy has been built. Thanks to that achievement, we have been able to choose, freely, to increase public spending in particular areas, while continuing to reduce public spending as a share of GDP. And unlike the Opposition when they were in office, we have been able to sustain our approach.

55. The Opposition, of course, are brim-full of ideas for spending ever higher amounts of the taxpayer's money. But the plain fact is that had their policies been implemented, the money simply would not have been there. *in*
no first place.
It was not there in the 1970s, and it would not have been there in the 1980s.

Centuries

56. The Autumn Statement, ~~which sets out~~ my first ~~forecast~~ ⁱⁿ ~~for~~ this Parliament, embodies ~~a~~ ^{the} consistent strategy that we have pursued since 1979. I commend it to the House.

PH



FROM: A P HUDSON
DATE: 8 January 1988

SIR T BURNS

- cc PS/Chief Secretary
- Sir P Middleton
- Sir G Littler
- Mr Turnbull
- Mr Odling-Smee
- Mr Peretz
- Mr H P Evans
- Mr R I G Allen
- Mr Pickford
- Mr A C S Allan
- Mr Cropper
- Mr Tyrie
- Mr Call
- Mr N Forman MP

*PH - spell out his more alternative approach.
- can set our policy in perspective: follow on stability.*

Mr Hudson

Some suggestions

PH

**CHANCELLOR'S SPEECH FOR AUTUMN STATEMENT DEBATE, 14 JANUARY:
OPENING SECTION, FIRST DRAFT**

I attach a shot at the opening section for the Chancellor's speech.

2. I should be grateful for any ideas from you and copy recipients to develop this. There is perhaps 15 minutes' worth here, and the Chancellor can perfectly well speak for half an hour, so we can afford to add to this.

3. I shall circulate the section on the UK economy as soon as I can.

4. Comments by mid-afternoon Monday, please.

APH

A P HUDSON

**CHANCELLOR'S SPEECH FOR AUTUMN STATEMENT DEBATE,
14 JANUARY**

OPENING SECTION, FIRST DRAFT

I beg to move the words on the Order Paper in my name and those of my Rt. Hon. Friends.

2. The Autumn Statement Debate this year is a little later than it has usually been in previous years. Part of the reason was to allow the Treasury and Civil Service Select Committee, which was only established on [date], to prepare its Report. I sympathise with the Committee's frustration that it was not constituted sooner, and I congratulate the RHM for Worthing and his colleagues on producing their lucid report so promptly.

3. The delay also enables me to reflect on developments, both in the world economy and at home, over a rather longer period than would otherwise have been the case. I welcome this opportunity, not least because this may well be my last chance to do so before the Budget which, I can now tell the House, will be on [date].

4. The Autumn Statement contains three elements: the public expenditure plans for the next three years; proposals for national insurance contributions; and the

Industry Act forecast. In current circumstances, it is understandable that the last of these has attracted the most attention.

5. I presented the Autumn Statement two weeks after the collapse of the world's stock markets on what has come to be known as Black Monday. At that time, there was a good deal of apprehension about the prospects for the world economy. The professional peddlers of gloom and doom, and some more rational analysts as well, predicted that the stock market collapse would lead to world recession in 1988. And those who did not go as far as that were also apprehensive about the outlook.

6. We have now all had rather more time to assess the implications and likely consequences of the stock market collapse. ^{Perhaps it is never possible to see what shocks and surprises lie ahead and} ~~With a few exceptions,~~ because there are some who see disaster round every corner, the apocalyptic predictions have disappeared. A consensus is developing ~~among the forecasters at home and abroad that,~~ while the turbulence in the market will tend to reduce the rate of growth of world economic activity, the prospect is still for reasonable expansion in 1988. The last two weeks have, as usual, also seen numerous articles and comments by businessmen, analysts, and pundits giving their own predictions and ambitions for 1988, ^{As always I have not had time to say} and it is striking ^{has been} how optimistic the general tone is.

7. There are a number of reasons why the mood has changed.

8. First, it is now easier to put the fall in the stock market itself into perspective. ^{has been increasingly seen as} It was, ~~essentially~~, a correction, following the rapid rise in the early part of the year. [Even at its lowest point, the London market was only slightly below the average level for 1986. And] ~~In~~ the three main markets - London, New York, and Tokyo - in spite of the sharp falls in October, price levels are currently higher than a year ago.

^{factor in the change of mood}
9. The second ~~reason for~~ ^{greater} optimism is that the evidence published since October, so far from suggesting that recession is imminent, suggests that the world economy is actually stronger than had previously been thought. Activity picked up in the course of 1987. ~~Taking the~~ ^{main} ~~seven~~ industrialised countries as a whole, ^{in the} Output in the third quarter of the year was over 3 per cent higher than a year earlier, with industrial production [in October] over 4 per cent up. The United States is growing strongly, and the momentum of the Japanese economy has picked up considerably, after a pause in 1986. ^{Nevertheless} The performance of continental Europe, and particularly Germany, ^{remains prosperous} is ~~much less encouraging~~, [but there is no sign that activity has actually slowed during the year].

|| The third factor has been the unexpected reduction in interest rates, as monetary authorities moved to meet demands for greater liquidity.
10. The ~~third~~ ^{fourth} positive development since the time of the Autumn Statement ^{is that} ~~has been~~ the policy measures ^{have been} taken by ~~several~~ the major countries to contribute to the reduction of the trade imbalances, which are one of the main underlying causes of the instability in the financial markets. The

below what it would otherwise have been.

Even so, there is likely to be little or no fall in the deficit for a year or two.

, but still too slow,

United States has taken action to make further progress in reducing its budget deficit. Congress passed just before Christmas a Bill which [reduces] the deficit by

\$30 billion for 1988 and \$45 billion for 1989. The

German Government ^{confirmed that in addition to its} ~~has acted to improve the momentum of~~ earlier ~~decisions to cut direct taxes in 1988 and 1990, it would provide for a high-fiscal deficit in 1988,~~ the economy, with a new package of investment measures,

and, more particularly, through a cut in the key interest rate from 3 per cent to 2½ per cent, the lowest rate for nearly 30 years. As the House may recall, this was part of a concerted move involving most European countries, in which we led the way.

which took account of the need for

11. These steps, ~~were taken as a result of~~ close international co-operation, ~~and~~ were embodied in the ~~communique issued by the G7 on 23 December~~.

But

12. Continuing co-operation between the major countries is vital if we are to keep the world economy on an even keel. ~~And I firmly believe that that co-operation should extend to securing a further period of stability in exchange rates, particularly the dollar.~~

INSERT RT.

13. In the [first two weeks] following the stock market fall, the foreign exchanges remained remarkably steady. But since [date], equity markets have stabilised, and attention has reverted to the foreign exchange markets, with the dollar declining significantly from its October levels.

14. The decline and volatility of the dollar present, in my judgement, a greater threat to the world economy than the stock market fall.

15. The experience of freely floating exchange rates in the 1970s and early 1980s demonstrated the failings of that approach. The theory was attractive: that exchange rates would find their own level so as to maintain trade and current account equilibrium, and would then remain broadly stable, since the fundamentals moved only slowly.

16. But the practice was very different. Instead of broad stability, we saw wild gyrations in the value of the dollar, in particular. Instead of trade equilibrium, we saw the development of the massive current account deficit in the United States and of its counterparts in the surpluses in Germany and Japan. And instead of buttressing an open trading system, free floating may have boosted protectionist pressures in the United States and elsewhere, from businesses who saw that the dollar was unreasonably high, and thought the odds were stacked against them.

17. There can also be little doubt that the gyrations in currencies were damaging to businesses generally. A stable climate enables businesses to plan for the future, and to concentrate their energies on improving their performance in their own markets, rather than in coping with frequent and confusing changes in the wider economic

background. Businesses benefit from a stable exchange rate, as the CBI have made clear [frequently/in their survey of ...].

18. Some commentators [should we specify the OECD?] have suggested that if countries can agree to co-operate on their fiscal and monetary policies, broad stability of exchange rates will follow automatically. I have to say that they are simply not living in the real world.

19. It is unrealistic to expect sovereign states, of their own accord, to align their international economic policies without some specific stimulus to do so. And the most likely candidate, by far, is the exchange rate, simply because that represents the interface between different countries' economies.

20. ~~The experience of the United States during the 1980s is a case in point.~~ It was clear from a very early stage ^{There was not only clear to many of us outside the United States,} that the budget deficit was unsustainable. Many in the United States ^{also} ~~itself~~ accepted this. But the stimulus to the Administration to start taking action came from the ^{with the need to finance the large deficit caused in part by} external side, ~~as~~ the overvalued dollar contributed to ~~the growing current account deficit.~~

21. The Americans' concern at these developments, and the perception of other leading countries that ^{to scale} ~~free~~ floating ^{of the dollar's appreciation} had proved damaging, led us to agree, at the Plaza meeting in September 1985, on a ^{action directly designed to deal} ~~more managed~~ approach to exchange rates. ^{The agreement also spelled out a} ~~collection of measures proposed to be taken by the various governments, designed to correct the scale of the policy imbalances.~~

22. ^{Subsequently we} ~~That approach has now been through two phases. The first, begun at Plaza, saw a substantial depreciation in the dollar, but one that was managed in an orderly way. The second was the period of stability under the Louvre Accord, which was signed in February of last year. This arose from the perception that the fall in the dollar had gone far enough, and that a period of stability would allow the major economies to adjust to the changes.~~

landmark was
~~The second was the period of stability under the Louvre Accord, which was signed in February of last year. This arose from the perception that the fall in the dollar had gone far enough, and that a period of stability would allow the major economies to adjust to the changes.~~ *Again*
the majority of ~~the~~ *part of* ~~the~~ *community found* ~~the~~ *one* ~~the~~ *policy adjustments that were necessary to correct the underlying structural imbalances.*

23. The Louvre Accord kept currencies remarkably steady for eight months. ^{it may be no coincidence that the period?} ~~And although it is hard to establish a precise causal link, it may not be coincidence that, over this period, world growth picked up momentum.~~

24. A number of people seized on the decline in the dollar that has occurred since October to suggest that the Louvre Accord was fundamentally flawed, and thus unsustainable, all along. This is more often asserted than argued, and many of those who assert it do so merely with the benefit of hindsight, though some have been consistent in their views.

on the way *step back to the context?* *some of the policy imbalances between countries and a move towards a more managed approach to floating exchange rates.*
25. My own view remains that the Accord was ^{a helpful} well founded, ~~for all the reasons I have given today.~~ There was nothing inherently unsustainable about it, and it is worth analysing the reasons why it ^{faltered} ~~broke down~~, in the fraught and turbulent atmosphere of the weeks following Black Monday, so that any mistakes are at least not repeated.

26. The first underlying reason for the dollar's decline was the lack of signs of adjustment in the trade imbalances. The markets therefore drew the conclusion that this problem could not be solved without a further dollar depreciation. I believe that view was mistaken. ^{Perhaps} Certainly the headline figures ^{has shown very little improvement} remained poor, though we shall see tomorrow whether those announced in December were an aberration, rather than a worsening of the trend. ~~But~~ the volume figures had adjusted very substantially indeed. [Figures for exports and imports showing how the year-on-year growth of exports was improving through 1987]. As I, and others, had warned, there was bound to be a lag before these developments fed through to the current account -this is the well known J curve. And a further dollar depreciation, so far from speeding up the adjustment of the current account, may well add to the length of the J curve.

27. The ^{first} second reason why the dollar came under pressure was that the market came to doubt the commitment of the American authorities to supporting it. It has been implicit in both the Plaza and Louvre agreements that a given pattern of exchange rates cannot be achieved simply by wishing it. In the end, domestic policies may need to be adjusted to do the job. And the markets [got the clear impression, which the US authorities did nothing to discourage, for a short, but crucial period] that, faced with the choice between higher interest rates and a sliding dollar, the US authorities would prefer the latter.

The explanation is that there was insufficient commitment on macro policies agreed at the Louvre & the US in particular were 8 made to reduce their deficit in fiscal year 1988 to anything like the extent envisaged at the Louvre

Henry Jones

28. The last [six weeks] of last year saw a good deal of nervousness in the foreign exchanges, with the dollar either falling or expected to fall.

29. Last week's rally, assisted by significant co-ordinated intervention by the G7 central banks, is something on which I hope and believe we can build. The United States demonstrated a renewed commitment to supporting the dollar, with the Federal Reserve Bank intervening to a greater extent than in recent weeks -and doing so in a deliberately public way. The background is also more promising in that the United States ~~and Germany~~ have [§] begun to meet more clearly the policy commitments in the Louvre Accord. ~~They and the Japanese reaffirmed, in the G7 communique,~~ ^{reaffirmed} that policy changes would continue to be necessary if the imbalances are to be reduced. ~~And a steadier pattern of exchange rates,~~ ^{and} which was also, of course, ~~part of the G7 communique,~~ may also entail ~~changes in domestic policy in due course.~~

Note wants to be

30. Exchange rate stability is not an easy option. But there are no easy options, in resolving the problems of the world economy. Stability means that we can do this in a spirit of co-operation, so as to avoid chaos, and threats to the world trading system. As Paul Volcker said in a speech in Geneva towards the end of last year,

"The health and vitality of an open international trading order will be

importantly dependent over time upon the willingness of Governments of large trading countries to reach some realistic collective judgement about the broadly appropriate level of exchange rates. Those judgements will, in turn, need to influence the design and implementation of domestic policies if they are to be meaningful and durable."

UNCLASSIFIED

pay



FROM: MRS JULIE THORPE
DATE: 11 January 1988

PS/CHIEF SECRETARY

cc PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Mr Dyer
Mr Pickford
Mr Hudson
Miss Wallace
Mr N Forman MP

AUTUMN STATEMENT DEBATE: THURSDAY 14 JANUARY

As you know there will be a debate on the Autumn Statement on Thursday 14 January. The Chancellor would like all ministers present for the opening and closing speeches.

Julie Thorpe

MRS JULIE THORPE
Diary Secretary



FROM: A P HUDSON
 DATE: 12 January 1988

PHJ

MR DYER

cc PS/Chief Secretary
 Sir P Middleton
 Sir T Burns
 Sir G Littler
 Mr Odling-Smee
 Mr Turnbull
 Mr R I G Allen
 Mr Pickford
 Mr A C S Allan
 Mr Cropper
 Mr Tyrie
 Mr Call
 Mr P R C Gray - No.10

AUTUMN STATEMENT DEBATE, 14 JANUARY: BOX LIST

Please could you let the House authorities know that the following people will be in the Official Box for the Chancellor's Speech on 14 January:

1. Mr Odling-Smee
2. Mr Turnbull
3. Mr R I G Allen
4. Mr Pickford
5. Mr A C S Allan
6. Miss Rutter
7. Mr Hudson
- 8.) Two out of Mr Cropper, Mr Tyrie and Mr Call.
- 9.)
10. Mr P R C Gray - No.10

Mr R I G Allen will not actually be sitting in the Box, but may need to go in to speak to officials. Please could Mr Cropper decide which of the Special Advisers should be in the Box.

2. Miss Rutter will let you know which other names she would like on the Box list to cover the rest of the Debate.

APH

A P HUDSON

FROM: G MICHIE *pmw*

DATE: 13 January 1988

1. MISS SINCLAIR (approved in draft)
2. CHIEF SECRETARY

cc **PS/Chancellor**
Sir Peter Middleton
Mr Anson
Mr Kemp
Mr Morick
Miss Peirson
Mr Turnbull
Mr R I G Allen
Mr Pickford
Mr Gieve
Mr Hudson

AUTUMN STATEMENT DEBATE : MATERIAL FOR CHIEF SECRETARY'S WIND-UP

Your Private Secretary's minute of 11 January asked for some additional material on VAT and tax approximation for the debate on Thursday.

P. Childs

RG

R G MICHIE

EC proposals for tax approximation

Background

On August 2 1987 the European Commission put forward a package of tax measures intended to contribute to the completion of the Single Market. It proposed a VAT standard rate band of 14-20 per cent, and a reduced rate band of 4-9 per cent. The proposed reduced rate would cover foodstuffs (except alcoholic drinks); fuel and power for heating and lighting; water; pharmaceutical products; books; newspapers and periodicals; and passenger transport. Construction and young children's clothing (which are now zero rated in the UK) would be standard rated. Under the Commission's proposals, rates of excise duty on alcohol, tobacco products and hydrocarbon oils would be harmonised. The proposals would require reductions in duty on alcohol ranging from about 40% for spirits to about 85% for wine. Cigarette duty would fall by about 10%.

2. If the Commission's package were adopted as drafted (with 5% VAT on reduced rate items, 15% standard rate) revenue from VAT would increase by about £3.6 billion in a full year; the excise proposals would produce an offsetting loss to the revenue of about £2 billion.

3. The current position is that ECOFIN has remitted proposals to the Economic Policy Committee for detailed economic analysis. The Committee's report is expected in Spring, with ECOFIN consideration of the findings in late Spring or early Summer. It would not be helpful to say too much at this stage about the UK's likely stance in negotiations.

Line to take (if necessary)

- (i) The Government strongly supports the goal of a single European market. We would welcome measures which reduced the delays and costs incurred by businesses as a result of border controls,

although such measures must not impede the continuing fight against drug trafficking and terrorism.

- (ii) However, we are not convinced that border fiscal controls are so onerous that they significantly hinder Community trade. Nor do we accept that the approximation of indirect taxes, along the lines proposed by the Commission, is necessary for further progress on the internal market.
- (iii) It is no secret that we have a number of fundamental difficulties with Commission approach - the question of future VAT zero rating and also the excise duty proposals. There are problems too for other Member States.
- (iv) On central issue of future VAT zero rating, the Prime Minister and the Chancellor have made the position perfectly clear: the UK will not accept proposals which would restrict our ability to use zero rating. Because Single European Act provides that changes in EC law in taxation area require unanimity, the UK's position is protected.

VAT Infraction Proceedings - (NB: This is entirely separate from the Commission's proposals on VAT approximation)

Background

Two separate infraction cases have been brought against the UK by the Commission. The first was in respect of the UK's exemption of spectacles and certain other medical goods which the Commission allege ought to be subject to VAT. The Advocate-General's Opinion, published on 7 July, agrees with the Commission.

2. The second case involves the Commission's challenge of some of the UK zero-rates which the Commission considers are not justified for "clearly defined social reasons and for the benefit of the final consumer". The most significant area under threat is construction where the Commission's challenge extends to domestic housing (other than "within a social policy") as well as commercial building .

