

SELDON
Group

5th March 1981

On the Prime Minister's behalf I am writing to thank you for your letter of 2nd March and your courtesy in sending her a copy of your Selsdon Group Brief, No 21.

Derek Howe
Political Office

Richard Ritchie Esq

The Selsdon Group

~~170, Sloane St., London SW1X 9QG.~~

~~Patron~~ ~~The Rt Hon The Lord Coleraine~~
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Professor Alan Walters Allan Stewart MP
Richard Ritchie
Chairman
Deputy Chairman Richard Henderson
Secretary Clive Elliot
Treasurer Robert Miller

21 Graveney Road,
Tooting,
London. SW17
home telephone: 767 3177
office telephone: 920 6036

March 2 1982.

Dear Mrs Thatcher,

I hope you won't consider the enclosed unhelpful. It is certainly not intended to be - and perhaps it will help redress some of the nonsense which is being spoken by your political opponents.

You will understand why we have concentrated upon public spending; but I in turn understand that it is not as easy as perhaps we suggest.

Yours sincerely,
Richard Ritchie

Richard Ritchie

(Conservative Candidate, Houghton-le-Spring Feb and October 1974; Wandsworth Tooting May 1979)

Brian Walden: "You haven't actually cut expenditure, have you,"

Margaret Thatcher: "Point taken, point taken, no we haven't"

(Weekend World, 1st February, 1981)

POINTS FOR TAKING

MEMO TO A SPENDTHRIFT GOVERNMENT

Richard Ritchie

Selsdon Group Brief no. 21

March 1981 75p

THE SELSDON GROUP

The Selsdon Group was formed early in 1973 to ensure that the case for the free market economy has the fullest hearing within the Conservative Party. The Group is for Conservatives who realise the economic freedom is the indispensable condition for political freedom. Its members reject the view that the "middle ground" is where elections are lost and won. They believe that the Party is returned to office when it adopts distinctive Conservative principles, as it did in 1970 and 1979, and that it will be returned again if it practises those principles.

The Officers of the Group are:

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Any enquiries about the Selsdon Group should be sent to:

The Secretary,
The Selsdon Group,
170 Sloane Street,
LONDON. SW1X 9QG

"... the truth is that from the outset the Government's monetary and fiscal policy was always modest and gradualist"

(The Secretary of State for Trade, 5th February, 1981, Hansard, c. 492)

INTRODUCTION

With these words Mr. John Biffen, who until a few weeks before had been the Treasury Minister with special responsibility for public expenditure, defended the Government's spending, revenue, and borrowing policies. They are, if anything, a flattering description of the economic policies pursued these last two years. Mrs. Thatcher's Government will soon have reached, if it has not already, its half way stage; and politicians in particular, who the moment they have fought one election begin thinking about the next, realise that henceforth every economic decision will be shaped by political considerations. As Mrs. Thatcher's Administration enters its third year, it is not unreasonable if her supporters begin to despair of the economic measures ever being taken that by all accounts she still understands and feels to be necessary.

If this expectation proves justified, the political outlook for the Conservative Party is far from happy. Tory MPs, with their desperate insistence that "we must get it right this time", are clearly aware of the danger; and Ministers have been trying hard to persuade the country that their strategy is intact and will soon show success, particularly on the inflation front. In reality, however, the speeches of these very Ministers recognise and emphasise the failures and disappointments of the past two years. The question is whether the Government can now rescue the situation or whether its electoral hopes are dependent upon the continuance of the troubles in the Labour Party. For despite good intentions and some brave decisions, this Conservative Government has failed to a serious and disappointing extent in virtually all the economic objectives it set itself before the election.

Of course, one would not believe this to be the case by listening to the Labour Party or indeed the Social Democrats. They both are under the misapprehension that Mrs. Thatcher is successfully translating into action what she says she intends to do in her speeches and interviews. She probably wishes that the Labour Party were correct in stating that public expenditure has been cut ruthlessly, that aid to industry has been stopped, and that government intervention as a whole is a thing of the past. The facts, however, simply do not support this analysis. It is only the high level of unemployment and the problems caused by a world-wide recession that has enabled the Labour Party to convince some that Britain is suffering from a "deflationary" policy.

