

MR. WALTERS

c.c. Mr. Wolfson
Mr. Ingham
Mr. Alexander ✓
Mr. Lankester

GEORGETOWN UNIVERSITY SPEECH

Thank you for showing me the draft of your speech for the Prime Minister, to give at Georgetown University next week. I have discussed it with Bernard Ingham, and I have seen Tim Lankester's minute of 12 February to you. You may find these further comments helpful.

This speech will inevitably be read for signs of flexibility or otherwise in the Government's pursuit of its economic strategy, and at present its tone is perhaps a little harsher in places than we need. On page 10, for instance, I think the phrase, "the cost of soldiering on seems frightfully high" is likely to be held against us, and over the page the formulation "we shall not yield" may be seen as unnecessarily defensive, perhaps even embattled, thus reinforcing the image already put across by Time magazine. Similarly, the phrase at the top of page 10, "there is no other way", will also be seen as an echo of "there is no alternative". The sort of approach which, without detracting in any sense from the substance, we have been moving towards, is to remind people that the previous Administration also found it necessary to adopt, albeit half-heartedly, a monetarist approach; and then to say that they succumbed to the temptation of giving up the fight and they cut and ran for false refuge.

The theme of economic freedom seems, if I may say so, an excellent one for this occasion, and Bernard Ingham has commented that he is sure it will go down well. I wonder if it would also be useful to incorporate a piece about some of the structural differences between the UK and US economies which constrain that freedom in our case, and encourage it in theirs - and the resulting resilience of the US economy to external shocks.

/ One of the main

One of the main differences between the two economies is, of course, the degree of dominance of the public sector. Your passages on pages 4-7 on the iniquities of the nationalised industries make powerful points - to which might be added the way they create strong union monopoly power - but they do seem to take up a rather high proportion of the speech given the low proportion of our successes in dealing with them.

I do not need to say that the inflation/unemployment argument on pages 8/9 has to be absolutely watertight in view of the reception given to the Prime Minister's speech in the economic debate on 5 February. The Sunday Times made a good point in saying that unemployment was only 1.4 per cent in 1966, after twenty years of demand management: should we make it clear that we are talking about more recent history?

Like Tim Lankester, we do not very much care for the reference to the "elimination of inflation". In the present political climate that sounds like a very hard line; more importantly, no-one has any expectation of achieving it. In the same spirit, I find the middle paragraph on page 9 unconvincing - surely we and most other countries have now grown to live with at least single figure inflation without losing our trust in either money or in institutions? The ability of people to adapt to cope with inflation always strikes me as being amazing: and the stronger point surely is the differential effects, hitting some people much harder than others.

A couple of details Bernard Ingham has picked up: it might be best to say that the Prime Minister agrees with President Reagan, rather than that Reagan "is absolutely right"; and the reference at the top of page 6 to "sterling's new peaks" is not entirely clear given sterling's fluctuations over the last ten years.

/ Finally,

Finally, two more constructive points: could we not make mention of the other leg of the strategy, namely improving the supply side of the economy, and specifically improving the operation of the labour market - that might well be of particular interest to an American audience? That could also be a peg on which to hang the other thing that I would be inclined to put in this speech, which is an approving quote of President Reagan. There was a good piece, for instance, in his inaugural speech about "unleashing the energy and individual genius of man", which might appeal to the Prime Minister.

If I can be of any further help - constructing the Prime Minister's economic speeches is sometimes a time-consuming process, and my time may be more easily made available than yours - please let me know.

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v.

16 February 1981

W. R.
H. S.
MR WALTERS

FILE

R.H.

cc:- Mr Alexander
Mr Wolfson

Thank you for your minute of 9 February with which you enclosed a draft of the Georgetown speech. Here are some comments:-

Page 4, top paragraph. It might be worth adding, on incomes policies, they have always broken down with an explosion of earnings.

Page 4, paragraph 2. It would be worth mentioning the additional bureaucracy and cost to industry of conforming to price controls. Also, what was the actual effect on inflation of price controls? Practically zero, yet industry was still damaged because of the uncertainty which the controls produced and the administrative costs of complying with them.

Page 4, paragraph 3. Steel is not strictly a monopoly. It might be better to have a new final sentence - "They also nationalised most of the steel industry". You could also mention shipbuilding as one of the monopolies - though scarcely a "commanding height".

Page 5. I wonder if the structure could be improved a little here. You have gone through the failures of incomes policy, price control and nationalisation on the previous page. Rather than starting off with the elimination of exchange controls as the first "major achievement", I would suggest that you have paragraphs describing how we have got rid of incomes policy, got rid of price control and started to denationalise. This would then be followed by the exchange control paragraph, and you could add a sentence on the elimination of dividend control.

