

13 June 1980

to
Cm

PRIME MINISTER

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ECONOMIC STRATEGY

In my covering note to Douglas Hague's paper, I said that I thought that both Budgets had been too little and too late. You wrote a question mark in the margin and this is a response to that question mark.

When I talk of Budget, I mean both Budget and Expenditure White Paper. It is in the latter area that we are obviously off course.

We have recognised the total confusion surrounding nationalised industry policy, and that is now being addressed. On public expenditure generally - which really means public sector pay - we haven't started. (My original suspicion that the need to de-index the whole of public sector pay, simply as part of the medium-term strategy, ^{was not generally understood,} is increasingly borne out by the papers received, by a recent conversation I had with someone in the Treasury, and by enquiries that Douglas has been making there, at my request.)

As I say, I believe that we are a long way off course; that nothing else matters until and unless we get this right. I enclose a copy of a letter I wrote to Geoffrey following a conversation I had with him, as our input to his Budget thinking. I have marked in yellow the most relevant passages.

If the Medium-Term Financial Strategy is to be achieved without colossal damage to the private sector, it has to be accompanied by the appropriate de-indexing of public sector pay and real cuts in manpower. But the de-indexing is the most important, the most urgent and the part that can be done fast. The third leg of the strategy is the rapid reduction in trade union power, and freeing-up of the labour market, so that the monetary medicine can work.

So we now have one leg of the stool, but the other two missing. And that leg of the stool - the monetary deceleration itself - bears down on the private sector first and foremost; on the employers, much more

than the work force; and, through interest rates and high exchange rate, on the very employers we need for the future - fast-growing, cash-hungry, exporting.

I believe that the likely problems arising out of the pay round will in fact present an opportunity for getting some of these things right, faster, while there is still time. I mention this in the context of relationships with trade union leaders and we are preparing a paper to explain what we mean.



JOHN HOSKYNS