



DRAFT SYNOPSIS FOR THE PRIME MINISTER'S SPEECH TO THE AUSTRALIAN  
INSTITUTE OF DIRECTORS

1. Introduction. Enjoying seeing and hearing about Australian economy at first hand. Some problems, but many enviable things. Propose to talk about the world economy and the roots of the present recession; and about the British Government's policies in relation to that background.
  
2. What has gone wrong with the world economy over the past decade? Why is it that, despite the best intentions of governments of all kinds, the world is to-day experiencing - at one and the same time - the worst unemployment and the worst inflation since the war? Growing realisation that causes are deep-seated and fundamental, and that problem will be solved only by resolute policies sustained over period of years. No short cut.
  
3. Economic prosperity of western world historically based on development of free markets - both national and international within framework of financial discipline. Free markets the economic dimension of the wider political freedom we cherish for its own sake; but have also proved the most effective way of meeting people's material needs in a complex and unpredictable world. Financial discipline - which received its classical expression in adherence to the gold standard and the doctrine of the balanced budget - the economic counterpart

of the wider social order that it is the duty of the State to provide. The two inextricably linked (Burke: "The only liberty I mean is a liberty connected with order; that not only exists along with order and virtue, but which cannot exist at all without them.")

4. Our individual political and economic freedoms thus sustained by a framework providing political order and financial stability. Fundamental error of past decades has been to turn this upside down: to restrict the freedoms of individual economic agents while removing the overall financial discipline .

5. Carried away by seemingly effortless economic progress of post-war years, these fundamentals became taken for granted and forgotten. Governments became over-ambitious about their role and their ability to shape their economies, leading to excessive expectations among the electorate. Increased government spending as a proportion of GDP meant growth of inflexible non-market sector of economy at expense of flexible market sector; and being financed by growing budget deficits and monetary expansion led inevitably to growing inflationary pressures. Increasing power and entrenchment of organised labour led to increasing rigidity of labour market, while proliferation of government regulation led to increasing rigidity of all markets.

6. Nevertheless for a time an overall world financial discipline maintained to some extent by system of fixed exchange rates based on the dollar, whose value was assured by non-inflationary policies pursued by a strong and vigorous United States. But inflationary financing of Vietnam war finally brought dollar standard to an end, leaving nothing in its place.

7. As productivity growth and economic performance faltered due to the hardened arteries of supply, increasingly desperate and doomed attempts were made to cure the ailment by the quick fix of injections of monetary demand. The inevitable outcome: still higher inflation - and the reinforcement of inflationary expectations. And - except perhaps in the very short run - still higher, not lower, unemployment.

8. World economy over past decade also hit by two massive increases - in 1973 and again in 1979 - in oil prices. Bound to have a dislocating effect on functioning of world economy as well as transfer of wealth from oil consuming countries. In first oil shock some countries accepted this transfer of wealth: others like UK tried to "accommodate" this in their fiscal and monetary policies, inflation the result. Those countries that did not inflate were right and were in a stronger position to face the second oil shock. Noteworthy that this time nobody is making the mistake we made first time round. But world's adjustment to the double oil price shock would have been quicker and better if the arteries had not already begun to harden before the shocks occurred. And the worse the capacity

to adjust, the higher the resulting unemployment.

9. The true nature of the worldwide economic problem, of which the current recession is the most obvious symptom, now widely recognised. At the economic summit of 1978 the two countries with the strongest economies, Germany & Japan, persuaded by others to 'reflate' and thus become the 'locomotives' that would pull the rest of the world back to path of growth and expansion. In the event the world was little helped - but those two countries still suffering the consequence of that misguided diagnosis, as their leaders made clear at this year's economic summit at Ottawa.

10. Over past decade or so world inflation has risen from cycle to cycle, and so has world unemployment (especially among young), while productivity growth and return on capital (profitability) have declined in almost all major economies. The notion that there is an inflation/unemployment trade-off now totally discredited.

11. Throughout the world increasing recognition that must return to basics: restore and maintain financial discipline, monetary and fiscal alike; restore and strengthen market forces, thus improving supply side of economy - remove labour market rigidities, attempts to rig relative wages, unwise tax and social security policies, sapping of individual initiative and enterprise by inexorable encroachment of government activity. Noteworthy that those economies suffering least in current recession - the vigorous newly industrialising countries of Asia - have stuck to these basics - financial discipline and microeconomic freedom.

12. Throughout world, too, growing emphasis on monetary targets (as in Australia), reduction of budget deficits and (Germany, US, etc), restoring market forces. Examples of latter: energy pricing and conservation. Possible reference to Managing Director of IMF (his brief and pithy speech at ... OECD ministerial meeting, June 1981, attached). But economy not a machine: it is people at work. Hence crucial importance of changing attitudes and expectations: this the challenge both to the people themselves and to their leaders throughout the world.

13. Each of us has to do this in our own way, just as each of us has to reimpose financial discipline in our own way. No escaping that responsibility. But each also has responsibility to rest of world. Need to eschew protectionism and beggar-my-neighbour policies. And need to get fiscal and interest rate balance right, avoiding undue reliance on latter which could destabilize international financial markets and retard world recovery.

14. It is in this context that UK Government has set its economic course. UK economy has suffered in full measure from rigidities and inflationary tendencies. Policies to reverse these trends, but bound to take time. Set out, for first time, medium term financial strategy: declining monetary growth and government borrowing. (Indeed Government borrowing in real terms already substantially reduced, despite recession, with consequent benefit to interest rates.) Curbs on Government spending. Reduced size of bureaucracy. Pay, price, dividend controls abolished. Also exchange controls - after 40 years. Substantial cuts in marginal income tax rates.

Denationalisation/privatisation. Other supply side measures.

15. Already major achievements. Inflation halved over past year; wage settlements now greatly reduced; substantially fewer man-hours lost in strikes; new mood of constructive realism on both sides of industry; overmanning and inefficiencies in British industry being effectively tackled at long last. Of course many difficulties remain and much still to be done. But these are long-term policies, which have already brought about essential preconditions of economic success and which will bring increasing dividends in years ahead. Obsession with short-term been our undoing in the past. Keynes said in the long run we are dead. But as former US Treasury Secretary (Simon) has pointed out, now Keynes is dead and we are in the long run.

16. Australian problems and policies show many similarities to our own (despite obvious differences). (Give examples of similar policies.) Similar problems; similar remedies; similar success if carried through with sensitivity and steadfastness.

Nigel Lawson draft

7 September 1981

Plan is never more



*Tim:*  
I think you are co-ordinating

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*This one. Alan Walters has also  
been asked for a draft.*

7 September 1981

*Phd  
7/9*

*Dear William,*

PRIME MINISTER'S SPEECH TO THE AUSTRALIAN INSTITUTE OF DIRECTORS

In your letter to Francis Richards of 20 August, copied to me, you conveyed the Prime Minister's request that the Financial Secretary should prepare a draft synopsis of a speech she is to deliver to the Institute of Directors lunch in Australia. You subsequently agreed to extend the deadline until today.

I attach a draft synopsis which the Financial Secretary has written. He hopes the Prime Minister finds it of use. He is of course happy to expand on his ideas and discuss them with her should she think that would be helpful.

I am copying this letter to Francis Richards (FCO).

*Yours sincerely,  
David Willetts*

D L WILLETTS  
Private Secretary

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