The Advocate General's Opinion was delivered on 2 December and he concluded that the UK had not failed to fulfill its obligations in respect of some zero-rates but had failed in respect of certain others including non-domestic construction and civil engineering.

3. The Court's consideration and its final judgement of both infraction cases will be based on the full pleadings (both written and oral) of the two parties and is expected to be delivered in the Spring. Until then, the consequences for the United Kingdom cannot be predicted and we shall need to see and study in detail the precise terms of the Court's judgements before the implications become clear and the Government is able to take decisions.

Line to take (if necessary)

The Government rejects the Commission's arguments and has mounted a vigorous defence before the European Court, both in written submissions and at oral hearings. In particular, we have contended that the zero rates under challenge do satisfy the necessary criteria and therefore the UK has the legal right to retain them.

RM14.6

RM

**CHANCELLOR'S SPEECH FOR AUTUMN STATEMENT DEBATE,
14 JANUARY**

I BEG TO MOVE THE MOTION ON THE ORDER PAPER IN MY NAME AND
THOSE OF MY RT. HON. FRIENDS.

[IF THE RT. HON. MEMBER FOR DEVONPORT HAD PLACED AN AGENT
DEEP IN THE ALLIANCE CONFABULATIONS WITH THE MISSION OF
WRECKING THE MERGER, SHATTERING THE LIBERALS AND
DISCREDITING THEIR LEADER, HE COULD NOT HAVE DONE BETTER
THAN HE HAS DONE WITH HIS HON. FRIEND THE MEMBER FOR
CAITHNESS AND SUTHERLAND.]

THE AUTUMN STATEMENT DEBATE THIS YEAR IS A LITTLE LATER
THAN IT HAS BEEN IN PREVIOUS YEARS.

PART OF THE REASON WAS TO ALLOW THE TREASURY AND CIVIL SERVICE SELECT COMMITTEE, WHICH WAS ONLY ESTABLISHED ON 24 NOVEMBER, TO PREPARE ITS REPORT.

I SYMPATHISE WITH THE COMMITTEE'S FRUSTRATION THAT IT WAS NOT CONSTITUTED SOONER, AND I CONGRATULATE THE RHM FOR WORTHING AND HIS COLLEAGUES ON PRODUCING THEIR REPORT AS PROMPTLY AS THEY DID.

IN MY BUDGET STATEMENT LAST MARCH, I WARNED THAT - AND I QUOTE -

"THE BIGGEST RISK TO THE EXCELLENT PROSPECT I HAVE OUTLINED IS THAT OF A DOWNTURN IN THE WORLD ECONOMY AS A WHOLE.

THERE ARE STILL SERIOUS IMBALANCES AFFLICTING THE THREE MAJOR ECONOMIES - THE UNITED STATES ON THE ONE HAND, AND JAPAN AND GERMANY ON THE OTHER - WHICH, IF NOT HANDLED PROPERLY, COULD LEAD TO A SIMULTANEOUS DOWNTURN IN ALL THREE.

AND THIS IN TURN COULD BE EXAGGERATED BY RENEWED TURMOIL IN THE FOREIGN EXCHANGE MARKETS, WHOSE TENDENCY TO OVERSHOOT IS AS NOTORIOUS AS IT IS DAMAGING."

RECENT EVENTS HAVE BROUGHT THOSE CONCERNS VERY MUCH TO THE FORE, AND I THEREFORE PROPOSE TO DEVOTE MOST OF MY REMARKS TODAY TO THE PROSPECTS FOR THE WORLD ECONOMY - NOT LEAST BECAUSE THIS MAY BE MY LAST OPPORTUNITY TO DO SO BEFORE THIS YEAR'S BUDGET STATEMENT, WHICH, I CAN NOW TELL THE HOUSE, WILL BE ON 15 MARCH.

THE IMPORTANT ISSUE OF PUBLIC EXPENDITURE WILL BE DEALT WITH BY MY RT. HON. FRIEND THE CHIEF SECRETARY, WHEN HE COMES TO WIND UP THIS DEBATE.

I PRESENTED MY AUTUMN STATEMENT TO THE HOUSE A BARE TWO WEEKS AFTER THE COLLAPSE OF THE WORLD'S STOCK MARKETS THAT HAS COME TO BE KNOWN AS BLACK MONDAY.

APPREHENSION ABOUT THE PROSPECTS FOR THE WORLD ECONOMY WAS AT ITS MOST ACUTE.

IT WAS WIDELY PREDICTED THAT THE EQUITY MARKET COLLAPSE WOULD INEVITABLY LEAD TO A MAJOR WORLD RECESSION THIS YEAR.

TWO MONTHS ON, IT IS EASIER TO PUT THE SHARP FALL IN THE STOCK MARKET IN OCTOBER INTO PERSPECTIVE.

ALTHOUGH THE SCALE AND SUDDENNESS OF THE FALL WERE UNPRECEDENTED, IT HAS INCREASINGLY BEEN SEEN AS IN LARGE MEASURE A CORRECTION, FOLLOWING THE RAPID RISE IN THE EARLY PART OF 1987.

IN THE THREE MAIN MARKETS - LONDON, NEW YORK, AND TOKYO - FOLLOWING THE SHARP FALLS IN OCTOBER SHARE PRICES HAVE NOT FALLEN ANY FURTHER SINCE THE END OF THAT MONTH, AND ARE AT MUCH THE SAME LEVELS AS A YEAR AGO.

THE IMPACT ON CONSUMER SPENDING - THE SO-CALLED "WEALTH EFFECT" - SHOULD THEREFORE BE LIMITED.

BUT A SHOCK SUCH AS THE STOCK MARKET COLLAPSE CAN READILY DAMAGE BUSINESS CONFIDENCE QUITE SEVERELY.

MOST OF THE MAJOR COUNTRIES THEREFORE ACTED PROMPTLY TO REDUCE INTEREST RATES, BOTH TO DEAL WITH THE IMMEDIATE RISK OF A LACK OF LIQUIDITY AND TO SUSTAIN BUSINESS CONFIDENCE.

I AM SURE THAT, IN THE CIRCUMSTANCES OF THAT TIME, THAT WAS RIGHT.

A FURTHER REASON WHY BUSINESS CONFIDENCE HAS REMAINED PRETTY WELL INTACT IS THAT ALL THE ECONOMIC EVIDENCE PUBLISHED SINCE OCTOBER, SO FAR FROM IMPLYING THAT WORLD RECESSION IS IMMINENT, SUGGESTS THAT THE WORLD ECONOMY PRIOR TO THE STOCK MARKET COLLAPSE WAS IN FACT MARKEDLY STRONGER THAN HAD EARLIER BEEN RECOGNISED.

SO ANY SLOWDOWN THERE MAY BE THIS YEAR WILL BE FROM A PRETTY VIGOROUS MOMENTUM OF GROWTH.

IT IS NOW CLEAR THAT ACTIVITY PICKED UP MARKEDLY DURING THE COURSE OF 1987.

TAKING THE SEVEN MAJOR INDUSTRIALISED COUNTRIES AS A WHOLE, OUTPUT IN THE THIRD QUARTER OF THE YEAR WAS OVER 3 PER CENT HIGHER THAN A YEAR EARLIER, WITH INDUSTRIAL PRODUCTION IN OCTOBER OVER 4 PER CENT UP.

IN THE UNITED STATES, INDUSTRIAL PRODUCTION IN THE THIRD QUARTER OF 1987 WAS 5 PER CENT UP ON A YEAR EARLIER, AND UNEMPLOYMENT REACHED ITS LOWEST LEVEL SINCE 1979.

JAPAN, THE WORLD'S SECOND LARGEST ECONOMY, WHICH HAD EARLIER BEEN A LITTLE SLUGGISH, BEGAN TO MOVE AHEAD BRISKLY, WITH INDUSTRIAL PRODUCTION AT THE LATEST COUNT SOME 8 PER CENT HIGHER THAN A YEAR AGO.

THE UNITED KINGDOM, AS I INDICATED IN THE AUTUMN STATEMENT, LOOKS TO HAVE ENJOYED 4 PER CENT GROWTH OVER LAST YEAR AS A WHOLE, WITH THE THIRD QUARTER STRONGER THAN THE FIRST TWO.

AND THE CANADIAN ECONOMY, TOO, IS BUOYANT.

IT IS ONLY THE PERFORMANCE OF CONTINENTAL EUROPE, AND PARTICULARLY GERMANY, WHICH REMAINS DISAPPOINTING, THOUGH EVEN THERE MODEST GROWTH IS CONTINUING.

THUS, OVERALL, WORLD GROWTH HAS BEEN PROVING EXTREMELY ROBUST.

BUT THE SERIOUS IMBALANCES IN THE WORLD ECONOMY REMAIN.

AT THE HEART OF THESE IMBALANCES LIES THE HUGE STRUCTURAL BUDGET DEFICIT IN THE UNITED STATES.

THIS IS PARTICULARLY DAMAGING, NOT JUST BECAUSE OF THE ENORMOUS SIZE OF THE UNITED STATES ECONOMY, BUT BECAUSE THE AMERICANS, WITH THEIR LOW PROPENSITY TO SAVE, HAVE PROVED WHOLLY UNABLE TO FINANCE THE DEFICIT FROM DOMESTIC SAVINGS.

THIS MEANS, INEVITABLY, THAT THE UNITED STATES REQUIRES LARGE CAPITAL INFLOWS FROM OVERSEAS, WITH THE COUNTERPART, SO LONG AS THIS STATE OF AFFAIRS PERSISTS, OF A LARGE CURRENT ACCOUNT DEFICIT.

FOR YEARS, THERE WERE CALLS FOR THE UNITED STATES TO REDUCE THEIR BUDGET DEFICIT - EXCEPT, I HAVE TO SAY, FROM THE FRONT BENCH OPPOSITE, WHICH URGED US TO EMULATE IT. BUT NOT NEARLY ENOUGH PROGRESS WAS MADE, NOT LEAST BECAUSE OF THE DIFFICULTY OF REACHING ANY SORT OF AGREEMENT BETWEEN THE ADMINISTRATION AND CONGRESS ON HOW TO GO ABOUT IT.

PRESIDENT REAGAN HIMSELF SAID, EARLIER THIS WEEK:

"THAT DEFICIT IS AN EMBARRASSMENT AND A SHAME - MOST DANGEROUS, PERHAPS, BECAUSE IT SIGNALS THE COMPLETE BREAKDOWN OF ONE OF THE MOST BASIC FUNCTIONS OF THE UNITED STATES GOVERNMENT."

THERE HAS NOW BEEN SOME ENCOURAGING PROGRESS, WITH THE LEGISLATION PASSED JUST BEFORE CHRISTMAS TO REDUCE THE DEFICIT, RELATIVE TO THE LEVEL IT WOULD OTHERWISE HAVE BEEN, BY \$30 BILLION FOR 1988 AND \$45 BILLION FOR 1989. BUT THESE STEPS WILL NOT BE SUFFICIENT, BY THEMSELVES, TO REDUCE THE DEFICIT TO A TOLERABLE LEVEL.

IT HAS BEEN CLEAR FOR SOME TIME THAT THE REDUCTION OF THE OTHER SET OF IMBALANCES - THE CURRENT ACCOUNT IMBALANCES - WILL DEPEND ON DOMESTIC DEMAND IN THE US GROWING MORE SLOWLY THAN THAT IN JAPAN AND GERMANY FOR SOME YEARS.

AND ONE OF THE PRIME OBJECTIVES OF THE MAJOR INDUSTRIALISED COUNTRIES, MEETING TOGETHER IN THE GROUP OF SEVEN, HAS BEEN TO ACHIEVE THIS IN AN ORDERLY WAY.

THE UNITED STATES ACTION, AND THE DECISION OF THE GERMAN AUTHORITIES TO REDUCE THEIR KEY DISCOUNT RATE FROM 3 PER CENT TO 2½ PER CENT, THE LOWEST RATE SINCE THE WAR, ARE HELPFUL STEPS, AND PAVED THE WAY FOR THE G7 COMMUNIQUE ISSUED ON 23 DECEMBER.

THAT COMMUNIQUE ALSO RE-EMPHASISED THE AGREEMENT TO CO-OPERATE TO FOSTER EXCHANGE RATE STABILITY, FOLLOWING A PERIOD OF TURBULENCE ON THE FOREIGN EXCHANGES WHICH HAD SEEN A FURTHER SLIDE IN THE DOLLAR.

WILD GYRATIONS IN EXCHANGE RATES CAN CREATE GRAVE UNCERTAINTY, AND DAMAGE BUSINESS CONFIDENCE.

COMPANIES IN ALL COUNTRIES FIND IT MORE DIFFICULT TO PLAN FOR THE FUTURE, AND HAVE TO SPEND PRECIOUS TIME, MONEY AND INGENUITY ON INSURING THEMSELVES AGAINST EXCHANGE RATE RISKS, WHEN THEY SHOULD BE CONCENTRATING ON THE REAL JOB OF IMPROVING COMPANY PERFORMANCE.

THAT IS WHY THE CBI, FOR EXAMPLE, HAS STRESSED THE IMPORTANCE TO ITS MEMBERS OF A STABLE EXCHANGE RATE.

IT IS THUS NATURAL THAT COUNTRIES SHOULD SEEK TO ACT TOGETHER TO PREVENT EXCESSIVE EXCHANGE RATE VOLATILITY. MOREOVER, HISTORY HAS SHOWN THAT A READINESS BY COUNTRIES TO COMMIT THEMSELVES TO SOME FORM OF EXCHANGE RATE STABILITY IS THE ONLY FEASIBLE WAY OF SECURING WIDER INTERNATIONAL CO-OPERATION ON ECONOMIC POLICY.

IF COUNTRIES ARE INDEED PREPARED TO ACCEPT SUCH COMMITMENTS WHOLEHEARTEDLY, THEY WILL FIND THEMSELVES

OBLIGED TO PURSUE DOMESTIC POLICIES CONSISTENT WITH THEIR EXCHANGE RATE OBJECTIVES.

THIS APPLIES MOST OBVIOUSLY TO MONETARY POLICY, THOUGH FISCAL POLICY ALSO HAS A VITAL SUPPORTING ROLE, PARTICULARLY OVER THE MEDIUM TERM.

IT IS, HOWEVER, AN ACADEMIC DREAM, DIVORCED FROM REALITY, TO IMAGINE THAT SOVEREIGN STATES WILL BE PERSUADED INTO CONSISTENT DOMESTIC POLICIES SIMPLY BY A PROCESS OF CAREFUL INTERNATIONAL ANALYSIS AND DISCUSSION.

OF COURSE, COUNTRIES MAY CHOOSE AT ANY TIME TO IGNORE THE IMPLICATIONS OF THE EXCHANGE RATE ARRANGEMENTS THEY HAVE ENTERED INTO.

SOVEREIGN STATES CANNOT, IN THE END, BE REQUIRED TO TAKE PARTICULAR COURSES OF ACTION.

BUT IF THEY ARE NOT PREPARED TO PLAY THEIR PART IN AN AGREEMENT WITH THE VISIBLE, MEASURABLE, OBJECTIVE OF BROAD EXCHANGE RATE STABILITY, WITHIN A FRAMEWORK OF LOW

INFLATION, IT IS HOPELESSLY UNREALISTIC TO IMAGINE THAT A MORE GENERAL AGREEMENT ON CONSISTENCY OF FISCAL AND MONETARY POLICY WOULD STAND ANY CHANCE AT ALL OF WORKING. THOSE WHO SUGGEST OTHERWISE ARE NOT LIVING IN THE REAL WORLD.

LET ME BE QUITE CLEAR.

I AM NOT SUGGESTING A RETURN TO ANYTHING LIKE THE RIGID EXCHANGE RATE SYSTEM THAT APPLIED UNDER BRETTON WOODS. BUT I BELIEVE THERE ARE CLEAR ADVANTAGES IN A MORE MANAGED APPROACH DESIGNED TO PREVENT THE WILD GYRATIONS OF RECENT YEARS, PARTICULARLY IN THE DOLLAR, AND IN SO DOING ACHIEVING GREATER INTERNATIONAL CO-OPERATION IN ECONOMIC POLICY MORE GENERALLY.

THE EVENTS OF RECENT YEARS UNDERLINE THE POINT.

IT IS MOST UNLIKELY THAT THE HEADY RISE IN THE DOLLAR DURING 1984 WOULD HAVE TAKEN PLACE IF THERE HAD BEEN AN EXCHANGE RATE AGREEMENT AT THE TIME, AND THE US

AUTHORITIES HAD THUS BEEN OBLIGED TO GIVE GREATER WEIGHT TO THE EXTERNAL VALUE OF THE DOLLAR IN THE CONDUCT OF MONETARY AND FISCAL POLICY.

AND HAD THAT BEEN SO, THE IMBALANCES THAT PLAGUE US TODAY, AND THE PROTECTIONIST THREAT THAT ACCOMPANIES THEM, COULD NEVER HAVE DEVELOPED TO THE EXTENT THAT THEY HAVE.

SINCE THE UNITED STATES BECAME CONVERTED IN 1985 TO THE DESIRABILITY OF CO-OPERATION ON EXCHANGE RATES, WE HAVE HAD THE PLAZA AGREEMENT IN SEPTEMBER 1985, DESIGNED TO DEAL DIRECTLY WITH THE PROBLEM OF DOLLAR OVERVALUATION, AND OVER THE FOLLOWING 15 MONTHS WE SAW AN ORDERLY, BUT SUBSTANTIAL, DEPRECIATION.

AND THE LOUVRE ACCORD, SIGNED IN FEBRUARY OF LAST YEAR, PROVIDED A PERIOD OF BROAD STABILITY, INTENDED TO ALLOW THE MAJOR ECONOMIES TO ADJUST TO THE MASSIVE EXCHANGE RATE CHANGES THAT HAD ALREADY TAKEN PLACE.

A NUMBER OF COMMENTATORS HAVE SEIZED ON THE DECLINE IN THE DOLLAR THAT HAS OCCURRED SINCE OCTOBER TO SUGGEST THAT THE LOUVRE ACCORD WAS FUNDAMENTALLY FLAWED, AND THUS UNSUSTAINABLE, FROM THE OUTSET.

I DISAGREE.