/Page 6, middle paragraph

Page 6, middle paragraph. It would be worth mentioning what privatisation we are doing - you might pick out examples from the attached list. You could then go on with the separate point about re-structuring. But on this, I am not sure it is quite right to call the re-structuring changes "dramatic": to a US audience (and indeed to a British audience) this epithet may sound a slightly hollow note coming in the wake of the huge extra spending on BL and BSC. It might be better simply to describe what is happening - e.g. we are seeing major improvements in productivity, and substantial capacity that cannot be competitive is being closed down.

Page 7, top paragraph. It would be worth mentioning explicitly that expenditure has gone up on account of the recession - although that is the implication of your draft.

Page 7, middle paragraph. I think the first sentence on the growth of public spending needs to be expanded a little. Can I suggest the following insert - "Although spending in the short run has been unavoidably increased because of the recession, we are the first Government in the UK since the War to be planning on an absolute reduction in public spending during our term of office."

~~But~~ I do not think the second sentence of that same paragraph is quite right when you say that "We have developed new systems of cash limits control ..." In fact, the present system is no different from what was inherited from Labour. But we are hoping to strengthen it (vide the Prime Minister's intervention a fortnight ago and the Chancellor's response that he will be announcing some modification of the cash limit system in the budget so as to make departments more cost conscious). I think the latter could be foreshadowed by your saying - "We are strengthening

the system of cash limit control ..."

Page 9, last paragraph. I am slightly dubious about saying that the Government's aim is "ultimately the elimination of inflation". Of course, in an ideal world, this is what we should be aiming for: but it goes a good deal further than the 1979 manifesto.

Page 11, first paragraph. The sentence, "We know that any monetary expansion ..." it does not read quite right - because of course the money supply is expanding.

Finally, one general comment. You have not commented at all on our monetary experience over the first 22 months - something that the Americans are interested in. Perhaps you are wise not to get into this simply because it is not an exactly brilliant story and because it raises some controversial control issues.

T. P. LANKESTER

12 February, 1981

Handwritten notes in blue ink: "more" and "many" with scribbles.

MR. ALEXANDER
MR. LANKESTER
MR. WOLFSON

Here is a first draft of the Georgetown
Speech. I have not yet sent it to the
Prime Minister. I would be glad of any
general comments.

Handwritten signature: "AAW" with a horizontal line underneath.

9 February 1981

cc MR. ALEXANDER
MR. LANKESTER
MR. WOLFSON

DRAFT

GEORGETOWN SPEECH

Mr. Chairman etc

When the scholars of this great university reflect on the history of Western Civilisation, they, like those in other institutions of learning, must be struck by its magnificent achievements. And nowhere have those achievements been more impressive than in the United States. The vast expansion of individual liberty, under a law common to all, has been one of the most astounding developments of Western man - and you citizens of this great Republic, borrowing copiously from our British laws and institutions, now enjoy a liberty of the individual unprecedented in history. The quality of our free life in the great Western democracies can be measured against the unending repressions and uniformity in totalitarian states. Our liberty has provided a fertile ground for the vast diversity and inventiveness of our people. We cherish it. We must defend it.

When we reflect on our liberty most of us think mainly in terms of our political freedoms. These are embodied in a system for protecting our individual rights against the arbitrary encroachments of political authority. The right to elect our legislators and those holders of great executive offices is one of the pillars of our freedoms. But it is not enough to support a just and free society. The other great pillar is the economic freedom of the individual.

/In the American

In the American Constitution, written by those few men of consummate genius, one finds the principle of economic freedom firmly embedded in the "pursuit of happiness". It is this freedom for a man to work for whoever he pleases, to employ whomsoever he pleases, to give, to receive, to save, to invest and to fructify; this freedom for enterprise is the basis upon which the material standards of the West have been improving for a period so long as to be quite unprecedented in the history of man.

Economic freedom requires the law to identify and defend the right to work and the right to property, the freedom to negotiate prices, wages and other contractual arrangements. Of course these rights are not absolute; society may very properly decide that no-one should have the freedom to buy and sell certain drugs or poisons. Life and health must be preserved. Similarly our laws may very well control the employment of juveniles. Children also should be protected. But such proscriptions are the exceptions rather than the rule. Freedom of contract is the presumptive basis of our system.

These are the ideals of a free society. Yet I fear that both in the United Kingdom and also, as President Reagan has said, in the United States these ideals have been much eroded. For many years the state has intervened more and more in proscribing the behaviour of both individuals and corporations. Usually the motives for such regulations have been laudable. It is said that the results of a free enterprise system are often unfair or unjust. In some cases such results violate what many would regard as the principles of social justice. Thus intervention on the

part of the state has been excused because it is said the state will provide a just outcome which can be seen to be fair to all. Sometimes this objective is enticingly called capitalism with a human face.

