



10 DOWNING STREET

Prime Minister

I have handed a copy to  
Cecil Parkinson

A handwritten signature in blue ink, appearing to be 'IAN GOW'.

IAN GOW

17.2.82



From: The Rt. Hon. Peter Walker, M.B.E., M.P.

HOUSE OF COMMONS

16th February 1982

PRIME MINISTER

MEMORANDUM ON A CONSERVATIVE STRATEGY FOR THE NEXT TWO YEARS

The Conservative party faces grimmer prospects than at any time since the end of the second world war. We are presiding over 3 million unemployed and, now, falling living standards for those still at work. We are confronted with the emergence of the SDP/Liberal alliance, the most ominous third-party threat in modern times. The potential for an electoral disaster for the Conservatives is clear.

British history is on the verge of one of those junctures in which a familiar political landscape is radically rearranged. In the past, Conservatives have had little to fear from such eruptions: through the ages we have been able to adapt to new alignments. This time there is every chance that we will be as much the victims as the Labour party. The country's current economic plight and the break-up of the Labour party have combined to make this possible.

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We are the first post-war government to have produced a substantial drop in the nation's real output. Despite several worth while achievements (the recent rise in productivity, for example, is encouraging) there is every chance that we will go into the next election campaign with output lower than it was when we were elected. At the same time, we have made only modest gains in conquering inflation which remains in double figures.

Voters, including Tory voters, are now clearly more worried about rising unemployment than rising prices. We have become associated in the public mind as the party of mass unemployment. The last time we were similarly tainted was in the 1930s. It took us a generation (and the success of Conservative governments of the 1950s) to rid ourselves of that smear. This time it is the young who blame us most and who associate us most with the dole queue. They are tomorrow's voters and their memories of early life without a job will not be easily erased.

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The dismal state of the Labour party, with its endless civil war between left and right and with the hard left winning the upper hand, makes Labour an unattractive alternative no matter how poor our own standing. But Labour is no longer the only major alternative. The break-up of the Labour party and the emergence of the SDP/Liberal alliance is the most serious threat to the Tory vote in this century. The Conservative move to the right and Labour's swing to the left has left a vacuum in the centre which the new alliance has rushed to fill.

So far there have been few Conservative defections to the alliance and I have urged my fellow MPs to resist its blandishments. SDP leaders, however, are effectively recreating the old Gaitskill Labour party - one that is operating in a political climate far more advantageous than Mr Gaitskill ever enjoyed. For a start, it is shorn of Labour's left and its trade union barons: both Labour liabilities. Second, it can be made to appear that it is not up against a moderate, centrist and successful Tory government, but one which is perceived to be hard-faced, unsuccessful and which has abandoned the centre ground. Mr. Gaitskill, after all, had to face the prosperity of the Churchill-Eden-Macmillan years.

The Conservative party has always been a coalition of the centre-right. We have survived as a party and performed well in government because we represented many of the aspirations of the middle and working classes. We were a natural haven for the moderate-minded from all walks of life. Now many of these Tory voters look on the SDP as their natural home. Of course, there have been third-party tides in the past which have come to nought. The Liberal "revivals" at Orpington and elsewhere are familiar to us all. But I believe the alliance challenge to be fundamentally different. For over a year now the alliance has topped the opinion polls. Post-war Liberals have never been able to achieve this. In the current climate it would be hard to envisage more fertile soil for the growth of a moderate alternative to the two main parties. As the SDP comes of age it will make its own mistakes and experience set-backs. No doubt this will be heartening to our party's election strategists. But the leaders of the SDP/Liberal alliance will have to be very inept indeed if they are to throw away the chance of being in a pivotal position on the day after the next general election.

The future of the Tory party is at stake. Large sections of the population from which we used to draw significant support (particularly the young and skilled workers) no longer feel that the Conservative Party represents their aspirations. No wonder many backbench Tory MPs are nervous about their political future.