AS PAUL VOLCKER OBSERVED IN A SPEECH IN GENEVA IN NOVEMBER,

"THE ARGUMENT OF SOME SEEMS TO BE THAT THE AGREEMENT SACRIFICED APPROPRIATE INTERNAL ECONOMIC MANAGEMENT TO THE REQUIREMENTS OF A STABLE EXCHANGE RATE. THAT SEEMS TO ME A MISREADING OF BOTH THE NATURE OF THE UNDERSTANDING AND, MORE BROADLY, THE NEED TO ACCORD THE REQUIREMENTS OF EXCHANGE RATE STABILITY MORE PROMINENCE IN ECONOMIC POLICY MAKING."

I WAS PLEASED TO NOTE, TOO, THAT THE SELECT COMMITTEE, IN THEIR REPORT - AND I QUOTE - "GIVE WEIGHT TO ENSURING REASONABLE STABILITY OF EXCHANGE RATES WHICH WAS THE ORIGINAL INTENTION OF THE LOUVRE AGREEMENT."

IT IS OF COURSE CLEAR, AND THIS IS IMPLICIT IN BOTH THE PLAZA AND LOUVRE AGREEMENTS, THAT STABILITY OF EXCHANGE RATES CANNOT BE ACHIEVED SIMPLY BY WISHING IT.

APPROPRIATE DOMESTIC POLICIES - FISCAL, AND IN PARTICULAR MONETARY - ARE NEEDED.

AND FOR A PERIOD, THE LOUVRE ACCORD BROUGHT THE NECESSARY RESULTS: STABLE EXCHANGE RATES, GREATLY HELPED BY THE FACT THAT INTEREST RATES IN THE UNITED STATES ROSE, AND THOSE IN JAPAN AND GERMANY EDGED DOWN.

WHAT BROUGHT STABILITY TO AN END WAS THE PERCEPTION IN THE MARKET THAT THE AMERICANS WERE NO LONGER COMMITTED TO THE LOUVRE AGREEMENT, AND WERE SIMPLY CONCERNED TO PREVENT ANY RISK OF DOMESTIC RECESSION.

THE MARKETS WERE ALSO AWARE THAT, AFTER COMMENDABLE PROGRESS IN FISCAL 1987, THE UNITED STATES LOOKED UNLIKELY TO REDUCE ITS BUDGET DEFICIT FOR FISCAL 1988 BY ANYTHING LIKE THE EXTENT AGREED AT THE LOUVRE.

DURING NOVEMBER AND DECEMBER, THE DOLLAR APPEARED TO BE GIVEN LITTLE WEIGHT IN UNITED STATES POLICY, WITH THE INEVITABLE RESULT OF TURMOIL ON THE FOREIGN EXCHANGES, WITH THE DOLLAR FALLING AND EXPECTED TO FALL FURTHER.

LAST WEEK, HOWEVER, THE US AUTHORITIES DEMONSTRATED A RENEWED COMMITMENT TO SUPPORTING THE DOLLAR, WITH THE FEDERAL RESERVE BANK INTERVENING, IN CONCERT WITH OTHER CENTRAL BANKS, TO A VERY MUCH GREATER EXTENT, AND DOING SO IN A DELIBERATELY PUBLIC WAY.

THIS ENDING OF A BRIEF BUT DAMAGING PHASE OF SO-CALLED BENIGN NEGLECT IS A STEP IN THE RIGHT DIRECTION.

BUT IT IS IDLE TO SUPPOSE THAT OFFICIAL INTERVENTION ON ITS OWN, EVEN WHEN IT IS CO-ORDINATED INTERNATIONALLY AND INVOLVES FULL US PARTICIPATION, AMOUNTS TO A COHERENT POLICY.

BUT INTERVENTION IS AN IMPORTANT TACTICAL WEAPON, AND IT WOULD BE FOOLISH NOT TO USE IT WHEN APPROPRIATE.

IN OUR OWN CASE, IT HAS HELPED US ACHIEVE A REMARKABLE DEGREE OF STABILITY FOR STERLING, PARTICULARLY AGAINST THE DEUTSCHMARK - SOMETHING THAT IS WIDELY WELCOMED BY BRITISH INDUSTRY - AND IN THE PROCESS TO BUILD UP OUR FOREIGN EXCHANGE RESERVES TO AN ADEQUATE LEVEL.

THE DESIRE AT THE LOUVRE TO ALLOW TIME FOR THE EXCHANGE RATE CHANGES TO HAVE THEIR EFFECT ON TRADE IMBALANCES IS EQUALLY IMPORTANT NOW.

THE FINANCIAL MARKETS WERE SURPRISINGLY SLOW TO WAKE UP TO THE IMBALANCES IN THE WORLD ECONOMY.

BUT HAVING DONE SO, THEY HAVE SHOWN SIGNS OF IMPATIENCE AT THE SLOWNESS OF THE ADJUSTMENT.

IN FACT IMPORTANT CHANGES ARE TAKING PLACE.

ALTHOUGH THE PUBLISHED US TRADE DEFICIT HAS SHOWN VERY LITTLE IMPROVEMENT SO FAR THE VOLUME FIGURES HAVE MOVED VERY SUBSTANTIALLY: IN THE YEAR TO THE THIRD QUARTER OF

1987, EXPORTS HAD RISEN BY 15 PER CENT, WHEREAS IMPORTS WERE UP BY ONLY 6 PER CENT.

AS MANY OF US HAD WARNED, THERE WAS BOUND TO BE A LAG BEFORE THESE DEVELOPMENTS FED THROUGH TO THE CURRENT ACCOUNT - THIS IS THE WELL KNOWN J-CURVE.

AND REPEATED DOLLAR DEPRECIATIONS, SO FAR FROM SPEEDING UP THE ADJUSTMENT OF THE CURRENT ACCOUNT, CAN ONLY ADD TO THE LENGTH OF THE J-CURVE.

THIS IS PARTICULARLY THE CASE IF, AT THE SAME TIME, DOMESTIC ACTIVITY IS NOT ADEQUATELY REINED BACK.

LOOKING FORWARD TO THE PROSPECTS FOR 1988, IT IS CLEAR THAT THERE REMAIN VERY REAL RISKS IN THE OUTLOOK FOR THE WORLD ECONOMY.

WHILE THERE IS NO IMMEDIATE PROSPECT OF RECESSION, THE SUBSTANTIAL DOLLAR DEPRECIATION COULD LEAD TO SERIOUS INFLATIONARY PRESSURES IN THE UNITED STATES.

AND THERE STILL REMAINS THE THREAT OF CREEPING PROTECTIONISM, WHICH COULD AT ANY TIME ESCALATE INTO A TRADE WAR.

BUT THE CURRENT STRENGTH OF THE WORLD ECONOMY, WHICH I ILLUSTRATED EARLIER, DOES GIVE US A BREATHING SPACE IN WHICH TO GET THE WORLD ECONOMY ONTO A MORE SUSTAINABLE FOOTING.

SOME OF THE NECESSARY STEPS HAVE ALREADY BEEN TAKEN.

MORE ACTION NEEDS TO FOLLOW.

WE MUST GET THE RIGHT POLICIES IN PLACE, AND PURSUE THEM WITH PATIENCE AND DETERMINATION - BECAUSE THERE ARE BOUND TO BE PERIODS OF DIFFICULTY WHICH WE SHALL HAVE TO RIDE OUT.

PROVIDED WE CAN DO THAT, ALTHOUGH THERE MAY BE SOME SLOWDOWN IN WORLD ECONOMIC GROWTH, I AM CONFIDENT WE CAN AVOID THE TWIN DANGERS OF INFLATION AND RECESSION.

UK Economy

CLEARLY, WE IN BRITAIN CANNOT WHOLLY INSULATE OURSELVES FROM DEVELOPMENTS OVERSEAS, AND WE SHOULD NOT IMAGINE OTHERWISE.

BUT SUBJECT TO THOSE INEVITABLE UNCERTAINTIES, IT IS CLEAR THAT THE BRITISH ECONOMY IS WELL PLACED TO CONTINUE THE EXCELLENT PROGRESS OF RECENT YEARS IN SPITE OF THE PROBLEMS FACED BY OTHER COUNTRIES AND THE TURBULENCE IN THE FINANCIAL MARKETS.

BRITAIN'S STRENGTH IS CLEAR TO THE OECD, WHICH FORECASTS THAT IN 1988 WE SHALL ONCE AGAIN BE AMONG THE FASTEST GROWING OF THE MAJOR INDUSTRIAL NATIONS.

IT IS CLEAR TO THE MANY THOUSANDS OF COMPANIES FROM OVERSEAS WHICH ARE COMING TO INVEST IN BRITAIN.

IT IS CLEAR TO THOSE WHO RUN INDUSTRY - TAKE, FOR EXAMPLE, THE AMERICAN CHAIRMAN OF BRITISH OXYGEN, MR RICHARD GIORDANO, WHO SAID LAST YEAR:

"IN THE LAST HALF DOZEN YEARS BRITAIN HAS DONE A PRETTY GOOD JOB.

IF I WAS A COMPANY HAVING TO SET UP IN EUROPE, IT IS
BRITAIN I WOULD CHOOSE."

AND IT IS CLEAR OF COURSE, TO THE BRITISH PEOPLE, AS
THEY DEMONSTRATED IN THE GENERAL ELECTION EIGHT MONTHS
AGO.

IN FACT THE STRENGTH OF THE ECONOMY IS CLEAR TO
EVERYBODY EXCEPT TO THE OPPOSITION IN THIS HOUSE.
THEIR PROBLEM IS THAT THEY ARE SO WEDDED TO LIVING IN THE
PAST THAT THEY CANNOT ACCEPT THAT THE POLICIES WE ARE
FOLLOWING, WHICH ARE PRECISELY THE REVERSE OF THOSE THEY
FOLLOWED WHEN THEY WERE IN OFFICE, CAN POSSIBLY HAVE LED
TO SUCCESS.

WHEN IT BECAME CLEAR THAT GROWTH IN 1987 WAS MOVING WELL
AHEAD OF THE ALREADY STRONG TREND OF THE PAST FIVE YEARS,
THE OPPOSITION PUT IT DOWN TO A SHORT-LIVED PRE-ELECTION
BOOM.

THE HM FOR DAGENHAM SPOKE LAST FEBRUARY OF THE "IRRESPONSIBLE AND PROFLIGATE SPENDING BOOM WHICH THE CHANCELLOR HOPES WILL SWEEP HIM TO A GENERAL ELECTION VICTORY".

I HAVE TO TELL HIM AND HIS HFs THAT GROWTH IN THE PERIOD SINCE THE GENERAL ELECTION HAS, IF ANYTHING, BEEN STRONGER THAN BEFORE, AND FURTHER NON-OIL GROWTH - LESS RAPID THAN IN 1987, BUT IN EXCESS OF ANYTHING EVER ACHIEVED UNDER THE LAST LABOUR GOVERNMENT - SEEMS LIKELY IN 1988.

THE OPPOSITION PUT THE ALLEGED PRE-ELECTION BOOM DOWN TO HIGHER CONSUMER SPENDING.

AGAIN, THEY ARE BARKING UP THE WRONG TREE.

GROWTH IN 1987 WAS STRONGER THAN IN 1986 BECAUSE INVESTMENT GROWTH PICKED UP AND EXPORTS INCREASED MORE RAPIDLY THAN IN THE PREVIOUS YEAR, IN THE AFTERMATH OF THE OIL PRICE COLLAPSE.

THE OPPOSITION ALSO CLAIMED THAT THIS SO-CALLED PRE-ELECTION BOOM WOULD BE INSTANTLY REVERSED.

IN THE LAST AUTUMN STATEMENT DEBATE, THE RHM FOR SPARKBROOK MADE ONE OF HIS JUSTLY NOTORIOUS PREDICTIONS:

"AN ELECTION VICTORY WOULD BE FOLLOWED BY A MASSIVE INCREASE IN TAXATION",

HE ALLEGED.

AND HE WENT ON:

"THERE WOULD BE MORE PUBLIC EXPENDITURE CUTS."

HE HAS NOW HAD HIS ANSWER ON PUBLIC EXPENDITURE, IN THE CLEAREST POSSIBLE TERMS, WITH THE SUBSTANTIAL INCREASES ANNOUNCED IN THE AUTUMN STATEMENT.

WHETHER HE WAS RIGHT OR WRONG ABOUT TAXATION, OF COURSE, REMAINS TO BE SEEN: BUT HE WILL ONLY HAVE TO WAIT ANOTHER TWO MONTHS NOW, UNTIL 15 MARCH, FOR THE MASSIVE INCREASE IN TAXATION HE SO CONFIDENTLY PREDICTED.

MEANWHILE, HAVING WARNED OF A DANGEROUS BOOM, THE OPPOSITION HAVE NOW REVERTED TO THEIR NORMAL CRY THAT HIGHER BORROWING AND LOWER INTEREST RATES - AN UNLIKELY COMBINATION, IF EVER THERE WAS ONE - ARE NEEDED TO STAVE OFF IMPENDING RECESSION.

IT WAS ONCE SAID THAT WALL STREET HAD CORRECTLY FORECAST THIRTEEN OUT OF THE LAST FIVE RECESSIONS.

THE OPPOSITION HAVE DONE BETTER.

THEY HAVE PREDICTED RECESSION IN EACH AND EVERY ONE OF THE LAST SIX YEARS, AND IT HAS NOT HAPPENED ONCE.

THE TROUBLE IS THAT ALL THE OLD BELIEFS THAT THEY HAVE CLUNG TO IN SPITE OF THE ACCUMULATING EVIDENCE, ARE BEING FINALLY AND DEFINITELY DISPROVED.

THEY BELIEVE THAT ECONOMIC GROWTH DEPENDS ON EVER HIGHER PUBLIC SPENDING, PAID FOR BY HIGHER BORROWING AND HIGHER TAXES AND ON EASY MONEY.

THEY SHOULD LOOK AT WHAT HAS HAPPENED IN 1987.

PUBLIC BORROWING, EVEN LEAVING ASIDE PRIVATISATION PROCEEDS, LOOKS LIKE TURNING OUT AT THE LOWEST LEVEL SINCE 1970-71.

INTEREST RATES, AS THEY THEMSELVES POINT OUT ARE IF ANYTHING ABOVE THE INTERNATIONAL AVERAGE.

AND WE HAVE SEEN THE STRONGEST PERIOD OF SUSTAINED GROWTH SINCE THE WAR.

FOR SOME TIME, THE OPPOSITION JUSTIFIED THEIR ATTACHMENT TO HIGHER BORROWING BY REFERENCE TO THE EXPERIENCE OF THE UNITED STATES.

THE RHM THE LEADER OF THE OPPOSITION URGED THE GOVERNMENT TO BORROW ON A MASSIVE SCALE, SAYING:

"THEY CANNOT EVEN SEE THE LESSON OF THE UNITED STATES ECONOMY WHEN IT IS STARING THEM IN THE FACE".

IT IS NOW ALL TOO CLEAR WHO LEARNT THE WRONG LESSON.

WITH HIS UNERRING INSTINCT FOR BACKING A LOSER, THE RHM MADE THE KEYSTONE OF HIS PARTY'S ECONOMIC POLICY WHAT HAS TURNED OUT TO BE THE AMERICANS' UNDOING - AN EXCESSIVE BUDGET DEFICIT.

RT. HON. AND HON. MEMBERS OPPOSITE COMPLETELY FAILED TO APPRECIATE THE REAL REASONS FOR THE RAPID CREATION OF NEW JOBS IN THE US.

THEY IGNORED THE ROLE PLAYED BY THE LOW TAX BURDEN.

THEY IGNORED THE IMPORTANCE OF LABOUR MARKET FLEXIBILITY AND LOW WAGE INCREASES, WHICH CONTRIBUTE SO MUCH TO THE FACT THAT UNEMPLOYMENT IN THE UNITED STATES IS LOWER THAN IN ANY MAJOR COUNTRY IN WESTERN EUROPE.

THEY COMPLETELY FAILED TO APPRECIATE THE IMPORTANCE OF DEREGULATION, AND THE ENTERPRISE ECONOMY.

AS USUAL THEY GOT THE WRONG END OF EVERY STICK.

THE SHORT POINT IS THIS.

A SUCCESSFUL ECONOMY CANNOT BE CREATED BY THE GOVERNMENT PUMPING IN MONEY.

IT DEPENDS ON THE PERFORMANCE OF BUSINESSES AND THE INDIVIDUALS WHO WORK IN THEM.

THAT IS WHAT LED TO THE OUTSTANDING PERFORMANCE IN 1987.

THAT IS WHAT HAS GIVEN US AN UPSWING OF UNPRECEDENTED LENGTH, STRENGTH, AND STEADINESS.

AND THAT IS WHAT ENABLES US TO LOOK FORWARD TO THE FUTURE WITH CONFIDENCE.

THE MOST TELLING EXAMPLE OF THE TRANSFORMATION IN BRITISH INDUSTRY IS MANUFACTURING.

THE OPPOSITION, OF COURSE, PAINT A GLOOMY PICTURE OF BRITISH MANUFACTURING, AS AN INDUSTRY IN TERMINAL DECLINE, IN CONTRAST TO AN ALLEGED GOLDEN AGE UNDER THEIR STEWARDSHIP.

NOTHING COULD BE FURTHER FROM THE TRUTH.

THE PLAIN FACT IS THAT MANUFACTURING OUTPUT FELL OVER LABOUR'S PERIOD IN OFFICE WHEREAS IT HAS RISEN DURING OURS.

BUT THE CONTRAST GOES FAR BEYOND THAT.

THE UNDERLYING STRENGTH OF BRITISH MANUFACTURING INDUSTRY HAS BEEN TRANSFORMED.

UNLESS A BUSINESS MAKES PROFITS, IT CANNOT POSSIBLY PRODUCE MORE GOODS OR CREATE JOBS.

BRITAIN'S MANUFACTURERS HAVE INCREASED THEIR PROFITABILITY FOR FIVE YEARS IN SUCCESSION, THE BEST PERFORMANCE FOR A GENERATION.

AND THEY HAVE ACHIEVED THIS BY MAKING RADICAL IMPROVEMENTS IN EFFICIENCY.

HELD BACK BY RESTRICTIVE PRACTICES AND OVER-MANNING, MANUFACTURING PRODUCTIVITY INCREASED BY BARELY 1 PER CENT A YEAR UNDER LABOUR.

SINCE 1979, IT HAS RISEN MORE THAN FOUR TIMES AS FAST.