This paper argues that in fact this Government's economic strategy has suffered as sharp a reversal as took place in the first two years of Mr. Heath's administration. The only difference is that Mr. Heath approved and defended his reversal, whereas Mrs. Thatcher is clearly unhappy and concerned that it should have happened. She appears to retain her original objectives; the question is whether there is still time during this administration to effect the changes necessary.

THE CONSERVATIVE ECONOMIC RECORD

In a widely read speech, the Financial Secretary to the Treasury, Mr. Nigel Lawson, has made his own assessment of "Thatcherism In Practice" (Zurich Society of Economists, 14th January, 1981). We can usefully borrow some of his facts, if not all his excuses.

1. The annual rate of growth of broad money in the first eighteen months of this Government was 16%; in the previous eighteen months it had been 15½%. The Government's published target was 9% plus or minus 2%. Lawson remarked "... we cannot, I believe, view with equanimity, so far as the medium term course of inflation is concerned, the fact that the growth of broad money has been running well ahead of the target rate".
2. "Total (government) expenditure, in real terms, will be very slightly higher this year (1980-81) than it was last year".
3. "... we have so far, on balance, increased the real burden of taxation overall".
4. "... the strength of the £ has undoubtedly been one of the main channels through which the crucial and marked change in trend from rising to falling inflation has been effected".

Perhaps most important of all, the Public Sector Borrowing Requirement is expected to be at least £13 billion, more than 50% above the Treasury's original forecast in the 1980 Budget.

This is not surprising when one considers the current level of public spending. Mr. Lawson admits this to be "very slightly higher" this year than last. In fact, on every definition public sector spending is hitting record levels and at a time when the economy itself is contracting. In the table below are given figures for General Government Final Consumption which is a measure of the goods and services actually used within the public sector itself, and which excludes the higher expenditure that may have been necessitated by the recession. By showing consumption in 1975 prices, we measure the volume of government spending; in the second column is shown the proportion which public expenditure, as defined by the White Paper, takes of GDP. On both counts, the Conservative record is bad.

	GENERAL GOVERNMENT FINAL CONSUMPTION (£BN)	P. EXPENDITURE PROP. OF GDP
1975	23.1	50.8
1976	23.6	48.6
1977	23.3	45.0
1978	23.9	45.7
1979	24.3	47.5
1980 Q1	6.13	50.7
Q2	6.18	50.6
Q3	6.19	51.3

SOURCE: ECONOMIC TRENDS

The conclusions that can be drawn from these figures are obviously more contentious. At the outset, however, it must be wondered how the Labour Party and Social Democrats can continue to make their accusation that there has been a radical reduction in the real level of public expenditure, and an obsessive preoccupation with the money supply thus leading to the current levels of unemployment. Whatever else this Government may be guilty of, it does appear to be sheer wishful thinking to make these charges against them.

But is Mr. Lawson correct in going on to argue, having recorded the facts, that in his view the "monetary conditions in the UK have not been inflationary so far"? This is a crucial matter for the Conservative Party. When answering attacks upon the levels of unemployment, Government Ministers have argued that:

- (i) inflation was always the top priority.
- (ii) there is now a definite fall in the underlying rate, and in the trend of inflation.
- (iii) it has always been recognised by economists that any fall in inflation would be accompanied by a temporary rise in the level of unemployment.

It is clear, however, that the fall in inflation cannot be explained by the money supply figures. A rising exchange rate has certainly been crucial; but this may well be reversed in which case the cost of imported raw materials and consumer goods will once again rise. This might take place against the bleak background of a rising money supply and a large PSBR which, with a falling pound, would be ever more difficult to finance.