Let me make it perfectly clear that the Conservative Government accepts that there is a powerful case for a compassionate government softening some of the harsh outcomes of market forces. All of us subscribe to the principle of helping those who cannot help themselves. The poor, the sick, the lame and the old; in a caring society the Government must by some means ensure an acceptable minimum standard of life. Indeed we are committed to a policy of maintaining and improving these basic conditions of life.

But both in Britain, and also in the United States, the reach of government has far exceeded this basic objective. Perhaps the most ambitious attempt at state intervention has been the control of incomes. In Britain since World War II we have seen many incomes policies. The ostensible objective was to ensure that we did not pay ourselves in aggregate much more than we had produced, and that the national product was shared fairly and equitably. Our experience - indeed our sad experience - has been that none of these incomes policies produced the effects which their sponsors so ardently claimed for them.

The control of incomes was supposed to be the only effective and fair way of reducing inflation. But our frequent experiments with

/incomes

incomes
 /policies have clearly demonstrated that inflation cannot be contained by such measures. Dividend and wage control gave rise to rigidities, inefficiency and manifest injustice. These controls eroded incentives and sapped the springs of effort and invention. The essential link between improved performance and increased rewards was virtually eliminated. It is inefficient to destroy incentive. It is also unjust.

On each occasion end of article

AS LATER IN EXPLANATION

The control of prices appears^{ed} necessary to avoid the injustices of the market. But appearances are deceptive. If they are effective maximum price controls discourage production, foster wasteful consumption and dissipate our time in queues - as you saw in the gasoline shortages of 1978. The abolition of price controls on energy, initiated by President Carter and recently completed by President Reagan, is absolutely right. Free prices are essential for a free people.

bureaucracy cost to industry - what was their effect?

In many cases the intervention of the state has gone much further to full public ownership of great industries. The Labour Party in Britain has always had a programme of massive nationalisation of the "commanding heights" of the economy and, while in office, they have made considerable progress: railways, steel, electricity, water, gas, all are now nationalised state monopolies.

shipbuilding

Nationalisation was supposed to make these great industries financially self-sufficient and havens of industrial peace and understanding between management and workers. Public corporations

/were alleged to be

were alleged to be more responsive to the needs of their customers, more speedily adaptive to new technology and more harmonious with the plans of other industries. These claims proved quite extravagant. Now in Britain we can count the cost of socialism. Nationalisation produced proliferating bureaucracies, rapidly escalating prices and large deficits, which were inevitably borne by the long-suffering taxpayer. Interventions and ownership by the state produced increasing involvement of politics in many labour disputes, investment and even day-to-day business decisions. Energies were diverted into producing political pressure rather than consummable goods. Nationalisation added great, seemingly immovable colossi to the existing rigidities of regulated Britain.

This was the controlled, regulated and much nationalised economy which my Government inherited when it came to power in 1979. Restoring economic freedoms to Britain was one of the great tasks which the Government set itself. After some 22 months in office some considerable progress can be reported. But we still have a long way to go.

structure wrong - incomes, prices, nationalisation.

One of our major achievements has been the elimination of exchange controls. The hideously complex battery of regulations and licences - the accumulation of over 40 years - was swept away in 1979 and 1980. Many commentators warned that, without this protection, sterling would sink to new lows. In fact, as you know,

/sterling climbed

climbed to new peaks. Capital did not flow out of Britain in an unstoppable tide. On the contrary. With the Government's programme towards a free economy well under way, many foreigners have seen Britain as a safe and profitable home for their assets. Free exchange is an essential attribute of a free society.)

One of our other achievements was to begin the long involved process of denationalisation - or as it is sometimes called privatisation. We are tackling the restructuring of inefficient nationalised corporations such as the British Steel Corporation, British Leyland, British Shipbuilders, and so on. These changes are dramatic. They must be pursued with firm purpose but also with compassion for those whose economic well-being is so intimately linked with these corporations. This will take time. And it takes a lot of money. I believe, however, that the British people have learned the lesson. In future extravagant programmes of nationalisation of industry will get the reception they deserve from the taxpayers.

The expanding burden on the taxpayer is the other side of the debased coin of socialism. Our programme, like that of President Reagan's administration, is to bring down rates of taxation. Only by allowing people to keep a large percentage of the incomes they earn can we develop incentive and enterprise in a free society. We have made progress by reducing the rates of income tax. But I must admit that we have not lightened the tax burden as much as I would have wished. And this is because

/of the immense

of the immense difficulties we have experienced in trying to reduce government expenditure. First, much of the spending, such as expenditure on unemployment benefits, rises proportionately with the eligible unemployed. And in the United States the "eligibility" spending categories have, I understand, also been responsible for much of the recent growth of federal government expenditure.

recession

Secondly, we have found ourselves in the difficult position of having to spend vast sums in order to get many of our nationalised industries competitive and return them to private ownership.