LAST JANUARY, THE RHM FOR MONKLANDS EAST SAID:

"WE WANT INCREASED PRODUCTIVITY IN AN EXPANDING INDUSTRIAL ECONOMY".

THAT IS PRECISELY WHAT WE HAVE SEEN.

IN THE PAST, STRONG GROWTH OF THE KIND WE HAVE SEEN, WOULD UNDOUBTEDLY HAVE QUICKLY FED THROUGH INTO MUCH HIGHER INFLATION.

IN FACT ALTHOUGH PRICES IN 1987 ROSE SOMEWHAT FASTER THAN IN THE PREVIOUS YEAR, AS THE ONE-OFF BENEFIT OF THE OIL PRICE FALL WAS LOST INFLATION HAS REMAINED LOW THROUGHOUT THE YEAR.

AT THE SAME TIME, UNEMPLOYMENT FELL RAPIDLY.

TODAY'S FIGURES SHOW THAT, DURING 1987 AS A WHOLE THE NUMBER OF PEOPLE OUT OF WORK FELL BY OVER HALF A MILLION, THE BIGGEST FALL ON RECORD WITH THE RATE FALLING FAR FASTER THAN IN ANY OTHER MAJOR COUNTRY OVER THE SAME PERIOD.

IN THE AUTUMN STATEMENT, I FORECAST THAT GROWTH IN 1988 WOULD BE 2½ PER CENT FOR THE ECONOMY AS A WHOLE, WITH THE NON-OIL ECONOMY GROWING AT 3 PER CENT.

I SHALL, OF COURSE, BE MAKING ANOTHER FORECAST IN THE BUDGET AND I DO NOT INTEND TO MAKE ONE TODAY.

BUT ON THE QUESTION OF THE NON-OIL ECONOMY, WHICH IS CRITICAL FOR NEW JOBS LET ME JUST SAY THIS.

GROWTH OF 3 PER CENT FOR THE NON-OIL ECONOMY IN 1988 WOULD BE A THOROUGHLY CREDITABLE PERFORMANCE.

THE LABOUR GOVERNMENT NEVER ONCE ACHIEVED 3 PER CENT GROWTH, WITH OR WITHOUT OIL.

INDEED, IT WAS ONLY ACHIEVED ONCE IN THE WHOLE OF THE 1970s.

BUT WE HAVE ACHIEVED THAT RATE IN FOUR OUT OF THE LAST FIVE YEARS.

KEEPING THE ECONOMY ON TRACK INVOLVES KEEPING A CONSTANT WATCH ON ALL THE INDICATORS OF HOW THE ECONOMY IS DEVELOPING, AND THEN TAKING ACTION AS NECESSARY.

I HAVE NEVER HESITATED TO ACT IN THE PAST WHEN I HAVE JUDGED THAT THERE WAS A RISK TO OUR INFLATION OBJECTIVES. I CAN ASSURE THE HOUSE THAT I SHALL NOT HESITATE TO DO SO IN FUTURE.

IT IS ONLY BY ACTING PROMPTLY THAT WE HAVE BEEN ABLE TO AVOID THE NEED FOR DRASTIC AND DESTABILISING LURCHES IN POLICY.

OUR TRACK RECORD SPEAKS FOR ITSELF.

PART OF THE JOB OF KEEPING THE ECONOMY ON TRACK INVOLVES MAINTAINING A REASONABLY STABLE EXCHANGE RATE, PARTICULARLY AGAINST THE DEUTSCHMARK.

THAT NOT ONLY MEANS THAT BUSINESSES KNOW WHERE THEY STAND: IT ALSO ACTS AS A FIRM ANCHOR AGAINST INFLATION. FOR MUCH OF 1987, THIS MEANT RESISTING UPWARD PRESSURE ON STERLING.

BUT AS I EXPLAINED TO THE CBI ANNUAL DINNER LAST MAY, AND AS THE GOVERNOR REAFFIRMED LAST WEEK, IT WOULD EQUALLY MEAN RESISTING SIGNIFICANT DOWNWARD PRESSURE, IF THAT WERE TO EMERGE.

CONCLUSION

MR SPEAKER WE ENTER 1988 WITH THE BRITISH ECONOMY IN GOOD SHAPE, AND THE PUBLIC FINANCES SOUNDER THAN AT ANY TIME SINCE THE WAR.

THAT IS NO COINCIDENCE.

WHEN WE CAME TO OFFICE IN 1979, WE GAVE THE HIGHEST PRIORITY TO RESTORING THE PUBLIC FINANCES TO A SOUND AND SUSTAINABLE CONDITION.

THAT IS ONE OF THE ROCKS ON WHICH THE NEW STRENGTH OF THE ECONOMY HAS BEEN BUILT.

THANKS TO THAT ACHIEVEMENT, WE HAVE BEEN ABLE TO CHOOSE, FREELY, TO INCREASE PUBLIC SPENDING, ESPECIALLY IN

PRIORITY AREAS, WHILE CONTINUING TO REDUCE OVERALL PUBLIC SPENDING AS A SHARE OF GDP.

AND UNLIKE THE OPPOSITION WHEN THEY WERE IN OFFICE, WE HAVE BEEN ABLE TO SUSTAIN OUR POLICY, YEAR IN, YEAR OUT.

THE OPPOSITION, OF COURSE, ARE BRIM-FULL OF IDEAS FOR SPENDING EVER HIGHER AMOUNTS OF THE TAXPAYER'S MONEY.

BUT THE PLAIN FACT IS THAT HAD THEIR POLICIES BEEN IMPLEMENTED, THE MONEY SIMPLY WOULD NOT HAVE BEEN THERE IN THE FIRST PLACE.

IT WAS CERTAINLY NOT THERE IN THE 1970s, AND IT WOULD NOT HAVE BEEN THERE IN THE 1980s.

THE AUTUMN STATEMENT WHICH WE ARE DEBATING TODAY, MY FIRST IN THIS PARLIAMENT, EMBODIES THE CONSISTENT STRATEGY THAT WE HAVE PURSUED SINCE 1979.

I COMMEND IT TO THE HOUSE.

1. Jonathan
2. PWP 3/6

FROM: J E MORTIMER
DATE: 14 JANUARY 1988

CHIEF SECRETARY

cc: Chancellor
Paymaster General
Mr Anson
Mr Turnbull
Mr Edwards

AUTUMN STATEMENT DEBATE: PROPOSED AMENDMENT CONCERNING OUR NET
PAYMENTS TO COMMUNITY INSTITUTIONS

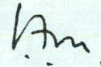
A group of Conservative back-benchers have proposed the attached amendment to the motion for this afternoon's debate. The amendment is unlikely to be called. If it is called, however, or if the point of the amendment is raised in debate, we suggest you respond as follows.

Line to take

- Government is concerned about the level of our net payments to Community institutions, and is working hard in the Community to achieve those reforms which will help bring the overall financial cost of the Community under better control.
- The amendment calls for a review of Community finances. The Government, along with all other member states, is already engaged on such a review on the basis of proposals put forward by the Commission. It has made clear that its first priority is to achieve effective and binding control over Community agricultural expenditure. Only then will it be prepared to address the Commission's proposal for additional own resources. The Government has also indicated that there can be

no dilution of the Fontainebleau abatement system - which has worked well, producing £3 billion of abatements since 1985.

- The increase in our net payments since the January White Paper has been caused primarily by a shortfall in agricultural receipts of around £200 million, higher than expected payments of agricultural levies and duties (£90 million), the payment of a VAT adjustment in August, and a £140 million payment of customs duties and agricultural levies which we now assume will be advanced from next April to next March.



J E MORTIMER

ORDERS OF THE DAY AND NOTICES OF MOTIONS

*Those marked thus * are Government Orders of the Day*

1 AUTUMN STATEMENT

The Prime Minister
Secretary Sir Geoffrey Howe
Mr Chancellor of the Exchequer
Mr Secretary Hurd
Mr Secretary Walker
Mr Secretary Younger

That this House approves the Autumn Statement presented by Mr Chancellor of the Exchequer on 3rd November 1987; welcomes the prospect of continuing low inflation and steady growth as the basis for maintaining the trend of rising employment; and congratulates Her Majesty's Government on the continuing reduction in the share of national income pre-empted by public expenditure.

As Amendments to the Prime Minister's proposed Motion (Autumn Statement):

Mr Neil Kinnock
Mr Roy Hattersley
Mr John Smith
Mr Gordon Brown
Mr Stanley Orme
Mr Derek Foster

Line 1, leave out from 'House' to end and add 'regrets that the Autumn Statement fails to provide adequate resources for the vital public services and the people who need them, particularly the National Health Service which consequently faces further under-funding next year, and, despite a deteriorating situation in the balance of trade and balance of payments and unsettled international economic relationships, does not propose measures to strengthen manufacturing industry and science and technology, promote vigorous regional development, or significantly reduce unemployment':

Mr Jonathan Aitken
Mr Bill Walker
Mr Nicholas Budgen
Mr Tim Janman
Mr Michael Brown
Mr Teddy Taylor

Mr Tony Marlow Mr Richard Shepherd Mr Roger Moate
Mr Richard Body Mr Nicholas Winterton Mrs Ann Winterton

Line 5, at end add 'but expresses concern that almost one-third of the entire increase in public expenditure since the January White Paper was in respect of net contributions to the European Community, which are estimated to amount to £1,400,000,000 in the current financial year, and considers that Her Majesty's Government should review, as a matter of urgency, the financial burdens of European Community membership, of which net contributions are only one small part'.

The Treasury and Civil Service Committee has reported on the Autumn Statement in its First Report, House of Commons Paper No. 197.

European Community Document No. 5079/87 + COR 1, First Quarterly Report of the Commission on the Economic Situation in the Community in 1987, is relevant.

On the Motion for the Adjournment of the House under Standing Order No. 9 Ann Widdecombe proposes to raise the subject of provision of health services in the South East Thames Regional Health Authority with special reference to Maidstone.

FROM: R D KERLEY

DATE: 14 January 1988

1. MR BURR *TBR 14/1*
2. CHIEF SECRETARY

cc PS/Chancellor - *amp*
 Sir P Middleton
 Mr Anson
 Mr Monck
 Mr Turnbull
 Mr Gilmore
 Mr Gieve
 Mr Waller
 Mr Bolt
 Ms Roberts
 Mr Tyrie
 Mr Call

AUTUMN STATEMENT DEBATE: MATERIAL FOR CHIEF SECRETARY'S WIND-UP

IAE2 have already provided briefing on this, as requested in your 11 January minute, and Mr Waller's minute of today includes a defensive line on the science budget provided by HE2. It is perhaps worth emphasising that the story on basic science is not a particularly strong one. Excluding increased expenditure on the British Antarctic Survey, which the Research Councils regard as a low priority but which has been decided by the Government, the real level of the Science Budget remains flat in 1988-89 and declines in 1989-90. It therefore seems preferable not to invite debate on the Science Budget and we would advise you against leading with this material. But there are also a couple of other points on which briefing may be helpful.

The Government's Science Policy

2. The Government's policy was set out in Cmnd 9849, the Government Response to the Education, Science and Arts Committee Report on the future of the science budget (attached). The key points are:

- greater concentration and selectivity of research activities:
- closer and better working with industry and commerce:
- better management yielding greater value for money:

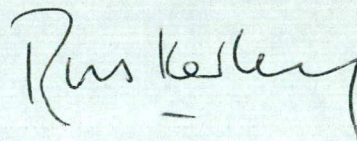
with the aim of improving the efficiency, competitiveness and innovative capacity of the United Kingdom economy.

3. Within this broad framework, the ABRC (Advisory Board for the Research Councils) has formulated proposals for a science strategy (see below), which the Government will be considering in due course as part of the process of developing specific policies to pursue the broad aims described above.

ABRC Report: A Strategy for the Science Base

4. In July 1987 the ABRC published a report giving their strategic advice on the science base. The ABRC strategy amounts to a shift in the strategic research priorities of the science base to place greater emphasis on exploitability coupled with greater concentration of resources. The latter would mean institutional changes in the university sector with universities divided into those doing research in all areas, those doing research in specific fields and those concentrating on teaching. There would be a move to inter-disciplinary research centres in and between universities. The report also proposes extra initial funding for restructuring costs, greater delegated freedom for Research Councils to manage their resources; and the idea of a link between the science budget and growth of GDP.

5. As the Secretary of State for Education announced on 3 November 1987 the increases for science in the Autumn Statement should allow scope for a worthwhile start in 1988-89 on the establishment of inter-disciplinary research centres, to which the Government attaches great importance. On the other recommendations of the ABRC report, he said that the Government would respond in due course in the light of comments received following wide-ranging consultations with the higher education and scientific communities and other interested bodies.



R D KERLEY

**THE FUTURE OF THE SCIENCE BUDGET: THE GOVERNMENT
RESPONSE TO THE FIRST REPORT FROM THE EDUCATION, SCIENCE
AND ARTS COMMITTEE: SESSION 1984-85**

Introduction

1. The Government welcomes this first Report from the Committee on the Science Budget and the science base, as recognising their importance and the significance of this expenditure by the Department of Education and Science; and as contributing to public understanding, awareness and debate. It notes, in particular, three of the Committee's main conclusions (para. 70) viz:

"1. The economy of a modern industrial state depends especially on the efficiency with which it can exploit science and technology and that basic or pure research, and related strategic research, is essential to this process.

3. The basic and strategic research supported by the Science Budget is of particular importance because it is this source, in combination with universities and polytechnics, which provides the science base for the development of new industry and advanced skills.

8. The Research Council system has served the nation well in the past and can do so in the future provided it has adequate resources."

The Government concurs in these conclusions, and shares the broad aims of the Committee's recommendations:—the desirability of securing the best possible value from the Science Budget; of sustaining and strengthening the dual support system under a single DES Minister with scientific and higher education responsibilities; and of improving the co-ordination, within Government, of policies and expenditure for research and development.

x | 2. The Department has recently (Hansard 11 March) set out the aim and objectives of its science policy:

"—To maintain and enhance the strength and quality of the science base in higher education and the Research Councils.

Consonant with this, the objectives are to encourage

—greater concentration and selectivity of research activities;

—closer and better working with industry and commerce;

—more funding from private sector sources;

—better management yielding greater value for money;

—increased flexibility enabling faster response to new scientific opportunities;

and to keep under review the balance between international and national scientific endeavours:

thereby

—to strengthen the knowledge and skills of the United Kingdom in science and technology;

and

—to improve the efficiency, competitiveness and innovative capacity of the United Kingdom economy."

FROM: M A WALLER

DATE: 13 January 1988

PWP

PS/CHIEF SECRETARY

cc. PS/Chancellor
Sir P Middleton
Mr Anson
Mr Monck
Mr Turnbull
Mr Gilmore
Mr Gieve
Mr Kerley
Ms Roberts
Mr N Williams
Mr Betenson
Mr Tyrie
Mr Call

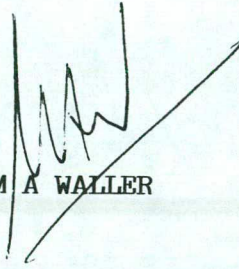
AUTUMN STATEMENT DEBATE: ADDITIONAL MATERIAL FOR CHIEF SECRETARY'S WIND UP

Following this afternoon's meeting with the Chief Secretary I attach the following additional material requested by the Chief Secretary:

- (i) A couple of paragraphs responding to possible criticism about cuts in spending on basic science and technology;
- (ii) Three paragraphs on inner cities providing both a description of existing inner city programmes and a general paragraph describing the Government's overall approach to the problems of inner cities (responding to possible criticisms that the Government does not care about inner city problems);
- (iii) A note identifying the main criticisms levelled at DTI's new policies during yesterday's debate with a suggested line to take in each case;
- (iv) A note on the criteria governing the provision of RSA and their practical application.

2. When making the point that economic growth is not restricted to the South the Chief Secretary will wish to bear in mind the latest figures on regional growth in GDP per capita published in the November issue of Economic Trends (which was published in mid December). Up until recently the official statistics on growth in Gross Domestic Product showed that since 1979 GDP per capita in Scotland, the North West and Wales had risen relative to the South East. The November

Economic trends, which both gives figures for 1986 for the first time and revises figures given previously for 1985, show that this neither is, nor ever was, true for any of these regions. I understand that EB have now warned the Chancellor's office of this.



M A WALLER

SPEAKING NOTE FOR AUTUMN STATEMENT DEBATE:

MATERIAL FOR WIND-UP ON R+D

Defensive line on basic science

The Government plans an increase in expenditure on basic science. There will be an addition to the Science Budget of around £50m in 1988-89 and around £65m in 1989-90 compared with previous plans. Indeed the Science Budget in 1988-89 will be at a new all-time peak in real terms and 13 per cent higher in real terms than it was in 1978-79. The budgeted increases provide for : higher research funding ; a pilot programme of university research centres (inter-disciplinary centres of excellence in universities funded by the Research Councils); the Medical Research Council special programme of research for AIDS; and increased funding for the British Antarctic Survey

Defensive line on cuts in R+D support

Government support for R+D overall should rise from £4750m this year to £4820m next year. Government support for R+D in the UK is greater as a percentage of GDP than either the US or Japan. The main problem is that private sector investment has in past been lower than our competitors. We believe that industry should increase its own expenditure on R+D, taking advantage of the very favourable economic climate created by Government policies - including rising profits, low inflation and deregulation of industry.

But the Government has also taken steps to improve co-ordination and value for money from its support for R+D by strengthening central arrangements, including the

● establishing a new Advisory Council on Science and Technology (ACOST) to co-ordinate Government policies on science and technology. This will report direct to the Prime Minister.

DTI support for R+D

No cuts are planned to DTI expenditure on R+D. Indeed overall spending on R+D and innovation is set to increase compared with previous plans as well as year on year.

But as announced by my Rt Hon and learned Friend on Tuesday, there is to be a shift of emphasis ^{in DTI, R+D spend} towards collaborative research especially longer-term research involving higher education and industry. There will be continued emphasis on technology transfer, industry-education links and non-project support, especially for smaller companies. But the Government's commitment to the support of high technology continues. A major initiative will encourage the use of private sector consultancy in key management areas by small and medium sized companies - including high technology areas. Support is also being made available for a superconductivity research programme.

