

IMMEDIATE

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DESKBY 062300Z

FROM F C D 062040Z OCT 81

TO IMMEDIATE UKDEL MELBOURNE

TELEGRAM NUMBER 241 OF 6 OCTOBER

FOLLOWING PERSONAL FOR PRIME MINISTER FROM CHANCELLOR OF THE EXCHEQUER:

1. WHEN WE SPOKE TO DAY ABOUT THE HEATH SPEECH I UNDERTOOK TO LET YOU HAVE A NOTE OF KEY POINTS WHICH COULD BE MADE - ON THE RECORD IF NECESSARY - IN RESPONSE TO QUESTIONS ABOUT IT. WILLIE WHITELAW AND I HAVE DISCUSSED WITH CECIL PARKINSON HOW THE PARTY MACHINE SHOULD HANDLE IT. AND, AS I TOLD YOU, PATRICK JENKIN HAS (AFTER TALKING TO ME) GONE ON TELEVISION AND RADIO TONIGHT: WE ALSO HAVE A NUMBER OF OTHER POTENTIAL CONTRIBUTORS, INCLUDING NIGEL LAWSON, LINED UP IN CASE MORE ARE REQUIRED, BUT WE ALL THINK IT RIGHT NOT TO RAISE THE TEMPERATURE. I MYSELF WILL USE A BY-ELECTION ENGAGEMENT ON THURSDAY IN CROYDON TO DEAL WITH THE ISSUES.

2. WHILE THE HEATH SPEECH CLEARLY IS A SIGNIFICANT EVENT, I AM SURE THAT WE SHOULD NOT QUOTE GO OVER THE TOP UNQUOTE IN REACTING TO IT. IT MADE THE HEADLINES IN THE FIRST EDITION OF THE STANDARD, BUT HAS BEEN WIPE OUT BY THE NEWS ON RADAR. EVEN AT LUNCHTIME IT WAS ONLY ITEM 3 ON TELEVISION NEWS. NEITHER THE TREASURY NOR THE BANK BELIEVE THAT IT WILL HAVE AN ADVERSE IMPACT ON THE MARKETS. GORDON RICHARDSON'S ADVICE IS THAT HEATH'S ARGUMENTS ARE SET OUT IN SUCH HYPERBOLIC TERMS, AND GARNISHED WITH SUCH SELECTIVE/ECCENTRIC READINGS FROM HISTORY (AND PARTICULARLY THE HISTORY OF 1970-74) THAT THEY WILL CARRY VERY LITTLE CONVICTION IN INFORMED CIRCLES.

3. GORDON RICHARDSON RIGHTLY POINTS OUT THAT IT IS MORE DIFFICULT TO JUDGE HOW FAR A SUSTAINED HEATH CAMPAIGN, WITH SUCCESSIVE ATTACKS ON DIFFERENT ASPECTS OF OUR ECONOMIC POLICIES, MIGHT UNDERMINE THEIR CREDIBILITY. (HE HAS FURTHER IMMINENT SPEAKING ENGAGEMENTS). BUT CONCEIVABLY THE EXTREMISM OF THE HEATH ARGUMENTS MIGHT DISSUADE OTHERS FROM JOINING IN: I AM TOLD THAT THE QUOTE BLUE CHIPS UNQUOTE - WHOSE PAPER COMES OUT ON THURSDAY MORNING - ARE ANGRY AND EMBARRASSED VAT BEING SCOOPED, AND BY SUCH AN ECCENTRIC ONSLAUGHT.

4. OF COURSE WE NEED TO REACT FIRMLY TO ALL THIS. THE POINTS BEING MADE AT THIS END ARE:

(A) IT IS A RANK FALLACY THAT WE COULD QUOTE SPEND OUR WAY OUT OF RECESSION UNQUOTE (I.E. BORROW MUCH MORE) WITHOUT SEEING A RESURGENCE OF INFLATION, AND AS A CONSEQUENCE INTEREST RATES RISING FURTHER AND FASTER. ECONOMICALLY AND POLITICALLY, THIS IS NONSENSE: NO WESTERN GOVERNMENT BELIEVES IT: OUR OWN EXPERIENCE (1971-3, 1974-6) REFUTES IT.

(B) IT IS NO LESS FALLACIOUS TO BELIEVE/PRETEND THAT HIGH INTEREST RATES ARE THE CAUSE, RATHER THAN THE CONSEQUENCE, OF INFLATION. THE WESTERN CONSENSUS, RENEWED AND REINFORCED AT OTTAWA AND THE RECENT IMF MEETINGS, IS THAT THE ESSENTIAL REQUIREMENT NOW IS NOT TO RELAX EFFORTS TO COMBAT INFLATION THROUGH STRICT FISCAL AND MONETARY POLICIES. (AND NB: ONE MAY ASK WHY INTEREST RATES - MLR - ROSE FROM 7-1/2 PERCENT TO 13 PERCENT BETWEEN JULY AND NOVEMBER 1973).