But progress is being made in reducing the rate of growth of public expenditure. We have developed new systems of cash limits control on the great departments of government. This cash squeeze is designed to eliminate inefficiencies and waste. It is achieving results. Our objective is to ensure that the taxpayer gets value for his money. Only then can we expect people to trust their government in its traditional role as the guardian of public order and our liberties.

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This trust in government has been eroded not merely by many years of profligate spending on social experiments but also by the persistent depreciation of the currency. Over the last years Britain has had a higher rate of inflation than any other Western economy (except Iceland). The pound is now worth only of its value years ago. And over the years since World War II the trend of inflation rates has been always upwards: from per cent in the 1950s to in the 1960s to per cent in the last decade. Although the United States has

/experienced

experienced rates of inflation somewhat lower than those of Britain, the trend is also inexorably upwards.

For many years we have been told that a little bit of inflation is good for you. Many economists assured us - indeed some still do so assure us - that inflation is necessary to maintain full employment, to facilitate growth and to keep the economy moving. The message was: spend your way to prosperity.

Of course it was difficult for governments to resist such insidious advice. Britain was among the first large economies in the West to pursue these policies. Programmes of deficit spending and stimulative monetary policies had immediate effects which were indeed euphoric. Output and employment expanded. But these effects were transitory and persisted only for a few months, after which employment and the rate of growth of production fell back to and even below the old levels. We learned a hard lesson - monetary expansion stimulates only a brief and temporary growth. Decay soon sets in. But such monetary expansion does have a permanent effect - albeit an unfortunate permanent effect. It raises the rate of increase of the price level. Inflation comes to stay.

Government however is urged - indeed enticed - to undertake another monetary expansion to stimulate growth and employment. It produces, however, only a brief euphoria, and again the inflation rate surges, and unemployment rises once more. With the hindsight

/of this sad history,

of this sad history, we can easily see how the inflation rate rose persistently throughout these decades. But more strikingly, the average level of unemployment has also risen. The normal percentage of unemployment was in the 1950s, in the 1960s and is now. Similarly, the rate of growth of output and productivity has fallen steadily over these decades. Our higher inflations have merely brought lower growth and burgeoning unemployment.

The lesson is clear. Inflation immiserates us all.

But the erosion of the currency not only has insidious effects the health of the economy; it also breaks a trust between the government and the governed. People depend on the use of currency in their everyday life. They freely enter into contracts with one another, the terms of which are stated in pounds sterling or United States dollars. The fabric of faith on which so much of our life depends rests on the maintenance of money values. The conventions of trust and respect together with our great financial institutions have evolved over many years. They have all been founded on reasonably stable money values. A reliable and safe currency is the central responsibility of government. Once the people lose their trust in money the freedom of men and women in society will be diminished or even, eventually, destroyed.

You will appreciate therefore why my government placed as a first priority the permanent reduction, and (ultimately the elimination, of inflation. In a free society this can be achieved only by reducing permanently the rate of growth of the stock of money.

/There is no other way.

There is no other way. We knew that it would involve some increase in unemployment. The transition could not be smooth and unruffled. When an economy has become addicted to frequent large draughts of inflationary finance, the process of reform must be beset by severe withdrawal symptoms. (Thus we expected some increase in the level of unemployment - and some transitory decline in output.) After these many years of inflationary drift the costs of reform have to be paid.

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But even now at this early stage we can already see some of the benefits of reform. The rate of inflation has come down from over 20% in to less than 8% over the period.,.,.,.,.,. This reduction is even greater than we had forecast or indeed hoped. A new realism has appeared in wage bargaining. Recently wage settlements have been predominantly below 10 per cent. And all this has been accompanied by a steep decline in industrial disputes. Management and employees are now working together in a harmony which has rarely been seen in the history of British industry since World War II.

The cynic may well ask: will it last? Understandably at this stage (or even earlier) of the fight against inflation many former governments have given up the struggle. The cost of soldiering on seems frightfully high. "Would not a little reflation be helpful in reducing the level of unemployment, should we not have a vast programme of public works, financed by the printing press, in order to increase jobs?" I am sure you have all heard

/these songs of

these songs of the Siren. Indeed the temptations are great.
But we shall not yield.

We know that any monetary expansion now would create jobs that are spurious and ephemeral. They would soon disappear in the next upsurge of inflation - as they have done time and time again since World War II. We do not seek a fickle solution. We want a firm foundation for a permanent prosperity.

In my discussions with your President I have been impressed with the striking similarity between our aims and our broad policies for reform. The President's goal is a stable price level. Ours too. The President's aim is to free the individual from government restraint. Ours too. The President's objective is to reduce public spending and balance the budget. Ours too.

From my experience in Britain over these 22 months of office, I can assure him that it is not going to be an easy ride. He knows that the road to reform is paved not with good intentions but with hard decisions. In President Reagan you have a man who is committed to the right road. We from our small islands wish him well and Godspeed.