Spk Jill Rutter

1. The Opposition have charged that this Government does not care about the inner cities. Mr Speaker, that is arrant nonsense. We are planning for an increase of about £50 million a year in Department of the Environment urban spending on last year's White Paper. This will bring total spending to £500 million a year - some 2½ times in real terms what was spent in 1978-79. In the last year or so alone we have set up 5 new Urban Development Corporations in England and Wales; doubled the size of the Inner Cities Initiative and Estate Action programmes; and introduced Urban Regeneration Grant; and last year spent around £200 million on MSC programmes on inner city partnership areas alone. And we have plans for creating three more smaller Urban Development Corporations, the extension of an existing Corporation and the establishment of Housing Action Trusts.

2. What we do not believe is that throwing money at the complex problems of the inner cities is the whole or indeed the main answer, as the Opposition and Labour controlled councils would have us believe. That has been tried and has failed. It has failed because indiscriminate, badly targetted and badly managed spending, whether by central Government and or profligate local authorities, drives away business and saps the morale and enterprise of individuals. Instead the successful revival of our inner cities is crucially dependent on working with the private sector and with those living in the inner cities to establish a climate which:

- encourages, rather than discourages, businesses to establish and grow in the inner cities;
- motivates and enables those who live in the inner cities to seek and obtain secure employment.

This is the only way to ensure self-sustaining growth in activity and jobs which are at the heart of any city's economic and social well being.

3. Mr Speaker, that is precisely what our policies are designed to do. The success of our initiatives shows what can be achieved - £2.2 billion private investment in London Docklands, 7 times public investment - and £530 million of private investment generated by £130 million of Urban Development Grant. Our policies represent both a coherent and realistic approach to the complex problems of our inner cities and an emphatic rebuttal of the Opposition's criticisms.

STATEMENT TO PARLIAMENT ON 12 JANUARY: ROLE OF THE DTI

Abolition of RDG reflects lack of commitment to effective regional policy?

Messrs Blair, Heffer etc.

Government remains committed to effective regional policy. The changes represent a strengthening of regional policy taking account of today's economic circumstances of growth, expansion and rising employment in the regions. Promises to make regional policy more effective by ensuring better use of increased resources being made available.

Existing levels of Regional Funding won't be maintained. £300m cut since 1979.

Messrs Blair, Jones, Millar

In 1979 RDG was paid automatically regardless of job effects. Changes since then to link grants to jobs have resulted in more effective targetting of resources on projects offering real additional jobs. The new changes are a further step in ensuring more effective use of regional funds. They do not represent a cut in regional aids; provision for regional incentives is being increased compared to 1987 White Paper.

RDG gave businesses certainty of guaranteed level of assistance.

Mr Britton

Gave degree of certainty but at a cost. RDG often claimed after decisions to invest made - without regard for whether it was needed. With bouyant economy and rising investment right to look for ways of using money more effectively in regions.

Too big a role for officials in commercial decisions.

Mr Tebbit

As my hon. friend made clear on Tuesday he is determined to ensure that the processes of giving assistance does not become bureaucratic or give too large a role to those administering it. They will not be concerned with rewriting the business plans of applicants but will concentrate primarily on assessing the requirement for grant if the project is to go ahead. They will rely on advice from senior outside industrialists such as IDAB.

Will changes deter large companies locating in the regions.

Messrs Jones, Ross, Glover

RSA, which unlike RDG is not limited to a fixed proportion of costs and is therefore more flexible, has played a major role in attracting large investors to the regions. This will continue to be available.

Changes represent an extension of DTI/central control.

Mr Bruce

No. The changes involve a shift in the balance of work away from the centre and the network of DTI regional offices is being extended to help the Department get closer to its customers. The Secretary of State for Scotland and Wales participated fully in the review of regional incentives and will administer largely through the Development Agencies, the new policies in their countries.

Changes should have included revision of Assisted Areas map.

Mr Blaker

Changing the Map is a very protracted process involving lengthy consultations including with the EC. Too soon after last review to embark on such a reappraisal, which would inevitably create uncertainty.

REGIONAL SELECTIVE ASSISTANCE: CRITERIA

1. Applications for Regional Selective Assistance are subjected to a package of tests.

2. A proposal will normally be rejected where it does not satisfy the tests for:

- additionality;
- viability of enterprise and project
- economic efficiency

3. The aim of the additionality test is to establish whether assistance is necessary for the project to go ahead at all or whether its nature, scale, timing or location would be sufficiently enhanced by the provision of assistance to justify it. Thereafter the aim is to provide the minimum necessary to achieve the additional benefits.

4. Assistance is only available for projects which are considered viable requiring a judgement on the financial position and prospects of the enterprise undertaking the project and the project itself. For the project, viable means after receipt of RSA on a once-and-for-all basis, the project can earn and maintain sufficient profits for the associated employment to be sustained without further subsidy.

5. The efficiency test is designed to ensure that only projects which assist the regional and national economy receive support, i.e. that regional benefits will not be bought at the expense of reduced economic efficiency in the economy as a whole. It involves an investment appraisal using discounted cash flow analysis, and for larger projects (grant exceeding £1 million) is complemented by an analysis of wider economic effects including market displacement, skills enhancement, technology transfer and competition.

6. The level of grant available to projects satisfying these tests is subject to additional EC and UK national rules governing, in particular, the proportion of total capital expenditure which might be met from grant, cumulation of aid from different sources and cost per job limits. The latter, currently £6,000 in Assisted Areas and £17,000 in Development Areas, are particularly important given that the case for regional policy is now considered primarily social, to reduce regional imbalances in employment opportunities, rather than economic. The allowable job count is net of any ^{job} lost as a result of direct displacement by the project.

SPEAKING NOTE FOR AUTUMN STATEMENT DEBATE.

MATERIAL FOR WIND-UP ON R+D

Defensive line on basic science

The Government plans an increase in expenditure on basic science. There will be an addition to the Science Budget of around £50m in 1988-89 and around £65m in 1989-90 compared with previous plans. Indeed the Science Budget in 1988-89 will be at a new all-time peak in real terms and 13 per cent higher in real terms than it was in 1978-79. The budgeted increases provide for : higher research funding , a pilot programme of university research centres (inter-disciplinary centres of excellence in universities funded by the Research Councils), the Medical Research Council special programme of research for AIDS, and increased funding for the British Antarctic Survey

Defensive line on cuts in R+D support

Government support for R+D overall should rise from £4750m this year to £4820m next year. Government support for R+D in the UK is greater as a percentage of GDP than either the US or Japan. The main problem is that private sector investment has in past been lower than our competitors. We believe that industry should increase its own expenditure on R+D, taking advantage of the very favourable economic climate created by Government policies - including rising profits, low inflation and deregulation of industry.

But the Government has also taken steps to improve co-ordination and value for money from its support for R+D by strengthening central arrangements, including the

establishing a new Advisory Council on Science and Technology (ACCST) to co-ordinate Government policies on science and technology. This will report direct to the Prime Minister.

DIT support for R+D

No cuts are planned to DIT expenditure on R+D. Indeed overall spending on R+D and innovation is set to increase compared with previous plans as well as year on year.

But as announced by my Rt Hon and learned Friend on Tuesday, there is to be a shift of emphasis ^{in DIT R+D spend} towards collaborative research especially longer-term research involving higher education and industry. There will be continued emphasis on technology transfer, industry-education links and non-project support, especially for smaller companies. But the Government's commitment to the support of high technology continues. A major initiative will encourage the use of private sector consultancy in key management areas by small and medium sized companies - including high technology areas. Support is also being made available for a superconductivity research programme.

UNCLASSIFIED

Draft of 13 January 1988

**CHANCELLOR'S SPEECH FOR AUTUMN STATEMENT DEBATE,
14 JANUARY**

THIRD DRAFT

I beg to move the motion on the Order Paper in my name and those of my Rt. Hon. Friends.

[INSERT (A) HONORS] ~~Insert 2 paragraphs 2nd & 3rd/4th/5th/6th/7th/8th/9th/10th/11th/12th/13th/14th/15th/16th/17th/18th/19th/20th/21st/22nd/23rd/24th/25th/26th/27th/28th/29th/30th/31st/32nd/33rd/34th/35th/36th/37th/38th/39th/40th/41st/42nd/43rd/44th/45th/46th/47th/48th/49th/50th/51st/52nd/53rd/54th/55th/56th/57th/58th/59th/60th/61st/62nd/63rd/64th/65th/66th/67th/68th/69th/70th/71st/72nd/73rd/74th/75th/76th/77th/78th/79th/80th/81st/82nd/83rd/84th/85th/86th/87th/88th/89th/90th/91st/92nd/93rd/94th/95th/96th/97th/98th/99th/100th~~

2. The Autumn Statement Debate this year is a little later than it has been in previous years. Part of the reason was to allow the Treasury and Civil Service Select Committee, which was only established on 24 November, to prepare its Report. I sympathise with the Committee's frustration that it was not constituted sooner, and I congratulate the RHM for Worthing and his colleagues on producing their report ^{as} promptly ^{as} *Reg. Int.*

PWP

CHANCELLOR'S SPEECH FOR AUTUMN STATEMENT DEBATE,
14 JANUARY

I BEG TO MOVE THE MOTION ON THE ORDER PAPER IN MY NAME AND
THOSE OF MY RT. HON. FRIENDS,

SORT OF
WILLIAMS *THORNTON*, *ETTRICK* - *LAUNDON* *HIS MUST* *FUEL*
LEFT CHAMBER. *BEGIN TO*

THAT IF THE RT. HON. MEMBER FOR DEVONPORT HAD PLACED AN AGENT
DEEP IN THE ALLIANCE CONFABULATIONS WITH THE *SPECIFIC* MISSION OF
WRECKING THE MERGER, SHATTERING THE LIBERALS AND
THEIR DISCREDITING *HIMSELF* *LEADER*, HE COULD NOT HAVE DONE BETTER
THAN HE HAS DONE WITH HIS HON. FRIEND THE MEMBER FOR
CAITHNESS AND SUTHERLAND. *!*

MR SPEAKER,

THE AUTUMN STATEMENT DEBATE THIS YEAR IS A LITTLE LATER
THAN IT HAS BEEN IN PREVIOUS YEARS.

PART OF THE REASON WAS TO ALLOW THE TREASURY AND CIVIL SERVICE SELECT COMMITTEE, WHICH WAS ONLY ESTABLISHED ON 24 NOVEMBER, TO PREPARE ITS REPORT.

I SYMPATHISE WITH THE COMMITTEE'S FRUSTRATION THAT IT WAS NOT CONSTITUTED SOONER, AND I CONGRATULATE THE RHM FOR WORTHING AND HIS COLLEAGUES ON PRODUCING THEIR REPORT AS PROMPTLY AS THEY DID.

IN MY BUDGET STATEMENT LAST MARCH, I WARNED THAT - AND I QUOTE -

"THE BIGGEST RISK TO THE EXCELLENT PROSPECT I HAVE OUTLINED IS THAT OF A DOWNTURN IN THE WORLD ECONOMY AS A WHOLE.

THERE ARE STILL SERIOUS IMBALANCES AFFLICTING THE THREE MAJOR ECONOMIES - THE UNITED STATES ON THE ONE HAND, AND JAPAN AND GERMANY ON THE OTHER - WHICH, IF NOT HANDLED PROPERLY, COULD LEAD TO A SIMULTANEOUS DOWNTURN IN ALL THREE.

AND THIS IN TURN COULD BE EXAGGERATED BY RENEWED TURMOIL IN THE FOREIGN EXCHANGE MARKETS, WHOSE TENDENCY TO OVERSHOOT IS AS NOTORIOUS AS IT IS DAMAGING."

RECENT EVENTS HAVE BROUGHT THOSE CONCERNS VERY MUCH TO THE FORE, AND I THEREFORE PROPOSE TO DEVOTE MOST OF MY REMARKS TODAY TO THE PROSPECTS FOR THE WORLD ECONOMY - NOT LEAST BECAUSE THIS MAY BE MY LAST OPPORTUNITY TO DO SO BEFORE THIS YEAR'S BUDGET STATEMENT, WHICH, I CAN NOW TELL THE HOUSE, WILL BE ON 15 MARCH.

THE IMPORTANT ISSUE OF PUBLIC EXPENDITURE WILL BE DEALT WITH BY MY RT. HON. FRIEND THE CHIEF SECRETARY, WHEN HE COMES TO WIND UP THIS DEBATE.

I PRESENTED MY AUTUMN STATEMENT TO THE HOUSE A BARE TWO WEEKS AFTER THE COLLAPSE OF THE WORLD'S STOCK MARKETS THAT HAS COME TO BE KNOWN AS BLACK MONDAY.

●

APPREHENSION ABOUT THE PROSPECTS FOR THE WORLD ECONOMY WAS AT ITS MOST ACUTE.

IT WAS WIDELY PREDICTED THAT THE EQUITY MARKET COLLAPSE WOULD INEVITABLY LEAD TO A MAJOR WORLD RECESSION THIS YEAR.

TWO MONTHS ON, IT IS EASIER TO PUT THE SHARP FALL IN THE STOCK MARKET IN OCTOBER INTO PERSPECTIVE.

ALTHOUGH THE SCALE AND SUDDENNESS OF THE FALL WERE UNPRECEDENTED, IT HAS INCREASINGLY BEEN SEEN AS IN LARGE MEASURE A CORRECTION, FOLLOWING THE RAPID RISE IN THE EARLY PART OF 1987.

IN THE THREE MAIN MARKETS - LONDON, NEW YORK, AND TOKYO - FOLLOWING THE SHARP FALLS IN OCTOBER SHARE PRICES HAVE NOT FALLEN ANY FURTHER SINCE THE END OF THAT MONTH, AND ARE AT MUCH THE SAME LEVELS AS A YEAR AGO.

THE IMPACT ON CONSUMER SPENDING - THE SO-CALLED "WEALTH EFFECT" - SHOULD THEREFORE BE LIMITED.

BUT A SHOCK SUCH AS THE STOCK MARKET COLLAPSE CAN READILY DAMAGE BUSINESS CONFIDENCE QUITE SEVERELY.

MOST OF THE MAJOR COUNTRIES THEREFORE ACTED PROMPTLY TO REDUCE INTEREST RATES, BOTH TO DEAL WITH THE IMMEDIATE RISK OF A LACK OF LIQUIDITY AND TO SUSTAIN BUSINESS CONFIDENCE.

I AM SURE THAT, IN THE CIRCUMSTANCES OF THAT TIME, THAT WAS RIGHT.

A FURTHER REASON WHY BUSINESS CONFIDENCE HAS REMAINED PRETTY WELL INTACT IS THAT ALL THE ECONOMIC EVIDENCE PUBLISHED SINCE OCTOBER, SO FAR FROM IMPLYING THAT WORLD RECESSION IS IMMINENT, SUGGESTS THAT THE WORLD ECONOMY PRIOR TO THE STOCK MARKET COLLAPSE WAS IN FACT MARKEDLY STRONGER THAN HAD EARLIER BEEN RECOGNISED.

SO ANY SLOWDOWN THERE MAY BE THIS YEAR WILL BE FROM A PRETTY VIGOROUS MOMENTUM OF GROWTH.

IT IS NOW CLEAR THAT ACTIVITY PICKED UP MARKEDLY DURING THE COURSE OF 1987.

TAKING THE SEVEN MAJOR INDUSTRIALISED COUNTRIES AS A WHOLE, OUTPUT IN THE THIRD QUARTER OF THE YEAR WAS OVER 3 PER CENT HIGHER THAN A YEAR EARLIER, WITH INDUSTRIAL PRODUCTION IN OCTOBER OVER 4 PER CENT UP.

IN THE UNITED STATES, INDUSTRIAL PRODUCTION IN THE THIRD QUARTER OF 1987 WAS 5 PER CENT UP ON A YEAR EARLIER, AND UNEMPLOYMENT REACHED ITS LOWEST LEVEL SINCE 1979.

JAPAN, THE WORLD'S SECOND LARGEST ECONOMY, WHICH HAD EARLIER BEEN A LITTLE SLUGGISH, BEGAN TO MOVE AHEAD BRISKLY, WITH INDUSTRIAL PRODUCTION AT THE LATEST COUNT SOME 8 PER CENT HIGHER THAN A YEAR AGO.

THE UNITED KINGDOM, AS I INDICATED IN THE AUTUMN STATEMENT, LOOKS TO HAVE ENJOYED 4 PER CENT GROWTH OVER LAST YEAR AS A WHOLE, WITH THE THIRD QUARTER STRONGER THAN THE FIRST TWO.

AND THE CANADIAN ECONOMY, TOO, IS BUOYANT.

IT IS ONLY THE PERFORMANCE OF CONTINENTAL EUROPE, AND PARTICULARLY GERMANY, WHICH REMAINS DISAPPOINTING, THOUGH EVEN THERE MODEST GROWTH IS CONTINUING.

THUS, OVERALL, WORLD GROWTH HAS BEEN PROVING EXTREMELY ROBUST.

BUT THE SERIOUS IMBALANCES IN THE WORLD ECONOMY REMAIN.

AT THE HEART OF THESE IMBALANCES LIES THE HUGE STRUCTURAL BUDGET DEFICIT IN THE UNITED STATES.

THIS IS PARTICULARLY DAMAGING, NOT JUST BECAUSE OF THE ENORMOUS SIZE OF THE UNITED STATES ECONOMY, BUT BECAUSE THE AMERICANS, WITH THEIR LOW PROPENSITY TO SAVE, HAVE PROVED WHOLLY UNABLE TO FINANCE THE DEFICIT FROM DOMESTIC SAVINGS.

THIS MEANS, INEVITABLY, THAT THE UNITED STATES REQUIRES LARGE CAPITAL INFLOWS FROM OVERSEAS, WITH THE COUNTERPART, SO LONG AS THIS STATE OF AFFAIRS PERSISTS, OF A LARGE CURRENT ACCOUNT DEFICIT.

FOR YEARS, THERE WERE CALLS FOR THE UNITED STATES TO REDUCE THEIR BUDGET DEFICIT - EXCEPT, I HAVE TO SAY, FROM THE FRONT BENCH OPPOSITE, WHICH URGED US TO EMULATE IT. BUT NOT NEARLY ENOUGH PROGRESS WAS MADE, NOT LEAST BECAUSE OF THE DIFFICULTY OF REACHING ANY SORT OF AGREEMENT BETWEEN THE ADMINISTRATION AND CONGRESS ON HOW TO GO ABOUT IT.