To the chagrin of Conservative MPs therefore one cannot escape the conclusion that there is a real danger of inflation once more rising and before the next election. Indeed, so long as the Public Sector Borrowing Requirement remains at its current levels there can never be a guarantee that inflation will not once more accelerate. A large PSBR gives too many hostages to fortune. As long as the gilt market's appetite is large there may be few problems, apart from industry's complaints about interest rates. It does not take many weeks without gilt sales, however, for the amount of money being printed to increase in an alarming and inflationary way.

Despite all past attempts and announcements, therefore, it follows that the Government's main duty should still be to bring its expenditure and revenue more into balance. It is an appalling fact that this gap has increased sharply despite the higher taxation levied by this Government - this alone should be proof enough of the extent to which government spending is out of control.

Some will argue that it is madness to seek to reduce the PSBR at a time of recession and high unemployment. There is, however, no evidence that either of these misfortunes has been caused by the present Government's policy or would be eased by its abandonment. Mrs. Thatcher is entitled to point, as she has, to the long-term secular upward trend in unemployment that has taken place over the past fifteen years at least, and despite a whole range of monetary policy applied during this period. The true causes of this persistent rise in unemployment are difficult to discover. It is inevitable that some unemployment will be caused temporarily by an unexpected fall in inflation. It is also highly likely that some of our unemployment is caused by Britain's membership of the EEC. This is not to argue that this membership has been either economically beneficial or harmful; it is to point out that a traditionally free-trading economy cannot be transformed into an increasingly

integrated "European" economy without transitional pains, of which unemployment (because of the different supply and demand pattern) is a prime example. Perhaps another main explanation for the current levels of unemployment is that the UK's pattern of production, and therefore employment, is bound to be different now that we are an economy self-sufficient in oil and therefore able to attract overseas funds in a way and to an extent which was denied us when all our oil was imported. Other causes plausibly blamed have included better unemployment pay and social security receipts, new labour legislation, legislation on tenancies and the general immobility of the housing market, and the growing and increasingly active role of government generally.

It is difficult to explain the unemployment phenomenon. It is not difficult to rule out the high-spending options that have been proposed as a way of solving the problem. The last Conservative Government made a perilous mistake in inflating the economy for fear of unemployment; Sir Geoffrey must not use unemployment as an excuse for failing to reduce the PSBR which must be his first budget priority.

PUBLIC EXPENDITURE AND THE CIVIL SERVICE

The PSBR must be reduced either by higher taxation or reduced state spending. There are good reasons why the Civil Service prefer the former to the latter, and it has perhaps been the inability of Ministers to control their civil servants which has led to the disappointments of this Government. Unfortunately, there is nothing new about this problem, and any Minister who assumes office with a high level of political commitment (in either direction) is likely to meet resistance from the British civil service. In theory a Minister should be able to dictate policy; thanks to the indiscretion of experienced members of the Labour Party, it is clear that in practice this is not the case, and it is a danger which faces all reforming governments and those few politicians who act out of principle rather than self-advancement.

There is no doubt that reducing public expenditure is difficult. One reason is that so much state spending represents current activity brought into existence by past political decisions. One price that has to be paid for democracy is that all governments are of necessity prisoners of their predecessors who at the time must be assumed to have represented the popular will. Another difficulty is that some public expenditure can be cut more easily and quickly than the rest although these are not necessarily the biggest items or the most sensible. Thus, it was Mr. Enoch Powell who, of all people, concluded in a speech in October 1979 that "the potentialities for a substantial percentage reduction in the proportionate claim of the state upon total resources are very limited". If this conclusion is correct - and it is one that suits the civil service mentality - it leaves the Government with no option but to increase taxation if the PSBR is to be reduced. This option is made easier by other considerations listed by Mr. Lawson in his Zurich speech. For example, he reminded his audience that:

1. "At the end of the day, central government has no direct control whatever over the one quarter or so of total general government expenditure that is accounted for by local government current spending."
2. "Public Service Pay accounts for some 30% of total general government expenditure."