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I do not want this memorandum, however, to be only a harbinger of doom and despair. There is enough of that around already. None of the trends I describe is irreversible and my purpose in writing to you is to suggest how best government policy can be developed to thwart them. We have until the autumn of 1983 to establish a trend of rising output, falling unemployment and diminishing inflation. There are ways to change direction other than u-turns and I would like to suggest resolute policies which do not involve the abandonment of any Tory principles, but which conform to the best traditions of our party. The alternate, I fear, is to preside over the demise.

### The Economy

The pursuit of our medium-term strategy will lead us into the next election campaign with inflation still hovering around double digits and unemployment around 3 million. There is nothing in official treasury forecasts to suggest otherwise. Even more worrying for our re-election chances is the near-certainty that, for the first time during this government, the real living standards of those in work will fall by around 4% this year, even with indexed income tax allowances and an increase in earnings of about 8%.

No We have constantly made the money supply and the public sector borrowing requirement the centrepieces of our economic strategy. I do not wish to deny that they are important, but they are only two of many indicators that need to be watched in a sophisticated economy. Sterling M3 and the PSBR were given such an elevated status because they were meant to lead to the control of inflation and new life for private enterprise. No such break-throughs have occurred. Instead, control of the money supply and the PSBR have become ends in themselves, with harmful results.

Our experience, and that of Mr Paul Volcker of the Federal Reserve in Washington, suggests that even the most dedicated monetarists have trouble in identifying an adequate measure of money and then controlling its growth within specified limits. In America, monetarism has brought high and erratic interest rates. In Britain interest rates have also been pushed higher in our effort to control the money supply, but sterling M3 is proving a difficult tiger to tame. Experience from both sides of the Atlantic suggests that any measure of money that is officially controlled quickly loses its meaning. Our own inflation rate, for example, has responded to other factors, regardless of the swings in sterling M3.

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The PSBR is an equally unreliable guide for economic policy-making. The size of the government deficit means different things at different stages of the business cycle. To run a huge PSBR during a boom would be indeed inflationary. However, we are in a severe recession and PSBR targets fixed in the past when such a downturn was not anticipated have little relevance. Today's high interest rates, for example, are less to do with a PSBR that is too high than with a desire to remain competitive with interest rates in Wall Street and to keep the sterling exchange rate within a certain range. The Chancellor's budget strategy is being drawn up in a self-imposed PSBR/M3 strategy which has little to do with what is needed to get the economy moving.

The country's gross national product fell 2.2% in 1980 and another 1.6% in 1981. The latest industrial output figures wipe out the recent encouraging gains. Manufacturing output is at its lowest for 15 years. Most important of all, despite last year's surge in productivity, the treasury estimates that our manufacturing competitiveness is still some 35-40% below end-1978. Today's productivity is no higher than mid-1979, despite the lengthening dole queues. These - rather than sterling M3 or the PSBR - are the harsh realities of the shopfloor.

While production has slumped, wages have soared. Since we took office the annual public sector wage bill has increased by nearly £20 billion. It now stands at almost £52 billion. Every 10% rise in public sector wages will now add over £5 billion to public expenditure. This dwarfs any efforts we can make at painful public spending cuts. The private sector has done better than we have at fighting inflationary wage demands. Even so, the private sector wage bill has increased by £30 billion.

At a time of slumping production, workers have priced themselves out of a job. Most galling for a Tory government, however, has been the way the public sector labour force has stayed cocooned from this trend: it has fallen by only 165,000 in the past three years. Private sector employment, however, has been slashed by over 1.25 million. Unemployment now costs the treasury, in PSBR terms, equivalent to a cost of £10 per week *No* per person left in work. If it is "normal" to have 1 million unemployed this means there is an extra burden of £7 per week per person employed, demanding a rise of 5% in productivity purely to meet this burden.

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I would like to see urgent emphasis given to jobs and productivity rather than esoteric financial targets. We need to implement policies to bring forth more investment and link wages closer to productivity. I suggest two ways the government should go about it:

Time-dated Investment Grants. We need to equip industry to meet an upturn in demand, especially when world trade picks up. Present tax rules do not encourage industry to invest when activity and profits are low. The incentives are greatest when times are good. Result: they accentuate whatever stage of the business cycle we are at.