PRESIDENT REAGAN HIMSELF SAID, EARLIER THIS WEEK:

"THAT DEFICIT IS AN EMBARRASSMENT AND A SHAME - MOST DANGEROUS, PERHAPS, BECAUSE IT SIGNALS THE COMPLETE BREAKDOWN OF ONE OF THE MOST BASIC FUNCTIONS OF THE UNITED STATES GOVERNMENT."

THERE HAS NOW BEEN SOME ENCOURAGING PROGRESS, WITH THE LEGISLATION PASSED JUST BEFORE CHRISTMAS TO REDUCE THE DEFICIT, RELATIVE TO THE LEVEL IT WOULD OTHERWISE HAVE BEEN, BY \$30 BILLION FOR 1988 AND \$45 BILLION FOR 1989. BUT THESE STEPS WILL NOT BE SUFFICIENT, BY THEMSELVES, TO REDUCE THE DEFICIT TO A TOLERABLE LEVEL.

IT HAS BEEN CLEAR FOR SOME TIME THAT THE REDUCTION OF THE OTHER SET OF IMBALANCES - THE CURRENT ACCOUNT IMBALANCES - WILL DEPEND ON DOMESTIC DEMAND IN THE US GROWING MORE SLOWLY THAN THAT IN JAPAN AND GERMANY FOR SOME YEARS.

AND ONE OF THE PRIME OBJECTIVES OF THE MAJOR INDUSTRIALISED COUNTRIES, MEETING TOGETHER IN THE GROUP OF SEVEN, HAS BEEN TO ACHIEVE THIS IN AN ORDERLY WAY.

THE UNITED STATES ACTION, AND THE DECISION OF THE GERMAN AUTHORITIES TO REDUCE THEIR KEY DISCOUNT RATE FROM 3 PER CENT TO 2½ PER CENT, THE LOWEST RATE SINCE THE WAR, ARE HELPFUL STEPS, AND PAVED THE WAY FOR THE G7 COMMUNIQUE ISSUED ON 23 DECEMBER.

THAT COMMUNIQUE ALSO RE-EMPHASISED THE AGREEMENT TO CO-OPERATE TO FOSTER EXCHANGE RATE STABILITY, FOLLOWING A PERIOD OF TURBULENCE ON THE FOREIGN EXCHANGES WHICH HAD SEEN A FURTHER SLIDE IN THE DOLLAR.

WILD GYRATIONS IN EXCHANGE RATES CAN CREATE GRAVE UNCERTAINTY, AND DAMAGE BUSINESS CONFIDENCE.

COMPANIES IN ALL COUNTRIES FIND IT MORE DIFFICULT TO PLAN FOR THE FUTURE, AND HAVE TO SPEND PRECIOUS TIME, MONEY AND INGENUITY ON INSURING THEMSELVES AGAINST EXCHANGE RATE RISKS, WHEN THEY SHOULD BE CONCENTRATING ON THE REAL JOB OF IMPROVING COMPANY PERFORMANCE.

THAT IS WHY THE CBI, FOR EXAMPLE, HAS STRESSED THE IMPORTANCE TO ITS MEMBERS OF A STABLE EXCHANGE RATE.

IT IS THUS NATURAL THAT COUNTRIES SHOULD SEEK TO ACT TOGETHER TO PREVENT EXCESSIVE EXCHANGE RATE VOLATILITY. MOREOVER, HISTORY HAS SHOWN THAT A READINESS BY COUNTRIES TO COMMIT THEMSELVES TO SOME FORM OF EXCHANGE RATE STABILITY IS THE ONLY FEASIBLE WAY OF SECURING WIDER INTERNATIONAL CO-OPERATION ON ECONOMIC POLICY.

IF COUNTRIES ARE INDEED PREPARED TO ACCEPT SUCH COMMITMENTS WHOLEHEARTEDLY, THEY WILL FIND THEMSELVES

OBLIGED TO PURSUE DOMESTIC POLICIES CONSISTENT WITH THEIR EXCHANGE RATE OBJECTIVES.

THIS APPLIES MOST OBVIOUSLY TO MONETARY POLICY, THOUGH FISCAL POLICY ALSO HAS A VITAL SUPPORTING ROLE, PARTICULARLY OVER THE MEDIUM TERM.

IT IS, HOWEVER, AN ACADEMIC DREAM, DIVORCED FROM REALITY, TO IMAGINE THAT SOVEREIGN STATES WILL BE PERSUADED INTO CONSISTENT DOMESTIC POLICIES SIMPLY BY A PROCESS OF CAREFUL INTERNATIONAL ANALYSIS AND DISCUSSION.

OF COURSE, COUNTRIES MAY CHOOSE AT ANY TIME TO IGNORE THE IMPLICATIONS OF THE EXCHANGE RATE ARRANGEMENTS THEY HAVE ENTERED INTO.

SOVEREIGN STATES CANNOT, IN THE END, BE REQUIRED TO TAKE PARTICULAR COURSES OF ACTION.

BUT IF THEY ARE NOT PREPARED TO PLAY THEIR PART IN AN AGREEMENT WITH THE VISIBLE, MEASURABLE, OBJECTIVE OF BROAD EXCHANGE RATE STABILITY, WITHIN A FRAMEWORK OF LOW

INFLATION, IT IS HOPELESSLY UNREALISTIC TO IMAGINE THAT A MORE GENERAL AGREEMENT ON CONSISTENCY OF FISCAL AND MONETARY POLICY WOULD STAND ANY CHANCE AT ALL OF WORKING. THOSE WHO SUGGEST OTHERWISE ARE NOT LIVING IN THE REAL WORLD.

LET ME BE QUITE CLEAR.

I AM NOT SUGGESTING A RETURN TO ANYTHING LIKE THE RIGID EXCHANGE RATE SYSTEM THAT APPLIED UNDER BRETTON WOODS. BUT I BELIEVE THERE ARE CLEAR ADVANTAGES IN A MORE MANAGED APPROACH DESIGNED TO PREVENT THE WILD GYRATIONS OF RECENT YEARS, PARTICULARLY IN THE DOLLAR, AND IN SO DOING ACHIEVING GREATER INTERNATIONAL CO-OPERATION IN ECONOMIC POLICY MORE GENERALLY.

THE EVENTS OF RECENT YEARS UNDERLINE THE POINT.

IT IS MOST UNLIKELY THAT THE HEADY RISE IN THE DOLLAR DURING 1984 WOULD HAVE TAKEN PLACE IF THERE HAD BEEN AN EXCHANGE RATE AGREEMENT AT THE TIME, AND THE US

AUTHORITIES HAD THUS BEEN OBLIGED TO GIVE GREATER WEIGHT TO THE EXTERNAL VALUE OF THE DOLLAR IN THE CONDUCT OF MONETARY AND FISCAL POLICY.

AND HAD THAT BEEN SO, THE IMBALANCES THAT PLAGUE US TODAY, AND THE PROTECTIONIST THREAT THAT ACCOMPANIES THEM, COULD NEVER HAVE DEVELOPED TO THE EXTENT THAT THEY HAVE.

SINCE THE UNITED STATES BECAME CONVERTED IN 1985 TO THE DESIRABILITY OF CO-OPERATION ON EXCHANGE RATES, WE HAVE HAD THE PLAZA AGREEMENT IN SEPTEMBER 1985, DESIGNED TO DEAL DIRECTLY WITH THE PROBLEM OF DOLLAR OVERVALUATION, AND OVER THE FOLLOWING 15 MONTHS WE SAW AN ORDERLY, BUT SUBSTANTIAL, DEPRECIATION.

AND THE LOUVRE ACCORD, SIGNED IN FEBRUARY OF LAST YEAR, PROVIDED A PERIOD OF BROAD STABILITY, INTENDED TO ALLOW THE MAJOR ECONOMIES TO ADJUST TO THE MASSIVE EXCHANGE RATE CHANGES THAT HAD ALREADY TAKEN PLACE.

A NUMBER OF COMMENTATORS HAVE SEIZED ON THE DECLINE IN THE DOLLAR THAT HAS OCCURRED SINCE OCTOBER TO SUGGEST THAT THE LOUVRE ACCORD WAS FUNDAMENTALLY FLAWED, AND THUS UNSUSTAINABLE, FROM THE OUTSET.

I DISAGREE.

AS PAUL VOLCKER OBSERVED IN A SPEECH IN GENEVA IN NOVEMBER,

"THE ARGUMENT OF SOME SEEMS TO BE THAT THE AGREEMENT SACRIFICED APPROPRIATE INTERNAL ECONOMIC MANAGEMENT TO THE REQUIREMENTS OF A STABLE EXCHANGE RATE. THAT SEEMS TO ME A MISREADING OF BOTH THE NATURE OF THE UNDERSTANDING AND, MORE BROADLY, THE NEED TO ACCORD THE REQUIREMENTS OF EXCHANGE RATE STABILITY MORE PROMINENCE IN ECONOMIC POLICY MAKING."

I WAS PLEASED TO NOTE, TOO, THAT THE SELECT COMMITTEE, IN THEIR REPORT - AND I QUOTE - "GIVE WEIGHT TO ENSURING REASONABLE STABILITY OF EXCHANGE RATES WHICH WAS THE ORIGINAL INTENTION OF THE LOUVRE AGREEMENT."

IT IS OF COURSE CLEAR, AND THIS IS IMPLICIT IN BOTH THE PLAZA AND LOUVRE AGREEMENTS, THAT STABILITY OF EXCHANGE RATES CANNOT BE ACHIEVED SIMPLY BY WISHING IT.

APPROPRIATE DOMESTIC POLICIES - FISCAL, AND IN PARTICULAR MONETARY - ARE NEEDED.

AND FOR A PERIOD, THE LOUVRE ACCORD BROUGHT THE NECESSARY RESULTS: STABLE EXCHANGE RATES, GREATLY HELPED BY THE FACT THAT INTEREST RATES IN THE UNITED STATES ROSE, AND THOSE IN JAPAN AND GERMANY EDGED DOWN.

WHAT BROUGHT STABILITY TO AN END WAS THE PERCEPTION IN THE MARKET THAT THE AMERICANS WERE NO LONGER COMMITTED TO THE LOUVRE AGREEMENT, AND WERE SIMPLY CONCERNED TO PREVENT ANY RISK OF DOMESTIC RECESSION.

THE MARKETS WERE ALSO AWARE THAT, AFTER COMMENDABLE PROGRESS IN FISCAL 1987, THE UNITED STATES LOOKED UNLIKELY TO REDUCE ITS BUDGET DEFICIT FOR FISCAL 1988 BY ANYTHING LIKE THE EXTENT AGREED AT THE LOUVRE.

DURING NOVEMBER AND DECEMBER, THE DOLLAR APPEARED TO BE GIVEN LITTLE WEIGHT IN UNITED STATES POLICY, WITH THE INEVITABLE RESULT OF TURMOIL ON THE FOREIGN EXCHANGES, WITH THE DOLLAR FALLING AND EXPECTED TO FALL FURTHER. LAST WEEK, HOWEVER, THE US AUTHORITIES DEMONSTRATED A RENEWED COMMITMENT TO SUPPORTING THE DOLLAR, WITH THE FEDERAL RESERVE BANK INTERVENING, IN CONCERT WITH OTHER CENTRAL BANKS, TO A VERY MUCH GREATER EXTENT, AND DOING SO IN A DELIBERATELY PUBLIC WAY.

THIS ENDING OF A BRIEF BUT DAMAGING PHASE OF SO-CALLED BENIGN NEGLECT IS A STEP IN THE RIGHT DIRECTION.

BUT IT IS IDLE TO SUPPOSE THAT OFFICIAL INTERVENTION ON ITS OWN, EVEN WHEN IT IS CO-ORDINATED INTERNATIONALLY AND INVOLVES FULL US PARTICIPATION, AMOUNTS TO A COHERENT POLICY.

BUT INTERVENTION IS AN IMPORTANT TACTICAL WEAPON, AND IT WOULD BE FOOLISH NOT TO USE IT WHEN APPROPRIATE.

IN OUR OWN CASE, IT HAS HELPED US ACHIEVE A REMARKABLE DEGREE OF STABILITY FOR STERLING, PARTICULARLY AGAINST THE DEUTSCHMARK - SOMETHING THAT IS WIDELY WELCOMED BY BRITISH INDUSTRY - AND IN THE PROCESS TO BUILD UP OUR FOREIGN EXCHANGE RESERVES TO AN ADEQUATE LEVEL.

THE DESIRE AT THE LOUVRE TO ALLOW TIME FOR THE EXCHANGE RATE CHANGES TO HAVE THEIR EFFECT ON TRADE IMBALANCES IS EQUALLY IMPORTANT NOW.

THE FINANCIAL MARKETS WERE SURPRISINGLY SLOW TO WAKE UP TO THE IMBALANCES IN THE WORLD ECONOMY.

BUT HAVING DONE SO, THEY HAVE SHOWN SIGNS OF IMPATIENCE AT THE SLOWNESS OF THE ADJUSTMENT.

IN FACT IMPORTANT CHANGES ARE TAKING PLACE.

ALTHOUGH THE PUBLISHED US TRADE DEFICIT HAS SHOWN VERY LITTLE IMPROVEMENT SO FAR THE VOLUME FIGURES HAVE MOVED VERY SUBSTANTIALLY: IN THE YEAR TO THE THIRD QUARTER OF

1987, EXPORTS HAD RISEN BY 15 PER CENT, WHEREAS IMPORTS WERE UP BY ONLY 6 PER CENT.

AS MANY OF US HAD WARNED, THERE WAS BOUND TO BE A LAG BEFORE THESE DEVELOPMENTS FED THROUGH TO THE CURRENT ACCOUNT - THIS IS THE WELL KNOWN J-CURVE.

AND REPEATED DOLLAR DEPRECIATIONS, SO FAR FROM SPEEDING UP THE ADJUSTMENT OF THE CURRENT ACCOUNT, CAN ONLY ADD TO THE LENGTH OF THE J-CURVE.

THIS IS PARTICULARLY THE CASE IF, AT THE SAME TIME, DOMESTIC ACTIVITY IS NOT ADEQUATELY REINED BACK.

LOOKING FORWARD TO THE PROSPECTS FOR 1988, IT IS CLEAR THAT THERE REMAIN VERY REAL RISKS IN THE OUTLOOK FOR THE WORLD ECONOMY.

WHILE THERE IS NO IMMEDIATE PROSPECT OF RECESSION, THE SUBSTANTIAL DOLLAR DEPRECIATION COULD LEAD TO SERIOUS INFLATIONARY PRESSURES IN THE UNITED STATES.

AND THERE STILL REMAINS THE THREAT OF CREEPING PROTECTIONISM, WHICH COULD AT ANY TIME ESCALATE INTO A TRADE WAR.

BUT THE CURRENT STRENGTH OF THE WORLD ECONOMY, WHICH I ILLUSTRATED EARLIER, DOES GIVE US A BREATHING SPACE IN WHICH TO GET THE WORLD ECONOMY ONTO A MORE SUSTAINABLE FOOTING.

SOME OF THE NECESSARY STEPS HAVE ALREADY BEEN TAKEN.

MORE ACTION NEEDS TO FOLLOW.

WE MUST GET THE RIGHT POLICIES IN PLACE, AND PURSUE THEM WITH PATIENCE AND DETERMINATION - BECAUSE THERE ARE BOUND TO BE PERIODS OF DIFFICULTY WHICH WE SHALL HAVE TO RIDE OUT.

PROVIDED WE CAN DO THAT, ALTHOUGH THERE MAY BE SOME SLOWDOWN IN WORLD ECONOMIC GROWTH, I AM CONFIDENT WE CAN AVOID THE TWIN DANGERS OF INFLATION AND RECESSION.

UK Economy

CLEARLY, WE IN BRITAIN CANNOT WHOLLY INSULATE OURSELVES FROM DEVELOPMENTS OVERSEAS, AND WE SHOULD NOT IMAGINE OTHERWISE.

BUT SUBJECT TO THOSE INEVITABLE UNCERTAINTIES, IT IS CLEAR THAT THE BRITISH ECONOMY IS WELL PLACED TO CONTINUE THE EXCELLENT PROGRESS OF RECENT YEARS IN SPITE OF THE PROBLEMS FACED BY OTHER COUNTRIES AND THE TURBULENCE IN THE FINANCIAL MARKETS.

BRITAIN'S STRENGTH IS CLEAR TO THE OECD, WHICH FORECASTS THAT IN 1988 WE SHALL ONCE AGAIN BE AMONG THE FASTEST GROWING OF THE MAJOR INDUSTRIAL NATIONS.

IT IS CLEAR TO THE MANY THOUSANDS OF COMPANIES FROM OVERSEAS WHICH ARE COMING TO INVEST IN BRITAIN.

IT IS CLEAR TO THOSE WHO RUN INDUSTRY - TAKE, FOR EXAMPLE, THE AMERICAN CHAIRMAN OF BRITISH OXYGEN, MR RICHARD GIORDANO, WHO SAID LAST YEAR:

"IN THE LAST HALF DOZEN YEARS BRITAIN HAS DONE A PRETTY GOOD JOB.

IF I WAS A COMPANY HAVING TO SET UP IN EUROPE, IT IS
BRITAIN I WOULD CHOOSE."

AND IT IS CLEAR OF COURSE, TO THE BRITISH PEOPLE, AS
THEY DEMONSTRATED IN THE GENERAL ELECTION EIGHT MONTHS
AGO.

IN FACT THE STRENGTH OF THE ECONOMY IS CLEAR TO
EVERYBODY EXCEPT TO THE OPPOSITION IN THIS HOUSE.
THEIR PROBLEM IS THAT THEY ARE SO WEDDED TO LIVING IN THE
PAST THAT THEY CANNOT ACCEPT THAT THE POLICIES WE ARE
FOLLOWING, WHICH ARE PRECISELY THE REVERSE OF THOSE THEY
FOLLOWED WHEN THEY WERE IN OFFICE, CAN POSSIBLY HAVE LED
TO SUCCESS.

WHEN IT BECAME CLEAR THAT GROWTH IN 1987 WAS MOVING WELL
AHEAD OF THE ALREADY STRONG TREND OF THE PAST FIVE YEARS,
THE OPPOSITION PUT IT DOWN TO A SHORT-LIVED PRE-ELECTION
BOOM.

THE HM FOR DAGENHAM SPOKE LAST FEBRUARY OF THE "IRRESPONSIBLE AND PROFLIGATE SPENDING BOOM WHICH THE CHANCELLOR HOPES WILL SWEEP HIM TO A GENERAL ELECTION VICTORY".