This approach, however, is at heart defeatist. It is better that the PSBR be financed honestly by taxation rather than through inflation; but the power to levy taxation should not be the excuse for maintaining public

expenditure at its current level. If taxation is increased, its main effect is to perpetuate a high level of state expenditure and to enhance the power of the state bureaucracy. The higher is public expenditure, and the more functions that are the responsibility of the State, then the more civil servants that need to be employed. It would be unnatural therefore if civil servants did not favour this high spending, high taxing approach.

The Conservative Party, however, should not accept that everything that can be done to contain or reduce public expenditure is being done. Perhaps the battle was lost the moment that Conservative Ministers began apologising for having to reduce state spending, rather than proclaiming their belief in the political as well as economic justification for such a policy. Government "cuts" should not be seen as emergency items, capable of reversal when the economic climate improves; they should be defended and championed as measures inherently desirable in themselves.

Once this approach is adopted, much else falls into place. No longer are public expenditure reviews seen as annual exercises to be undertaken reluctantly; no longer are they occasions when Ministers quarrel with each other to save their departments (which means their civil servants); instead they become the main purpose of a government's existence. They must be the justification for this Government's continuance.

FUTURE ACTION

If it is accepted that further public expenditure reductions are essential, and that these are desirable both for political as well as economic reasons, one can approach the Government's expenditure plans in a fresh light. No longer is one looking for miscellaneous and piecemeal savings which, it is hoped, will add up to something significant once the exercise is completed. Instead, one is looking for whole areas of activity in which the State has no reason to engage; and in transferring these activities to the Private sector, one can also be rid of that part of the Whitehall/Government machine which exists to manage them.

A Government wishing to reduce its expenditure will find its task easier if it is prepared to regard as no longer sacrosanct the areas of Defence, Education, Health and Social Security. Even if one were to remove from the budget altogether all the other programmes listed in the White Paper (Cmd. 7841), this would not achieve as great a saving as reducing by half the expenditure on these major items. In fact, the Government's White Paper on Expenditure is proud that "Expenditure on defence, law and order, health and social security rises over the survey period"; it is hardly surprising therefore that public expenditure is higher this year than last.

It should not be supposed that making reductions in these areas is more difficult and politically painful than in the fields traditionally chosen by governments. Of course, there will be uproar and organised opposition whenever there is even talk of government cuts; but if this is going to be forthcoming in any event, the Government might as well take the steps which will achieve their objective in the long-term. One of the most disturbing aspects of the political scene at present is that the country was prepared for real reductions in spending; that the media, Opposition, and trade unions have reacted as if these were taking place; that the Government has met with the political unpopularity which is inevitable in such circumstances; and yet the cuts have not been made and therefore the Government cannot look to the advantages which would have justified the policy and rebutted the criticisms.

Hence economies should be sought in all areas, and the big-spending programmes should not be excluded. However, it must be accepted that one cannot reduce these major items without the necessary political will. For example, private education must be welcomed, not just defended; the private provision of health must be encouraged, not just tolerated; and financial assistance to those in need must henceforth be in money rather than in the provision of subsidised services. Obviously, no exceptions for firms in difficulty such as British Leyland or industries such as British Steel can be allowed; in the long-term, it will always be cheaper to put such cases into the hands of the Receiver so that the assets where possible can be profitably employed by the private sector. The experience of the past two years suggests that large cuts in state spending cannot take place without the adoption of this approach.

Even so, one cannot leave this area without discussing for a moment the policies and expenditure of the Department of Industry. Here is a Department headed by a Minister who has more reason than most to reduce his department's activities and expenditure. These activities - such as "picking winners", subsidising loss makers, and regional policy - should have no place in any government's programme for a free economy. It is not only that money can be saved here to reduce the PSBR; it is that money spent here can be economically harmful. Yet, if we look at the Department's record to date we see very little difference from what has gone before. Sir Keith has less enthusiasm than his socialist predecessors in distributing tax-payers' money, but he does it all the same. No wonder the Government has difficulty "getting the message across" while its most senior members simply wring their hands over their essentially socialist ever-expanding departments.