Time-limited grants, however, would be counter-cyclical and designed to generate a surge in investment over the next two years. The government would announce that all investment undertaken before, say, 1st April 1984 would qualify for a 10% grant (an alternative would be increased allowances, but that would not help companies in the red and paying no tax).

Such a grant would encourage industry to bring its investment plans forward and boost beleaguered capital goods firms. I estimate the net exchequer cost at around £1.3 billion in 1982/83. More jobs, higher growth and better productivity would be the gains.

Any efforts to stimulate growth, however, would be lost if the extra money was gobbled up by inflationary wage demands. Traditional incomes policies have proved hard to sustain. On the other hand the free collective bargaining of the past three years has had a terrible effect on jobs, profits and our competitive position. I suggest a new approach.

A Sector-by-Sector Incomes Policy. In the months ahead living standards will fall, council house rents will rise (affecting 66% of trade unionists), so will rates and national insurance contributions. In the absence of any government initiative it is likely that the 1982/83 wage round will see union demands for big pay rises, despite the high level of unemployment.

I believe, therefore, in some of the major sectors of the economy careful consideration should be given to pay talks in which various sectors would benefit if their workers and managers agree to pay restraint. If we can achieve some major pay victories as a result of these initiatives a new climate will be created. For example, in the next few months the major negotiation will take place for the construction industry. This is a national negotiation. Construction

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accounts for around 11% of the gdp and is the biggest single employer of manual labour. It has a 60 year old, well established, national negotiating machinery and the joint board sets national rates for the basic weekly wage rate and guaranteed minimum earnings. It normally achieves this in June each year after a March to June bargaining routine.

A high award will mean higher public expenditure, more inflation, less investment and more unemployment. If the government was to state, however, that a low wage settlement by the joint board would be followed by a government construction package (say £1 billion in extra public investment for a 3% pay deal) then the unions would be encouraged to restrain wages in return for more jobs (up to 120,000) in their industry.

In other major negotiations, such as the engineering industry, the Government could respond to low settlements with investment grants more generous than the 10% suggested above. Investment in plant and machinery would take place over a fixed period of time thus bringing forward orders in a phase which would not result in a sharp wage increase. In the areas for which I am responsible schemes along these lines could be introduced to obtain wage restraint in the food industries and the agricultural machinery industries. Many public sector pay talks could be handled in the same way, with the promise of more investment in public projects in return for low pay deals. Such an incomes policy would clearly establish the link between wage restraint and investment, and hence jobs. We have two years, at most, in which to reap its benefits.

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Low pay deals plus an investment surge would transform our economic circumstances. At the very least, they would get things moving before the next election. Export-led growth, however, is best of all and cannot happen with the present exchange rate policy. The treasury and the Bank of England have no formal target for sterling. But since mid-1981 they have been anxious to prevent any significant fall in the pound's value, even if it means raising interest rates. This has been a double blow to industry which needs lower interest rates and a lower exchange rate for British exports to boom.

A lower exchange rate should be accompanied by more government activity on trade. We live in an era of nation-state competition, whether we like it or not. Our government must do more to assist the efforts of private enterprise salesmen.

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A two-year programme of international visits led by Ministers accompanied by teams of top businessmen needs to tout the world for fresh orders and contracts. There needs to be an overall strategy on a country-by-country basis. At home, fairly amateurish Buy British campaigns over the last 2½ years have succeeded in reducing our food imports by nearly £1 billion per year. But there is a further £5 billion of food imports we could attack by the creation of a highly professional marketing operation similar to that organised by the French, the Germans and the Danes. If that can be done in the agricultural sphere there are doubtless many other areas where an intelligent Buy British campaign would reap rewards.

A sense of economic progress is vital if we are to fight the next election on a winning platform. But there are other areas where action is needed to wean back traditional Tory voters we have lost over the past three years.