I HAVE TO TELL HIM AND HIS HFs THAT GROWTH IN THE PERIOD SINCE THE GENERAL ELECTION HAS, IF ANYTHING, BEEN STRONGER THAN BEFORE, AND FURTHER NON-OIL GROWTH - LESS RAPID THAN IN 1987, BUT IN EXCESS OF ANYTHING EVER ACHIEVED UNDER THE LAST LABOUR GOVERNMENT - SEEMS LIKELY IN 1988.

THE OPPOSITION PUT THE ALLEGED PRE-ELECTION BOOM DOWN TO HIGHER CONSUMER SPENDING.

AGAIN, THEY ARE BARKING UP THE WRONG TREE.

GROWTH IN 1987 WAS STRONGER THAN IN 1986 BECAUSE INVESTMENT GROWTH PICKED UP AND EXPORTS INCREASED MORE RAPIDLY THAN IN THE PREVIOUS YEAR, IN THE AFTERMATH OF THE OIL PRICE COLLAPSE.

THE OPPOSITION ALSO CLAIMED THAT THIS SO-CALLED PRE-ELECTION BOOM WOULD BE INSTANTLY REVERSED.

IN THE LAST AUTUMN STATEMENT DEBATE, THE RHM FOR SPARKBROOK MADE ONE OF HIS JUSTLY NOTORIOUS PREDICTIONS:

"AN ELECTION VICTORY WOULD BE FOLLOWED BY A MASSIVE INCREASE IN TAXATION",

HE ALLEGED.

AND HE WENT ON:

"THERE WOULD BE MORE PUBLIC EXPENDITURE CUTS."

HE HAS NOW HAD HIS ANSWER ON PUBLIC EXPENDITURE, IN THE CLEAREST POSSIBLE TERMS, WITH THE SUBSTANTIAL INCREASES ANNOUNCED IN THE AUTUMN STATEMENT.

WHETHER HE WAS RIGHT OR WRONG ABOUT TAXATION, OF COURSE, REMAINS TO BE SEEN: BUT HE WILL ONLY HAVE TO WAIT ANOTHER TWO MONTHS NOW, UNTIL 15 MARCH, FOR THE MASSIVE INCREASE IN TAXATION HE SO CONFIDENTLY PREDICTED. ~~IF,~~

IN DEBT, THERE IS ONE.

MEANWHILE, HAVING WARNED OF A DANGEROUS BOOM, THE OPPOSITION HAVE NOW REVERTED TO THEIR NORMAL CRY THAT HIGHER BORROWING AND LOWER INTEREST RATES - AN UNLIKELY COMBINATION, IF EVER THERE WAS ONE - ARE NEEDED TO STAVE OFF IMPENDING RECESSION.

IT WAS ONCE SAID THAT WALL STREET HAD CORRECTLY FORECAST THIRTEEN OUT OF THE LAST FIVE RECESSIONS. THE OPPOSITION HAVE DONE BETTER. THEY HAVE PREDICTED RECESSION IN EACH AND EVERY ONE OF THE LAST SIX YEARS, AND IT HAS NOT HAPPENED ONCE.

THE TROUBLE IS THAT ALL THE OLD BELIEFS THAT THEY HAVE CLUNG TO IN SPITE OF THE ACCUMULATING EVIDENCE, ARE BEING FINALLY AND DEFINITELY DISPROVED. THEY BELIEVE THAT ECONOMIC GROWTH DEPENDS ON EVER HIGHER PUBLIC SPENDING, PAID FOR BY HIGHER BORROWING AND HIGHER TAXES AND ON EASY MONEY. THEY SHOULD LOOK AT WHAT HAS HAPPENED IN 1987.

PUBLIC BORROWING, EVEN LEAVING ASIDE PRIVATISATION PROCEEDS, LOOKS LIKE TURNING OUT AT THE LOWEST LEVEL SINCE 1970-71.

INTEREST RATES, AS THEY THEMSELVES POINT OUT ARE IF ANYTHING ABOVE THE INTERNATIONAL AVERAGE.

AND WE HAVE SEEN THE STRONGEST PERIOD OF SUSTAINED GROWTH SINCE THE WAR.

FOR SOME TIME, THE OPPOSITION JUSTIFIED THEIR ATTACHMENT TO HIGHER BORROWING BY REFERENCE TO THE EXPERIENCE OF THE UNITED STATES.

*31
JL
1984*
THIS SHOWS HOWS LOW BORROWING URGING
~~THE RHM~~ THE LEADER OF THE OPPOSITION ~~URGED~~ THE GOVERNMENT TO BORROW ON A MASSIVE SCALE, SAYING:

"THEY CANNOT EVEN SEE THE LESSON OF THE UNITED STATES ECONOMY WHEN IT IS STARING THEM IN THE FACE".

(GOT THE LESSON WRONGS.
IT IS NOW ALL TOO CLEAR WHO ~~LEARNT THE WRONG LESSON.~~

WITH HIS UNERRING INSTINCT FOR BACKING A LOSER, THE RHM MADE THE KEYSTONE OF HIS PARTY'S ECONOMIC POLICY WHAT HAS TURNED OUT TO BE THE AMERICANS' UNDOING - AN EXCESSIVE BUDGET DEFICIT.

RT. HON. AND HON. MEMBERS OPPOSITE COMPLETELY FAILED TO APPRECIATE THE REAL REASONS FOR THE RAPID CREATION OF NEW JOBS IN THE US.

THEY IGNORED THE ROLE PLAYED BY THE LOW TAX BURDEN.

THEY IGNORED THE IMPORTANCE OF LABOUR MARKET FLEXIBILITY AND LOW WAGE INCREASES, WHICH CONTRIBUTE SO MUCH TO THE FACT THAT UNEMPLOYMENT IN THE UNITED STATES IS LOWER THAN IN ANY MAJOR COUNTRY IN WESTERN EUROPE.

THEY COMPLETELY FAILED TO APPRECIATE THE IMPORTANCE OF DEREGULATION, AND THE ENTERPRISE ECONOMY.

AS USUAL THEY GOT THE WRONG END OF EVERY STICK.

THE SHORT POINT IS THIS.

A SUCCESSFUL ECONOMY CANNOT BE CREATED BY THE GOVERNMENT PUMPING IN MONEY.

IT DEPENDS ON THE PERFORMANCE OF BUSINESSES AND THE INDIVIDUALS WHO WORK IN THEM.

THAT IS WHAT LED TO THE OUTSTANDING PERFORMANCE IN 1987. THAT IS WHAT HAS GIVEN US AN UPSWING OF UNPRECEDENTED LENGTH, STRENGTH, AND STEADINESS.

AND THAT IS WHAT ENABLES US TO LOOK FORWARD TO THE FUTURE WITH CONFIDENCE.

THE MOST TELLING EXAMPLE OF THE TRANSFORMATION IN BRITISH INDUSTRY IS MANUFACTURING.

THE OPPOSITION, OF COURSE, PAINT A GLOOMY PICTURE OF BRITISH MANUFACTURING, AS AN INDUSTRY IN TERMINAL DECLINE, IN CONTRAST TO AN ALLEGED GOLDEN AGE UNDER THEIR STEWARDSHIP.

NOTHING COULD BE FURTHER FROM THE TRUTH.

THE PLAIN FACT IS THAT MANUFACTURING OUTPUT FELL OVER LABOUR'S PERIOD IN OFFICE WHEREAS IT HAS RISEN DURING OURS.

BUT THE CONTRAST GOES FAR BEYOND THAT.

THE UNDERLYING STRENGTH OF BRITISH MANUFACTURING INDUSTRY HAS BEEN TRANSFORMED.

~~UNLESS A BUSINESS MAKES PROFITS, IT CANNOT POSSIBLY PRODUCE MORE GOODS OR CREATE JOBS.~~

BRITAIN'S MANUFACTURERS HAVE INCREASED THEIR PROFITABILITY FOR FIVE YEARS IN SUCCESSION, THE BEST PERFORMANCE FOR A GENERATION.

~~AND THEY HAVE ACHIEVED THIS BY MAKING RADICAL IMPROVEMENTS IN EFFICIENCY.~~

~~HELD BACK BY RESTRICTIVE PRACTICES AND OVER-MANNING, MANUFACTURING PRODUCTIVITY INCREASED BY BARELY 1 PER CENT A YEAR UNDER LABOUR.~~

~~SINCE 1979, IT HAS RISEN MORE THAN FOUR TIMES AS FAST.~~

LAST JANUARY, THE RHM FOR MONKLANDS EAST SAID:

"WE WANT INCREASED PRODUCTIVITY IN AN EXPANDING INDUSTRIAL ECONOMY".

THAT IS PRECISELY WHAT WE HAVE SEEN.

IN THE PAST, STRONG GROWTH OF THE KIND WE HAVE SEEN, WOULD UNDOUBTEDLY HAVE QUICKLY FED THROUGH INTO MUCH HIGHER INFLATION.

IN FACT ALTHOUGH PRICES IN 1987 ROSE SOMEWHAT FASTER THAN IN THE PREVIOUS YEAR, AS THE ONE-OFF BENEFIT OF THE OIL PRICE FALL WAS LOST INFLATION HAS REMAINED LOW THROUGHOUT THE YEAR.

AT THE SAME TIME, UNEMPLOYMENT FELL RAPIDLY.

TODAY'S FIGURES SHOW THAT, DURING 1987 AS A WHOLE THE NUMBER OF PEOPLE OUT OF WORK FELL BY OVER HALF A MILLION, THE BIGGEST FALL ON RECORD WITH THE RATE FALLING FAR FASTER THAN IN ANY OTHER MAJOR COUNTRY OVER THE SAME PERIOD.

IN THE AUTUMN STATEMENT, I FORECAST THAT GROWTH IN 1988 WOULD BE 2½ PER CENT FOR THE ECONOMY AS A WHOLE, WITH THE NON-OIL ECONOMY GROWING AT 3 PER CENT.

I SHALL, OF COURSE, BE MAKING ANOTHER FORECAST IN THE BUDGET AND I DO NOT INTEND TO MAKE ONE TODAY.

BUT ON THE QUESTION OF THE NON-OIL ECONOMY, WHICH IS CRITICAL FOR NEW JOBS LET ME JUST SAY THIS.

GROWTH OF 3 PER CENT FOR THE NON-OIL ECONOMY IN 1988 WOULD BE A THOROUGHLY CREDITABLE PERFORMANCE.

THE LABOUR GOVERNMENT NEVER ONCE ACHIEVED 3 PER CENT GROWTH, WITH OR WITHOUT OIL.

INDEED, IT WAS ONLY ACHIEVED ONCE IN THE WHOLE OF THE 1970s.

BUT WE HAVE ACHIEVED THAT RATE IN FOUR OUT OF THE LAST FIVE YEARS.

KEEPING THE ECONOMY ON TRACK INVOLVES KEEPING A CONSTANT WATCH ON ALL THE INDICATORS OF HOW THE ECONOMY IS DEVELOPING, AND THEN TAKING ACTION AS NECESSARY.

I HAVE NEVER HESITATED TO ACT IN THE PAST WHEN I HAVE JUDGED THAT THERE WAS A RISK TO OUR INFLATION OBJECTIVES. I CAN ASSURE THE HOUSE THAT I SHALL NOT HESITATE TO DO SO IN FUTURE.

IT IS ~~ONLY~~ ^{PROMPTLY} BY ACTING PROMPTLY THAT WE HAVE BEEN ABLE TO AVOID THE NEED FOR DRASTIC AND DESTABILISING LURCHES IN POLICY.

OUR TRACK RECORD SPEAKS FOR ITSELF.

PART OF THE JOB OF KEEPING THE ECONOMY ON TRACK INVOLVES MAINTAINING A REASONABLY STABLE EXCHANGE RATE, PARTICULARLY AGAINST THE DEUTSCHMARK.

THAT NOT ONLY MEANS THAT BUSINESSES KNOW WHERE THEY STAND: IT ALSO ACTS AS A FIRM ANCHOR AGAINST INFLATION. FOR MUCH OF 1987, THIS MEANT RESISTING UPWARD PRESSURE ON STERLING.

BUT AS I EXPLAINED TO THE CBI ANNUAL DINNER LAST MAY, AND AS THE GOVERNOR REAFFIRMED LAST WEEK, IT WOULD EQUALLY MEAN RESISTING SIGNIFICANT DOWNWARD PRESSURE, IF THAT WERE TO EMERGE.

CONCLUSION

MR SPEAKER WE ENTER 1988 WITH THE BRITISH ECONOMY IN GOOD SHAPE, AND THE PUBLIC FINANCES SOUNDER THAN AT ANY TIME SINCE THE WAR.

THAT IS NO COINCIDENCE.

WHEN WE CAME TO OFFICE IN 1979, WE GAVE THE HIGHEST PRIORITY TO RESTORING THE PUBLIC FINANCES TO A SOUND AND SUSTAINABLE CONDITION.

THAT IS ONE OF THE ROCKS ON WHICH THE NEW STRENGTH OF THE ECONOMY HAS BEEN BUILT.

THANKS TO THAT ACHIEVEMENT, WE HAVE BEEN ABLE TO CHOOSE, FREELY, TO INCREASE PUBLIC SPENDING, ESPECIALLY IN

PRIORITY AREAS, WHILE CONTINUING TO REDUCE OVERALL PUBLIC SPENDING AS A SHARE OF GDP.

AND UNLIKE THE OPPOSITION WHEN THEY WERE IN OFFICE, WE HAVE BEEN ABLE TO SUSTAIN OUR POLICY, YEAR IN, YEAR OUT.

THE OPPOSITION, OF COURSE, ARE BRIM-FULL OF IDEAS FOR SPENDING EVER HIGHER AMOUNTS OF THE TAXPAYER'S MONEY.

BUT THE PLAIN FACT IS THAT HAD THEIR POLICIES BEEN IMPLEMENTED, THE MONEY SIMPLY WOULD NOT HAVE BEEN THERE IN THE FIRST PLACE.

IT WAS CERTAINLY NOT THERE IN THE 1970s, AND IT WOULD NOT HAVE BEEN THERE IN THE 1980s.

THE AUTUMN STATEMENT WHICH WE ARE DEBATING TODAY, MY FIRST IN THIS PARLIAMENT, EMBODIES THE CONSISTENT STRATEGY THAT WE HAVE PURSUED SINCE 1979.

I COMMEND IT TO THE HOUSE.

PWP



Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

15 January 1988

The Editor
Official Report
House of Commons
London

Dear Sir,

**CHANCELLOR OF THE EXCHEQUER'S SPEECH IN AUTUMN STATEMENT DEBATE,
14 JANUARY**

... I enclose copies of some pages of the Chancellor's speech in yesterday's debate, with a handful of corrections marked. I should be grateful if you could make these for the bound volume.

The third point of column 472 is more than stylistic. I realise that you do not like beginning sentences with "yet" or "but". But the "yet" at the start of the final sentence of that paragraph refers not only to interest rates but also to public borrowing, so not to start a new sentence actually changes the sense.

... I enclose also a copy of column 436, where there is one printing error.

Yours sincerely,

Andrew Hudson

A P HUDSON

[Mr. Lawson]

prior to the stock market collapse was in fact markedly stronger than had earlier been recognised. So any slowdown there may be this year will be from a pretty vigorous momentum of growth.

It is now clear that activity picked up markedly during the course of 1987. Taking the seven major industrialised countries as a whole, output in the third quarter of the year was more than 3 per cent. higher than a year earlier, with industrial production in October more than 4 per cent. up. In the United States, industrial production in the third quarter of 1987 was 5 per cent. up on a year earlier, and unemployment reached its lowest level since 1979. Japan, the world's second largest economy, which had earlier been a little sluggish, began to move ahead briskly, with industrial production at the latest count some 8 per cent. higher than a year ago. The United Kingdom, as I indicated in the Autumn Statement, looks to have enjoyed 4 per cent. growth over last year as a whole, with again the third quarter stronger than the first two. The Canadian economy, too, is buoyant. It is only the performance of continental Europe, and particularly Germany, which remains disappointing, though even there modest growth is continuing.

Thus, overall, world growth has been proving extremely robust. However, the serious imbalances in the world economy remain.

At the heart of those imbalances lies the huge structural budget deficit in the United States. That is particularly damaging, not just because of the enormous size of the United States economy, but because the Americans, with their low propensity to save, have proved wholly unable to finance the deficit entirely from domestic savings. This means, inevitably, that the United States requires large capital inflows from overseas, with the counterpart, so long as this state of affairs persists, of a large current account deficit.

For years, there were calls for the United States to reduce its budget deficit—except, I have to say, from the Opposition Front Bench, which urged us to emulate it. But not nearly enough progress was made, not least because of the difficulty of reaching any sort of agreement between the Administration and the Congress on how to go about it. Indeed, I was interested to see that President Reagan himself said earlier this week:

"That deficit is an embarrassment and a shame—most dangerous, perhaps, because it signals the complete breakdown of one of the most basic functions of the United States Government."

There has now been some encouraging progress, with the legislation passed just before Christmas to reduce the deficit, relative to the level it would otherwise have been, by \$30 billion for 1988 and \$45 billion for 1989. But these steps, welcome though they are, will not be sufficient, by themselves, to reduce the deficit to a tolerable level.

It has been clear for some time that the reduction of the other set of imbalances—the current account imbalances—will depend on domestic demand in the United States growing more slowly than that in Japan and Germany for some years to come. One of the prime objectives of the major industrialised countries, meeting together in the Group of Seven, has been to achieve this in an orderly way. The United States action, and the decision of the German authorities to reduce their key discount rate from 3 per

cent. to 2½ per cent., the lowest rate they have had since the war, are helpful steps, and paved the way for the G7 communiqué issued on 23 December.

That communiqué also re-emphasised the agreement to co-operate to foster exchange rate stability, following a period of turbulence on the foreign exchanges which had seen a further slide in the dollar.

Wild gyrations in exchange rates can create grave uncertainty, and damage business confidence throughout the world. Companies in all countries find it more difficult to plan for the future, and have to spend precious time, money and ingenuity on insuring themselves against exchange rate risks, when they should be concentrating on the real job of improving company performance. That is one of the main reasons why the CBI, for example, has stressed the importance to its members of a stable exchange rate.

