

Briefing Note

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THE STRENGTH OF THE BRITISH ECONOMY

The crisis in the South Atlantic has tested not only the diplomatic and military capability of the United Kingdom, but also its economic strength. The economy is proving equal to the test. The Market movements are reflecting the underlying strength of Britain's position:

- * The major banks reduced their base rate of interest on 8th June by $\frac{1}{2}$ per cent to $12\frac{1}{2}$ per cent.
- * The trade weighted index of the exchange rate was 90.9 on that day, only 0.3 per cent below the average for the first quarter of 1982.
- * The Financial Times all share index reached an all-time high on the same day.

This confidence in the markets arises because the Government has resisted what Mr. Leon Brittan, Chief Secretary to the Treasury, has called "an almost irresistible clamour to open the floodgates of monetary and fiscal irresponsibility" (Iver, 24th May 1982). The results of the Government's strategy are now to be seen:

- * Restraint on government borrowing is responsible for downward pressure on interest rates.
- * Inflation is being brought down, and the medium-term financial strategy is firmly in place to control monetary growth.
- * Recent results on productivity, pay settlements and competitiveness have been very heartening.

As Sir Geoffrey Howe has said: "At a time of considerable economic tension, confidence in our underlying strength remains firm. There have been no sudden changes of direction and no panic measures. Nor will there be. The world can see that there is no need for them." (St. Helier, 27th May 1982).

Markets have also been reassured by the Government's determination, stated clearly from the early days of the crisis, that the money needed to finance the Falklands operation will not be found by using the printing press. Mr. John Biffen has pointed out: "National honour can rarely be redeemed on the cheap. There is a price in blood and a price in treasure. Let it be clearly stated that the costs being incurred in the South Atlantic have to be met from a variety of non-inflationary sources" (London, 7th June 1982).

Historical perspective. "It is hard to think of any government since the war which could have faced the inevitable risks of military action on such a scale (as now underway to regain the Falkland Islands) without living in mortal fear of a collapse of sterling", said Mr. Leon Brittan (ibid.). He went on: "We hear much of what the last government did or did not do to deter Argentine aggression. But does anyone seriously think that an administration whose credit was exhausted and under which sterling slid to its all-time low could have launched a task force to defend its citizens 8,000 miles away?"

Sir Geoffrey Howe has also compared our situation now with that under Labour. In those days, "We were the country where financial probity only prevailed when the IMF was watching. Some people doubted whether the future could offer anything but a continuation of lingering and demoralising decline." Since then, there had been a sea-change. "People no longer refer with disdain to the British disease; rather, they speak approvingly of the British medicine" (ibid.).

Unanimity at Versailles. The seven Heads of State and Government of the major industrial countries met in Versailles on 4th-6th June at the annual economic summit meeting. Speaking after the meeting, Mrs. Thatcher said: "I've never known such unanimity of economic and financial policies." She said that the communique "confirms the sort of policies Britain has been following" (Daily Telegraph, 7th June 1982).

The summit communique, which represents the views of all the leaders, including the socialist President of France, stated: "Growth and employment must be increased. This will be attained on a durable basis only if we are successful in our continuous fight against inflation. That will also help bring down interest rates which are now unacceptably high, and to bring about more stable exchange rates. In order to achieve this essential reduction in real interest rates, we will, as a matter of urgency, pursue prudent monetary policy and achieve greater control of our budgetary deficits."

This demonstrates that the Government is well within the mainstream of international opinion within the free world. All of these countries recognise, like Britain, the need for a responsible balance between fiscal and monetary policy. That is why Germany, for example, has cut its budget deficit by 30 per cent this year. Other countries, such as Italy, the Netherlands, Belgium, Australia and Sweden are taking similar measures. Sir Geoffrey has observed that, "If there could be progress in achieving some reductions in the American deficit, the principal remaining obstacle to a fall in world interest rates would be removed" (ibid.).

The UK Opposition parties show every sign that they are prepared to let inflation accelerate. This clearly contradicts the considered opinion of all the leaders of the free world that lower inflation is a necessary condition for higher output and employment. Mr. Leon Brittan said: "Had we accepted even the characteristically half-hearted and confused reflationary prescription offered by the Alliance, let alone the full-blooded £9 billion package urged by Labour, our prospects now would be very difficult ... The economic policies, like the political values, of the Conservative Government have instead been those of responsible nations throughout the free world ... (Britain) now leads the world in pressing forward with policies internationally recognised to be correct" (ibid.).

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