It would be easy to accuse Sir Keith of political cowardice, and to look forward to his recantations the moment he leaves office. Sir Keith, however, is not a political coward; and because he is the least devious of politicians one can be certain that he believes what he says. He is not capable of deceit or deception; and yet he has allowed his Department to pursue an interventionist path when he should by now have taken effective steps to disband it altogether by abandoning its functions. One can only conclude that it is impossible to exaggerate the difficulties in persuading civil servants - over whom individual Ministers have very little sanction and whom they may often have insufficient technical information to disregard completely - to withdraw from the everyday activities in which they are now entrenched.

It also would be a mistake to suppose that it is only civil servants who wish to maintain the status-quo; large corporations, the city, the CBI and the plethora of trade associations all have detailed vested interests in government and are now totally accustomed to regular consultations with civil servants, from which they hope to gain advice, advantage, and assistance. The behaviour of the CBI, particularly over the past year, has confirmed that not only can a Conservative Government expect no help from big business, but it can look forward to its efforts actually being undermined by an organisation which represents a wide range of conflicting interests, and whose staff have the same reasons as civil servants for maintaining an interventionist regime.

CONCLUSION

In the last three months, painful memories of 1972 have suddenly been revived. On February 11, Mr. Francis Pym informed the Conservative Party that "commonsense tells us that changed circumstances make adjustments necessary in both tactics and timing, to meet altered conditions". He cited

the young unemployed, the development areas, and "some key firms, like British Leyland" as all deserving of additional government support. If all that Mr. Pym was saying is that any government must be free to alter its policies to assist its objectives, then this would be open to little dispute: but despite protestations to the contrary, it is now impossible to reconcile the Government's policy in practice with its pre-election commitments.

Mr. Pym's speech was closely followed by the Government's defeat at the hands of the National Union of Mineworkers and the National Coal Board. From this appalling incident, the Conservative Party should learn a few lessons. Firstly, the management and workers of a nationalised industry can make it impossible for economic and commercial decisions to prevail. It follows, therefore, that it is impractical and dangerous for governments to expect nationalised industries to behave as if they were in the private sector. There is every incentive for both management and unions not to do so. Only by a policy of total de-nationalisation can governments be relieved of their responsibilities for the State sector; and until there is de-nationalisation, there will be many more cases of a Government's expenditure programme being ~~decimated~~ ^{thwarted} by the nationalised industries.

Some of the Government's economic measures have been brave and necessary. They were right to abolish exchange controls; they have done away with dividend and price controls; and they have successfully resisted to date pressure for the introduction of formal wage controls. They have attempted, with some success, to remove Government from the day-to-day economic decisions which face British industry. It would also be ungenerous not to congratulate Mrs. Thatcher on reducing significantly the planned public expenditure inherited from the Socialists.

Unfortunately, none of this has been enough; and it is difficult to see how this Government can now summon up the will to take those measures which would have been so much easier had they been implemented the moment Mrs. Thatcher's administration assumed office. Perhaps we shouldn't be surprised. Of the present Cabinet, Mrs. Thatcher, Mr. Whitelaw, Lord Hailsham, Lord Carrington, Sir Geoffrey Howe, Sir Keith Joseph, Mr. Pym, Mr. Prior, Mr. Walker, Mr. Heseltine, Mr. Atkins, Mr. Jenkin, and Mr. Carlisle were all significant figures in Mr. Heath's last administration. Only Mrs. Thatcher, and Sir Keith Joseph were prepared after the election to remove Mr. Heath; and it sometimes seems as if it is only Mrs. Thatcher today who is preventing the Cabinet from following the identical path most of its members pursued nine years ago.

On 1st February, 1981 Mrs. Thatcher was interviewed by Mr. Brian Walden on "Weekend World". The following exchange took place:

Walden: "You haven't actually cut expenditure, have you?"

Thatcher: "Point taken, point taken, no we haven't."

It is time they did.