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Sir Douglas Lovelock - C & E

CONSERVATIVE PARTY FINANCE COMMITTEE - 4 NOVEMBER 1980

A discussion on economic policy was opened by Rt Hon Geoffrey Rippon MP. Forty present.

2. Mr Rippon recalled that he had had reservations about the government's strategy from the outset. He did not believe that the government could control the quantity of money by interest rates and he was not convinced that by controlling M3 one would necessarily control inflation. High interests were therefore a mistake. Meanwhile the government had muffed its chances on public expenditure: it should have abolished Clegg sooner, acted more forcefully on public sector pay, and avoided cuts on capital projects in the public sector.

3. We were now in a tail spin, with M3 and PSBR running out of control and interest rates making things worse rather than better through their lethal impact on the cost of debt servicing. We would be bound eventually to adopt a public sector pay policy, and in the present situation it would probably be necessary to raise taxes on alcohol and tobacco.

4. Michael Latham felt that we were rapidly getting into a position where our policy was defeating the commitments of our Manifesto - direct tax cuts and measures to get the economy going. What was the purpose of high interest rates? To oblige industry to borrow less and to get rid of its workers. But even the present MLR was not a clean rate. "The Bank of England has been holding interest rates down with, I am sure, the approval of everybody in this room" [No! - N Budgen]. Mr Latham was totally opposed to raising taxes. Income tax should be cut; this would regenerate the economy and put purchasing power back into circulation.

5. Peter Hordern felt that Geoffrey Rippon had not said what alternative there was to the government's policies. You would either have to resort to incomes policies, or adopt the position that M3 did not matter. Both policies had proved highly inflationary in the past. Mr Hordern agreed with the government's interest policy; it was not high interest rates themselves that were depressing industry, but the fact that industry was having to support a bloated public sector on an ever decreasing base. There ought to be cash limits for pay in the public sector not exceeding five or six per cent.

6. John Browne. We had:

i. failed to give the monetary policy a chance, by leaving too many rigidities in place in the economy (nationalised industry, labour cartels, indexation);

ii. failed to get forecast Expenditure down fast enough;

iii. failed to use interest rates properly. We should have let them rise higher early on; it would not then have been necessary to keep them highish for so long.

The exchange rate was too high, and we ought now to start cutting MLR gradually at ½ to 1 per cent per annum.

7. Michael Shaw felt that there were close similarities now with the situation in 1971, but he believed that the Party did not, this time, lack the guts to carry on. The counter inflation campaign was going according to plan and it would work. But we had failed with the public sector. Mr Shaw felt that we might well find ourselves forced, at some stage, to put restrictions on inward capital movements.

8. Jock Bruce-Gardyne felt that we had not "wasted" the last eighteen months. Inflation was coming down well. He also drew the parallel with 1971 and he implored the government not to consider reducing taxes and raising expenditure, as happened before. No public expenditure ought to remain sacrosanct in the present round - not even defence. It would be better to increase personal taxation than to let the PSBR ride away.

9. Kenneth Baker felt that the government's policy of general restraint was right. But our supporters were perplexed by the apparent failure of the chosen weapons. We ought to have concentrated on the PSBR rate than the money supply. Milton Friedman had dropped himself as pilot, when he declared for quantitative controls. The government's most manifest failure was on public sector incomes.

10. Terence Higgins felt that the government's basic policy must be right. Control of M3 was necessary, but not sufficient. The PSBR must be brought down. It was a choice between high PSBR and high interest rates or low PSBR and low interest rates. But time was running out. We would need to increase indirect taxation - the regulator was available. It would be dangerous to cut MLR before the PSBR was brought to heel.

11. Tony Grant considered that small businessmen were entitled to cynicism. The conduct of policy so far had been unimpressive; the local authorities were the nigger in the woodpile. A calculated risk may have to be taken on interest rates in order to prevent crucifixion of a lot of innocent and decent small businesses.

12. William Waldegrave remarked that only one speaker, Michal Latham, had advocated general reflation. But the government had not behaved entirely as if it believed in what it was doing; interest rates should have been allowed to go higher in order to protect the monetary targets. Defence would have to give, and we ought to resort to indexed debt. We had to realise that if we insisted on nationalised industries improving their trading figures further, this was tantamount to a further switch of resources from the private to the public sector.

13. John Townend felt that if we increased direct taxes we would lose the confidence of the managerial classes, and that we could not increase the indirect taxes too far or that would hoist the RPI. So it had to be restrictive of public sector pay.

14. Robert Taylor was the only open critic of Geoffrey Rippon's Times letter. In 1972 we had lost our nerve. Time was not running out now; we had still got plenty of time and our policies would undoubtedly work. Government expenditure had to be cut: the

government should withdraw totally from industrial training, and big economies should be made in the PSA.

15. John Butcher concentrated on retrenchment of the public sector, especially pay.

16. Brandon Rhys Williams was very satisfied with government policy, but unfortunately we had got our tactics wrong. We had tried to do things too quickly, eg income tax cuts. We ought not to keep on confusing the issue by publishing targets all the time. Gross over-manning had to be eliminated from the public sector. Taxes on drink and tobacco should be raised, and VAT as well. Interest rates could, and should, be reduced very sharply, to the point where the international speculator would not know whether the next movement would be up or down.

It was vital to fulfil our CTT commitments, especially as regards business.

17. Nick Budgen felt that in the first eighteen months there had been too much tough talk and too much soft action. Now it should be the other way round. We had imperatively to reduce the PSBR, probably by raising indirect taxes: even income tax.

18. Nick Lyell felt the strategy was obviously right. On the spending front only pay gave any real freedom for manoeuvre. He hoped it would be possible to bring interest rates down before too long.

PJC

P J CROPPER
5 November 1980