#### The Council House Tenant

We have always needed at least 40% of council house votes to win an election. Yet in three years we will have doubled council house rents and only sold less than 10% of the total stock of council houses in this government's lifetime. In last year's local authority elections there was a huge swing against us on the council estates. This new hostility towards us on the council estates of Britain is something that must be tackled in a radical way. Several years ago I proposed that almost all council houses should be transferred to their tenants on a mortgage repayment scheme. Such a bold initiative needs to be reconsidered.

I know that you believe that, with real effort, we could sell 1 million council houses by election day. But this would still leave well over 80% of council house tenants to resent the massive rent increases we have imposed upon them. If you reject my simple, radical plan then I suggest you consider a much greater enducement than the current 50% discount provided the sale takes place within the next two years. We need to reach out to the majority of council tenants, not just those who can afford the present scheme.

#### Rates

You recognise the need to do something positive before polling day. But white papers, green papers and manifesto promises will look limp, given our past performance. The Chancellor should transfer more local government spending to general taxation to bring about a significant drop in rates in the spring of 1983. Teachers' salaries are nationally negotiated and a considerable portion of the total burden. Some element of them could make up the transfer, followed by proposals to be pursued after the election.

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### Education

In the 1974 and 1979 elections we did well with the educational establishment vote. But spending cuts have created considerable hostility. We need to regain their confidence by reaffirming our belief in the future of education. New advances in information technology will revolutionise education as we think of it today: diversity and experiment will be the hallmarks of the new information society. A Tory approach will cope far better with this revolution than Labour's penchant for rigid, centralised control. We need to spell out our vision of education's future in a new document which we should regard as the successor to the 1944 Education Act.

### Race Relations

In the 1970 we worked hard to win the confidence of Britain's racial minorities. In 1979 we won a fair percentage of their votes. Since then, the increasing decline of the inner cities and their large-scale youth unemployment has dissipated much of that goodwill. I believe that, as a start, we need to move urgently to implement the main proposals of the Scarman Report. Legislation in the autumn is not good enough. Without action now we risk another summer of inner-city unrest and a further long step down the road to American-style ghettos, seething with racial discontent. Our race problems are solvable, if only the will to do so is there. The Conservative government needs to demonstrate to blacks and Asians that it has that will.

### Law and Order

Despite our manifesto promises, crime has been a major growth industry over the past three years. I believe much of the increase is connected with our poor economic performance, and particularly the rise in unemployment. We have kept our promises to the police on pay and numbers so we will keep the police vote. But not the law and order vote. We need to tackle the more frightening areas of crime as a matter of urgency.

### Europe

The Labour party is likely to campaign on an anti-European programme just when the opinion polls show voters are swinging in the EEC's favour once more. We need to trumpet the dangers of Britain-out-of Europe. Employers, for example, with substantial trade with the EEC should brief their employees on the danger to jobs and wages if we left. Labour still thinks an anti-Europe stance is a vote-winner. But if we are seen to be the instigators of a strong campaign to keep Britain in Europe we will benefit from a genuine fear of leaving Europe.

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We have a decent record of defending the elderly in spite of recession and inflation. Next time the pensioners' vote will be substantially higher than it was at the previous election. Yet, because we appear hard-faced when it comes to public spending and welfare, we reap little credit - even among the elderly - for a policy we should be proud of. The same could be said for our policies towards BL and other public corporations. We should not apologise for the effective use of public money.

It is the task of party organisation to see that the elderly and employees of firms connected with major government investment like BL are individually informed of the manner in which this government has safeguarded their livelihoods and their standards. This together with the European campaign demands a detailed organisation by the party of a higher quality than anything we have seen before.

I have tried to make constructive comments with regard to the economy and also to list some of those features of our domestic life which more than any others motivate the voters to either continue their allegiance to the party or to move to an alternative. Time is now running out and a clear and constructive strategy urgently needs to be pursued.

If we do this I have every confidence we can win the election in 1983 or 1984 and have the opportunity of governing for a further five years, perhaps during a five-year period when world conditions will themselves be more conducive to expansion.

PETER WALKER