It is thus natural that countries should seek to act together to prevent excessive exchange rate volatility. Moreover, history has shown that a readiness by countries to commit themselves to some form of exchange rate stability is the only feasible way of securing wider international co-operation on economic policy.

Mr. Stuart Holland (Vauxhall): I am most grateful to the Chancellor for giving way. There is a paradox in what he is saying. He is talking about robust economic growth, which he is extrapolating from one quarter's figures for several countries, before the stock market crash. What are his comments on the OECD forecast for a slow-down in European OECD countries to 1.5 per cent. of GDP by 1989? Does he recognise that United States growth will have slowed down from about 3 per cent. a year in 1985 to not much more than 1.5 per cent. in 1989?

While exchange rate stability is an objective in itself, it is the volume effect on demand for United States exports that will be crucial. What action will the Chancellor take, with other Finance Ministers, to get spending going in the global economy, which is the real basis for the recovery of the United States' trade and payments deficit?

Mr. Lawson: Clearly I should not have given way to the hon. Gentleman.

Mr. Holland: Answer the question.

Mr. Lawson: As I have said on a number of occasions, there is likely to be some slowing down of world economic growth this year but it is a slowing down from a considerably higher level than was earlier recognised—the level in 1987. Far from there being any of the dangers that the hon. Member for Vauxhall (Mr. Holland) mentioned, the policies he advocates would simply lead to a resurgence of inflation.

If countries are indeed prepared to accept wholeheartedly the exchange rate commitments to which I was referring before that rather lengthy and inconsequential intervention, they will find themselves obliged to pursue domestic policies which are consistent with their exchange rate objectives. That applies most obviously to monetary policy, though fiscal policy also has a vital supporting role, particularly over the medium term. It is, however, an academic dream, divorced from reality, to imagine that sovereign states will be persuaded into consistent domestic policies simply by a process of careful international analysis and discussion.

Of course, countries may choose at any time to ignore the implications of the exchange rate arrangements they

[Mr. Lawson]

the excellent progress of recent years in spite of the problems faced by many other countries and the turbulence in the financial markets.

Dr. Jeremy Bray (Motherwell, South): The Chancellor has emphasised the importance of exchange rate stability; he has emphasised the dependence of exchange rates upon the fundamentals, but he has said that it is not realistic to expect different Governments to agree about wider economic matters within their domestic economies. Can he reconcile those three statements?

Mr. Lawson: Yes, indeed. This has been the lesson of history. What I said was that the wider co-operation that has occurred has been a result of the acceptance by the major countries of an external discipline. The gold standard was a good example; it operated successfully for a long time. That is the point which I was seeking to make, and am I sorry that the hon. Gentleman failed to understand it.

Britain's strength is clear to the OECD, which forecasts that in 1988 we shall once again be among the fastest growing of the major industrial nations.

It is clear to the many thousands of companies from overseas which are coming to invest in Britain. It is clear to those who run industry—take, for example, the American chairman of British Oxygen, Mr. Richard Giordano, who said last year:

"In the last half dozen years, Britain has done a pretty good job. If I was a company having to set up in Europe, it is Britain I would choose."

And it is clear, of course, to the British people, as they demonstrated in the general election only eight months ago.

In fact, the strength of the economy is clear to everybody except to the Opposition in this House. Their problem is that they are so wedded to living in the past that they cannot accept that the policies we are following, which are precisely the reverse of those they followed when they were in office, can possibly have led to the success we see around us.

When it became clear that growth in 1987 was moving well ahead of the already strong trend of the past five years, the Opposition put it down to a short-lived pre-election boom. I am sorry that the hon. Member for Dagenham (Mr. Gould) is not here. Being of New Zealand origin he may, I hope, have gone back to his native land to learn an excellent lesson from the policies being pursued by the Labour Government in New Zealand. They could certainly teach him a lot. Anyhow, last February he spoke of the

"irresponsible and profligate spending boom which the Chancellor hopes will sweep him to a general election victory".—[*Official Report*, 18 February 1987; Vol. 110, c. 942.]

I am glad that the Opposition accept that we had a sweeping victory. I have to tell the hon. Member for Dagenham and his hon. Friends that growth in the period since the general election has, if anything, been stronger than it was before the election, and further non-oil growth—less rapid than in 1987, but still in excess of anything ever achieved under the Labour Government—seems likely in 1988.

The Opposition put the alleged pre-election boom down to higher consumer spending. Again, they are barking up the wrong tree. Growth in 1987 was stronger

than in 1986 precisely because investment growth picked up and exports increased more rapidly than in the previous year, in the aftermath of the oil price collapse.

The Opposition also claimed that this so-called pre-election boom would be instantly reversed. In the last Autumn Statement debate, which I looked at just before coming to the Chamber, the right hon. Member for Birmingham, Sparkbrook (Mr. Hattersley) made one of his justly notorious predictions:

"An election victory would be followed by a massive increase in taxation".

he alleged. He went on:

"There would be more public expenditure cuts."—[*Official Report*, 17 December 1986; Vol. 107, c. 1253.]

He has now had his answer on public expenditure in the clearest possible terms, with the substantial increases announced in the Autumn Statement. Whether he was right or wrong about taxation, of course, remains to be seen, but he will only have to wait now for another two months, until 15 March, for the massive increase in taxation which he so confidently predicted, if indeed there is one.

Meanwhile, having warned of a dangerous boom, the Opposition have now reverted to their normal cry that higher borrowing and lower interest rates—an unlikely combination, if ever there was one—are needed to stave off impending recession.

It was once said that Wall Street had correctly forecast 13 out of the last five recessions. The Opposition have done even better, because they predicted recession in each and every one of the last six years, and in each and every case they have been wrong.

The trouble is that all the old beliefs that they have clung to, in spite of the accumulating evidence, are being finally and definitively disproved. They believe that economic growth depends on ever higher public spending, paid for by higher borrowing and higher taxes, and on easy money. They should look at what happened last year. Public borrowing, even leaving aside privatisation proceeds, looks like turning out at the lowest level since 1970-71. Interest rates, as the Opposition themselves point out, are, if anything, a little above the international average. Yet we have seen the strongest period of sustained growth since the war.

For some time the Opposition justified their attachment to higher borrowing by reference to the experience of the United States. The whole House, and certainly my hon. Friends, will recall the right hon. Member for the Opposition urging the Government to borrow on a massive scale and saying:

"They cannot even see the lesson of the United States economy when it is staring them in the face".—[*Official Report*, 31 July 1984; Vol. 65, c. 236.]

It is now all too clear who got the wrong lesson. With his unerring instinct for backing a loser, the right hon. Member made the keystone of his party's economic policy what has turned out to be the American undoing—an excessive budget deficit.

Right hon. and hon. Members of the Opposition completely failed to appreciate the real reasons for the rapid creation of new jobs in the United States. They ignored the role played by the low tax burden. They ignored the importance of labour market flexibility and low wage increases, which contribute so much to the fact that unemployment in the United States is lower than in any major country in western Europe. They completely

ed to appreciate the importance of deregulation and of the enterprise economy. As usual they got the wrong end of every stick.

The short point is this. A successful economy cannot be created by the Government pumping in money. It depends on the performances of businesses and the individuals at all levels who work in them. That is what led to the outstanding performance in Britain in 1987. That is what has given us an upswing of unprecedented length, strength and steadiness. That is what enables us to look forward to the future with confidence.

The most telling example of the transformation in British industry is to be found in manufacturing. The Opposition, of course, always paint a gloomy picture of British manufacturing as an industry in terminal decline, in contrast with what they allege to have been a golden age under their stewardship. Nothing could be further from the truth, and I will give the figures for 1979.

The plain fact is that manufacturing output fell over Labour's period in office whereas during our whole period of office since 1979 it has risen. But the contrast goes far beyond that, because the underlying strength of British manufacturing industry has been transformed. Britain's manufacturers have increased their profitability for five years in succession, the best performance for a generation.

Does the right hon. and learned Gentleman the Member for Monklands, East (Mr. Smith) wish to intervene? He will have his chance in a moment, anyway.

Mr. John Smith: I thank the right hon. Gentleman for encouraging me to ask the obvious question. He said that he wanted to be judged by output. Can he tell us by how much manufacturing output has increased since 1979, after eight years of Conservative Government?

Mr. Lawson: The point that I am making is such a simple one that even the right hon. and learned Member ought to understand it. It is that during the whole of the Opposition's period of office manufacturing output fell, and during the whole of our period in office it has risen. That is clear to everybody, even the right hon. and learned Gentleman.

In the past, strong growth of the kind we have seen would undoubtedly have quickly fed through into much higher inflation. In fact, although prices in 1987 rose somewhat faster than in 1986, as the one-off benefit of the oil price fall was lost, inflation remained low throughout the year. At the same time unemployment fell rapidly. Today's figures—which I am sure the right hon. and learned Member for Monklands, East will want to welcome as soon as he gets up to speak—show that during 1987 as a whole the number of people out of work fell by more than half a million—the biggest fall on record, with the rate falling far faster than in any other major country over the same period.

In the Autumn Statement, I forecast that growth in 1988 would be 2½ per cent. for the economy as a whole, with the non-oil economy growing at 3 per cent. I shall, of course, be making another forecast in the Budget and I do not intend to make one today. However, on the question of the non-oil economy, which is critical for new jobs, let me just say this. Growth of 3 per cent. for the non-oil economy in 1988, although slower than last year, would be a thoroughly creditable performance. The Labour Government never once achieved 3 per cent. growth, with

or without oil. Indeed, it was only achieved once in the whole of the 1970s, yet we have achieved that rate of growth in four out of the last five years.

Keeping the economy on track involves keeping a constant watch on all the indicators of how the economy is developing and then taking action as necessary. I have never hesitated to act in the past when I have judged that there was a risk to our inflation objectives. I can assure the House that I shall not hesitate to do so in future. It is precisely by acting promptly that we have been able to avoid the need for drastic and destabilising lurches in policy. Our track record speaks for itself.

We enter 1988 with the British economy in good shape and the public finances sounder than at any time since the war. That is no coincidence. When we came to office in 1979 we gave the highest priority to restoring the public finances to a sound and sustainable condition. That is one of the rocks on which the new strength of the economy has been built. Thanks to that achievement, we have been able to choose to increase public spending, especially in priority areas, while continuing to reduce overall public spending as a share of gross domestic product. Unlike the Opposition when they were in office, we have been able to sustain our policy year in, year out.

The Opposition, of course, are brimful of ideas for spending ever higher amounts of the taxpayer's money, and no doubt we shall hear more of them today. The plain fact is that, had their policies been implemented, the money simply would not have been there in the first place. It was certainly not there in the 1970s, and it would not have been there in the 1980s either.

The Autumn Statement which we are debating today, my first in this Parliament, embodies the consistent strategy that we have been pursuing since 1979. I commend it to the House.

4.48 pm

Mr. John Smith (Monklands, East): I beg to move, to leave out from "House" to the end of the Question and to add instead thereof:

'regrets that the Autumn Statement fails to provide adequate resources for the vital public services and the people who need them, particularly the National Health Service which consequently faces further under-funding next year, and, despite a deteriorating situation in the balance of trade and balance of payments and unsettled international economic relationships, does not propose measures to strengthen manufacturing industry and science and technology, promote vigorous regional development, or significantly reduce unemployment'.

I suppose that it is not unusual for this Chancellor of the Exchequer to dodge the main issue in the debate, but we should remind him that the debate is about the Autumn Statement. Although it is interesting to hear his views on the world economy and although it is important that we should discuss that matter, among other things, one would have expected a Chancellor of the Exchequer who had proposed the Autumn Statement—this is the first opportunity which the House has had formally to debate it—to defend and argue for the propositions contained in this crucial statement of the pattern of public expenditure. However, the Chancellor is fulfilling his promise that he would not say a word about it. He said that he would leave it to his right hon. Friend the Chief Secretary, who, of course, will be the last speaker in the debate, so there will be no opportunity for any hon. Member to hear the Government's views about the

agreement on anything significant. The statement at the end of December did not stabilise the markets until Governments intervened. The whole of OECD is now slowing down and the effects of cuts in the United States budget deficit will aggravate that. How on earth can the Government be confident that the United Kingdom economy will continue to grow when the rest of the world is slowing down? Why do they not hold a meeting of the G7 countries to meet those targets for recovery asked for by United States Treasury Secretary Baker last year?

Mr. Lilley: The G7 statement did help to stabilise financial markets.

Mr. Holland: Why did you intervene?

Mr. Lilley: We never comment on intervention by the British Government. If the hon. Gentleman believes statements that other countries were intervening, he can draw that inference from the G7 statement. We are reasonably confident that the British economy will do well in future because the policies that have brought us prosperity are precisely the policies needed in times of difficulty, if difficulty should arise.

The Opposition's response to the past three questions sounds rather like the Noel Coward song that bad times are just around the corner.

Mr. John Townend: Does my hon. Friend agree that, because of the twin deficits—the trade deficit and the federal deficit in America—America cannot continue to be the engine of the world's economy? Britain is playing its part; its high growth rate has resulted in a small balance of payments surplus. Does my hon. Friend think that the two surplus countries of Japan and Germany are doing enough to fill the gap left by America?

Mr. Lilley: My hon. Friend is quite correct. It is important that the surplus countries as well as the deficit countries play their part in removing the imbalances that have plagued the world economy. The Japanese economy is growing strongly in terms of domestic demand and we hope to see a strengthening of growth in Germany as well. My hon. Friend is right. The British economy has been the strongest growing major economy in the western world.

Mr. Beith rose—[*Interruption*].

Mr. Speaker: Order.

Mr. Beith: Do not the Chancellor's autumn forecasts depend on major corrections in the United States economy and on an expansion in domestic demand in West Germany and Japan? As that has been the subject of the Foreign Secretary's discussions with the Japanese Government, how can the Minister regard it as a fruitless subject for discussion?

Mr. Lilley: No country in the OECD sets quantitative targets for GDP growth; that was the basis of the question that I answered initially. The outlook in Japan is for quite strong domestic growth, which will contribute to the removal of imbalances between Japan and the United States, and that is something which I welcome. I also welcome the presence of the hon. Member for Berwick-on-Tweed (Mr. Beith) today. I was sorry that he was not in the Select Committee yesterday when we were discussing, among other matters, VAT. We would have been interested to hear his views on where he would apply it.

Mr. Soames: Does my hon. Friend agree that growth within the OECD is inextricably linked to free trade? Will

he assure the House that, together with our OECD partners, we shall do all that we can to promote free trade with Japan?

Mr. Lilley: My hon. Friend has hit on one of the most important aspects of the future of the western economy. We must resist all pressures to move towards protectionism. Free trade brings prosperity to all partners and we are foremost in promoting it.

Civil Service (Information Management)

2. **Mr. Dalyell:** To ask the Chancellor of the Exchequer if he has issued any guidance on information management in the Civil Service, as a result of lessons learnt during and since the Westland affair; and if he will make a statement.

The Paymaster General (Mr. Peter Brooke): No, Sir.

Mr. Dalyell: I gave the Paymaster General's office four days' notice of my question in the hope of a considered reply. Does the Minister dispute that, given the enunciation by Sir Kenneth Clucas, who is a distinguished civil servant, on 4 January the Prime Minister put Sir Robert Armstrong in a very difficult position and that it was unethical for the Cabinet Secretary to embark on an inquiry to which he knew the answer before he started?

Mr. Brooke: I have nothing to add to what has already been said by my right hon. Friend the Prime Minister, and other Ministers, in statements and in reply to questions.

Mr. Marlow: Is my right hon. Friend satisfied that the system of information control within the Civil Service is sufficiently robust to prevent the leaking of unauthorised information to the hon. Member for Linlithgow (Mr. Dalyell)? If not, will he do something about it?

Mr. Brooke: I think that my hon. Friend will agree that his question had a rhetorical purpose, and that rhetorical purpose was caught.

Inflation

3. **Mr. Bill Walker:** To ask the Chancellor of the Exchequer if he will make a statement on the latest outlook for inflation.

The Chancellor of the Exchequer (Mr. Nigel Lawson): The forecast in the Autumn Statement was that inflation would be 4½ per cent. in the fourth quarter of 1988. I shall present a new forecast at Budget time in the usual way.

Mr. Walker: Can my right hon. Friend tell the House when was the last time the rate of growth exceeded the rate of inflation, as it did in the third quarter of last year? Can he also confirm that low prices are good for competition, jobs and the economy?

Mr. Lawson: My hon. Friend is absolutely correct in pointing to the central importance of keeping inflation low for the strength of the economy. The very good performance of the British economy in all aspects over the past few years has been achieved because we have put inflation at the forefront of our policies. As for the comparison that my hon. Friend made between the rate of inflation and the rate of growth, it is more valuable to look at the figures for a whole year than for a quarter. We have not had the final figures for 1987 yet, and will not have them for a little while, but it may well be that 1987 proves to have been the first year for a generation in which the rate of growth has exceeded the rate of inflation.



Handwritten signature

FROM: J J HEYWOOD
DATE: 3 March 1988

MR CULPIN

cc PS/Chancellor
PS/Chief Secretary
Sir P Middleton
Mr Monck
Mr Scholar
Mrs Lomax
Mr Eason IR
Mr Mace IR
Mr Farmer IR
Mr Cayley IR
Mr Spence IR
PS/IR

FINANCIAL SECRETARY'S SPEECH IN THE BUDGET DEBATES

The Financial Secretary has been giving some thought to the subjects he would wish to cover in his Budget Speech.

2. He would be grateful for chunks on the following subjects:

- (i) Wider Share Ownership Survey (1000 words): a section on the detailed results of the survey and a reference to Budget measures affecting PEPs, and employee share schemes (Mrs Lomax and Mr Farmer).
- (ii) Independent Taxation: (1000 words) analysing the case for reform and the virtues of the chosen route compared with alternative possibilities. The Financial Secretary would like to say something about the benefits of the reform to low-income married women and, in particular, to the elderly (FP and Mr Mace).
- (iii) CGT (500 words) on the rationale for the reform and the consequences, perhaps drawing on the IFS' recent work (FP, FIM and Mr Cayley).

BUDGET SECRET: TASK FORCE LIST

- (iv) Lloyd's (200 words): a section on the changes (Mr Spence).
- (v) Forestry (200 words): a section on the changes (Mr Monck).

3. Do you have any further suggestions?

J.H.W.

JEREMY HEYWOOD
Private Secretary

BUDGET SECRET: TASK FORCE LIST