

Miles - we shall  
follow some of these  
points in  
speech

PERSONAL



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PRIME MINISTER

As you probably know, the "Blue Chip" Dining Club published yesterday their pamphlet "Changing Gear", launching it with a press conference and a number of broadcasts by individuals on radio and television. The chief interest of the pamphlet for a wider audience undoubtedly lies in its comments on economic policy and the importance of a change in style and tone of voice. The pamphlet's launch has been somewhat overshadowed and its impact diminished by Ted Heath's activities. However in the longer run I suspect that their relative importance could switch, Ted's outbursts being so much more immoderate in both tone and content, and much less well-written too.

..... 2. I attach a copy of the text, side-lined for quick skimming; a very brief summary of the most important arguments, which deals mainly with the economic content; and some brief comments.

3. Over and above policy, there remains the discussion of the closely related questions of style and flexibility, which are dealt with in Chapter 1. These remarks will undoubtedly strike many chords both in the party and outside, and I think we must heed them: a number of their policy prescriptions and much more of their argument appears to have been prompted by their failure to see that our case is nothing like as "simplistic" as they suggest.

4. That said, my own inclination in commenting on it in public at this stage would be to stress that it supports the

PERSONAL



thrust of Government policy in most respects - and to point to its cautious overt attitude to reflation, emphasis on goals we support, such as helping industry, holding down pay, and so on. Where there are differences of view with the Government, in some cases the proposals offered are unrealistic (however desirable), e.g. a Heseltine-like trade-off of lower pay for higher investment; and in others imprudent, e.g. downgrading the objective of lower inflation.

5. We shall try to formulate a more considered line tomorrow in the light of the initial public reactions.

(G.H.)

9 October 1981

CHANGING GEAR: SOME SALIENT POINTS

<u>Chapter</u>		<u>Page</u>
I	Dangers of being dominated by economic theories.	1
General	Need to shift emphasis from inflation to unemployment. Dangers of inflexibility; and the old Liberal laissez faire model. Mastering inflation not of itself enough to ensure recovery; real demand must be expanded too in a non-inflationary way.	2 3
II	Critique of the Lawson theory of expansion (viz that demand grows when price growth falls below that of money): too vulnerable to shocks, and will not act sufficiently quickly, seen politically. <u>Acceptance that crude reflation will be no good.</u> Though all economic theories are immensely vulnerable, that would be no justification for doing nothing. Time for "decisive action". Govt should undertake capital spending and help industry similarly, in exchange for pay restraint and fall in living standards.	5 6
Economic Policy	Also it should cut NIS, interest rates, soften energy prices - again, the quid pro quo in restraint in pay; the sanction, income taxes. Gross cost £4-5bn for 2 years on capital, £2bn NIS; of which half might return to exchequer in lower benefits etc. If this overburdened public finances, income tax would have to to up.	7
	Admittedly "reflationary ... but some upswing in borrowing can probably be accommodated without affecting interest rates much ..."	
III		
Industry	Steer middle way between Benn-Godley and	8

laissez-faire.

Selective assistance for sunrise industries.

Cut current public spending by more and have more capital spending. 9

Some scepticism about regional policy benefits. 10

More on R&D to match competitors. Help Science Parks. 11,12

Supercharge existing small business programmes, simplify their taxes. 13

Press on with NI privatisation, regionalisation, removal of monopolies. Introduce audit and regulation of their prices. 14

More effective anti-dumping.

## IV

## Employment &amp; Productivity

Six major reforms urged in next stage in reforming TU law: enforceable procedure; higher closed shop compensation; no union-only contracts; review-procedures for closed shops; lifting obligation on employers to maintain guaranteed pay when <sup>employees</sup> rendered idle by disputes; no-strike provisions in return for compulsory arbitration in vulnerable sectors. 17

Encourage unions to join debate about economic policy. More moves to wider share ownership, code of practice on participation. 18

## V

## Labour Force

Reorganise training/apprenticeship on German model. 20

"Costs of upgrading ... MSC's present schemes on the German model are not as great as might appear." 21

More flexibility in the retirement age, but not compulsory lowering. 22

Chapter

Page

Social Policy

Make family the theme, to which poverty the greatest threat. 23

"The case seems strong for the promotion of family income at the lower end of the scale."  
Introduce mothers benefit, uprate child benefit to unemployed children's rates. All to be paid for from married man's tax allowance. 24

Phase out pensioners' earnings rule and Inv income surcharge. 25

Rebuild bridges between NHS and Private Sector.

VII  
Constitutional

Reform H of Lords to strengthen checks and balances. 26,27

Equivocal discussion of PR and, to a lesser extent, devolution. 29

Reform rates with transfer of some functions to CG, and new local tax.

VIII  
Foreign,  
Defence,  
Europe

Qualified enthusiasm for Trident. 30

Argue for "reforms aimed at stabilising the world's economic system and developing trade". 31

IX  
Conclusion

One nation.

## BRIEF COMMENTS

1. Unlike most critics, the Blue Chips identify ways in which their tax and expenditure proposals might be funded. Thus they are prepared to see income tax raised to finance their proposed increases in capital spending and the cut in NIS if the markets necessitate it and if offsetting cuts in public sector pay cannot be achieved. And they would phase out the married man's tax allowance to fund the changes they propose in Social Security.

2. On the other hand this does not of itself make their preferred proposals feasible, nor the presentation realistic. Several aspects of their case provokes serious scepticism.

(a) They are arguing, for preference, for as much as a PSBR increase as can be got away with, for the explicitly stated reason that more borrowing would not much affect interest rates. This is even less easy to believe today than when the pamphlet was written.

(b) They criticise general reflation violently, while themselves commending a kind of selective reflation as if it were radically different merely by virtue of their having listed in detail how the money would be spent.

(c) They openly advocate taking risks with the inflationary prospect in the belief that it isn't of great importance politically or in determining employment prospects. History supports neither judgement.

(d) The trade-off between lower pay and on the other hand an NIS cut and higher investment is not negotiable, however desirable.

(e) Some of their costing is optimistic. Flexible early retirement would be rather costly, and would necessitate higher NI contributions. The cost of German-type training for the young would not self-evidently be "not as great as might appear", indeed the opposite is probable.

(f) The opening attack on the excessive importance of the money

supply target and objective of mastering inflation is a caricature, which perhaps suggests they are victims of their own and others' rhetoric. Ministers have, of course, long argued for a very wide range of measures over and beyond monetary control, and implemented them in substantial measure, particularly to encourage the supply side, an aspect of policy <sup>paper</sup> ~~the~~ does not discuss as such.

(g) The Blue Chips clearly believe the Government can still do a lot to create effective real demand, and neglect the way that a flexible exchange rate and open financial markets now shortcircuit that "Keynesian" process before it can deliver growth, and punish one with higher import prices, worsened inflation and higher interest rates instead.

(h) They give the strong impression of believing that it is the PSBR which determines the level of real demand and that monetary control can be dispensed with. Experience on the other hand shows that monetary control is essential, and that the money supply determines demand - in which case the failure to discuss what are the proper monetary targets is a serious gap. It is also now clear that in broad terms interest rates fall and the share of private spending in economic activity rises if the PSBR is cut; and that PSBR increases are not expansionary.