SHAW, M.P.

10 DOWNING STREET

18th February, 1981

Thank you very much for your letter of 16th February, and for the thoughtful Memorandum which you enclosed.

I comment briefly on your Summary.

As I have made clear on many occasions, the Government is anxious to reduce interest rates, as soon as can do this, consistently with out determination to reduce the rate of growth of the money supply.

Government expenditure is still running at too high a level and the size of the P.S.B.R. has a crucial effect on interest rates. We are still doing out utmost to reduce Government spending, and I assure you that we will persevere in this task. The exchange rate is governed by market forces, and although there are, undoubtedly, disadvantages in the present relatively high rate, there are clear advantages as well.

I have sent a copy of your Memorandum to Leon Brittan, and I wonder if you would like to discuss it with him. I suggest Leon rather than Geoffrey, because Geoffrey is very heavily engaged in the preparation of his Budget.

I very much appreciate what you say in the fourth paragraph.

Michael Shaw, Esq., D.L., J.P., M.P.

10 DOWNING STREET

18th February, 1981

I enclose a copy of a letter dated 16th February which I have received from Michael Shaw, together with a copy of the enclosure, and of my reply.

Would you be kind enough, please, to have a word with Michael about this?

Leon Brittan, Esq., QC, MP.

MICHAEL SHAW, D.L., J.P., M.P.

HOUSE OF COMMONS
LONDON, SW1

16th February 1981.

Dear Prime Minister,

I have read so many conflicting reports as to Government thinking on our present economic position, that, hesitantly, I feel that I must write to you.

In the Autumn I felt that the only way that I could clear my mind on the problem was to put my thoughts to paper.

Accordingly I did so – & today on rereading what I then wrote, I feel that my present thoughts have not changed at all – except that I am now even more worried than I then was.

I know the present tremendous burdens that must be on you – & the depth of expert advice that is available to you. – Nonetheless, it is just possible that the views of a loyal supporter may be of some use.

It is for that reason that I venture to enclose a copy of the memorandum I then wrote.

Please do not dream of replying! Yours ever Michael.

Reflections of an old Backbencher
<u>concerning our present economic difficulties</u>

<u>1st November, 1980</u>

We have been warned that we should not lose our nerve and do a 'U' turn, as was done in 1971 under the last Conservative Government.

This is to completely misread both history and our present position.

What happened then was that, reflationary measures having been taken, there was a longer time lag than expected before the results began to appear. Before that happened, the Government lost its nerve and continued to take further reflationary measures. I say the Government advisedly - because the Back Bench Finance Committee, which then included at least one of the present Treasury team, strongly and persistently pleaded that there was no need for further action and that the upturn would come - albeit somewhat later than expected.

At that time we were right to accept the problem as a single one - capable of a general overall solution.

Now we are told that the deflationary measures that we have taken have clearly <u>not</u> yet worked and so we should continue them.

Again, it seems that we are to assume that the problem is an overall one. Until it has been wholly and successfully resolved - then the overall deflationary measures must remain.

Of course, I remain convinced that we must take every necessary step to stop inflation - even if it means an increase in taxation.

Yet this demands not a blind following of a single system - but a more detailed treatment of the several aspects of the problem.

I analyse the problem as being between the private and public sectors.

The Government's cures involve high interest rates and the cut back in Government spending.

So far as the private sector is concerned, the cure is working and the proper projection of Government policy ought now to be a substantial drop in interest rates.

- This could not in any way be regarded as a 'U' turn

- but rather as a successful continuation of policy.

But because the full effects of what we have done in the private sector have not yet appeared, we seem prepared to go on dishing out the same harsh medicine.

In other words, so far as the private sector is concerned, it is 1971 all over again.

Then - having provided a tonic, we failed to recognise it was working - so we provided more tonic - so that the economy ended up over-provoked.

Now - it seems - having provided a depressant, we are again failing to recognise how effectively it is working - so that the dosage continues - with damaging and, in some cases, fatal consequences.

But - it may be said - our policies have not been effective in the public sector.

- I agree - and of course we must seek to be more effective in fulfilling our policies in that public sector.

But just because our policies with regard to the public sector have not as yet worked, does that mean that we have to keep on administering the same strong medicine to the private sector?

- I believe not. The necessary disciplines in the public sector are all to do with the decisions of Government - local or national.

The discipline of interest rates, whilst so important to the private sector, is not the same critical factor in the public sector.

It may be argued that this is not true and that if interest rates are now lowered the following consequences will ensue:-

1. Industry will borrow more.

2. Less money will be attracted to this country.

3. The continuing and, as yet, uncontrolled public loan demand will then force up interest rates once again.

4. The value of the pound will fall.

In the first place Industry will still only borrow what it has to. The rate of interest, whatever the drop may be, will still be substantial.

Secondly, the high rate of interest is not the deciding factor in attracting money to this country - it is the strength of our oil resources and the confidence in our present Government.

Thirdly, whilst we must continue to press hard to reduce the need for public sector borrowing, there seems no point at all in paying greater interest charges than we need.

Fourthly, the value of the pound is overstated. A reduction of interest rates will not, of itself, cause a dramatic fall. - Some fall would be both realistic, desirable and of proper help to industry.

Finally, I refer to another matter. I do not believe that any country is strong enough to leave its currency entirely at the mercy of the market place.

As long as it is, then over-cautious policies must be pursued to make its currency at all times clearly attractive.

Even so, the sudden whims of a Bunker Hunt, the Arab economy or even world opinion as a whole could send such a currency out of control.

Of course, there should be as great a freedom of movement of sterling as possible - but it must be orderly. There must be some restraint, when huge sums can slosh around the world markets - capable of causing immense harm to the stability of sterling and our national economy.

In summary - what do I want?

1. Lower interest rates.

2. A continued attack on Government expenditure.

3. Some restraint on the free movement of the pound.