(C) IT IS A FURTHER FALLACY TO SUGGEST THAT ONE COULD JOIN AN EXCHANGE RATE SYSTEM, ONE OF WHOSE PURPOSES IS TO HELP GOVERNMENTS TO HOLD THE LINE AGAINST INFLATION, AND THEREBY ACQUIRE THE FREEDOM TO INFLATE AT A RATE MUCH HIGHER THAN THAT OF ONE'S PARTNERS. SIX WEEKS IN THE SNAKE IN 1972 SHOULD HAVE DEMONSTRATED TO ALL CONCERNED AT THE TIME THE HIGH COSTS OF ATTEMPTING TO STAY WITHIN A SEMI-FIXED SYSTEM WITH AN ECONOMIC PERFORMANCE DIFFERING WIDELY FROM THE NORM.

(D) NO LESS NAIVE IS THE IDEA THAT EUROPE, RING-FENCED BY EURO-EXCHANGE CONTROLS, COULD INSULATE ITS FINANCIAL MARKETS FROM THE REST OF THE WORLD. ALL EXCHANGE CONTROLS LEAK, AND ARE NO ANSWER TO THE FLOWS ARISING FROM 'LEADS AND LAGS' OR FOREIGN HOLDINGS OF STERLING. AND OURS IS, AND HAS ALWAYS BEEN, AN OPEN ECONOMY: WE EXPORT ONE-THIRD OF OUR GNP. AND IF, PER CONTRA, ONE COULD SUCCEED, CONSTRUCTING A SOLID RING-FENCE, WHERE WOULD ONE END UP: LIKE POLAND? (NB: THERE IS SOME INCONGRUITY BETWEEN ARGUING (BRANDT REPORT) FOR GREATER RESOURCE FLOWS TO DEVELOPING COUNTRIES (OR INDEED EUROPE'S ROLE IN RECYCLING OPEC FUNDS TO DEVELOPING COUNTRIES), AND ARGUING NOW FOR A RING-FENCED QUOTE FORTRESS EUROPE UNQUOTE).

(E) FINALLY, THE HEATH ARGUMENT THAT A SOGGY CONSENSUS IS THE WAY TO GET INFLATION DOWN SIMPLY WON'T WASH. WE ARE FAR FROM BEING AGAINST CONSENSUS AS SUCH: INDEED WE WANT THE WIDEST POSSIBLE ACCEPTANCE OF THE NEED TO REMEDY THE FUNDAMENTAL PROBLEMS OF THE U K ECONOMY, I.E. EXCESSIVELY HIGH LABOUR COSTS AND DECLINING COMPETITIVENESS. WE ARE NOW MAKING REAL PROGRESS IN DEALING WITH THESE PROBLEMS: THE HEATH TEXT DOES NOT ADDRESS THEM AT ALL.

5. THERE IS ONE ADDITIONAL POINT: THE HEATH PRESCRIPTION, THOUGH DRESSED UP AS A EUROPEAN SOLUTION, IS NOT ONE WHICH THE EUROPEAN LEADERS OF THE HEATH ERAN OR TODAY, WOULD RECOGNISE. THE FACT IS THAT THE GOVERNMENT'S PRESENT POLICIES, TO WHICH HE TAKES SUCH VIOLENT OBJECTION, ARE BEING PURSUED BY NEARLY ALL THE EUROPEAN COUNTRIES: A TOTAL ABOUT-FACE BY THEM WOULD BE A NECESSARY PRE-CONDITION FOR THE HEATH PLAN.

6. IN GENERAL, WILLIE WHITELAW, CECIL PARKINSON AND I TAKE THE VIEW THAT, WHILE YOU CLEARLY CANNOT AVOID ALL COMMENT, IT WOULD BE BEST (IN MELBOURNE AND AT THE AIRPORT ON RETURN) TO AVOID MAKING TOO MUCH OF ALL THIS. IT WILL BE A DAY OR TWO BEFORE WE CAN FULLY ASSESS THE PRESS AND PUBLIC REACTION. WE CAN REVIEW TACTICS WHEN YOU ARE BACK.

CARRINGTON



(2)

10 DOWNING STREET

Prime Minister

A handwritten signature in black ink, appearing to be 'M' or 'N' with a long, sweeping tail.

I'm not sure if you saw this
in the box last night.

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