From: The Rt.Hon. Sir Keith Joseph, Bt., M.P.

The Rt.Hon. Mrs. Margaret Thatcher, M.P.,
Prime Minister,
10 Downing Street,
London, S.W.1.

6th August 1981.

I only bother you with this letter just before you go on holiday in case you should think that the contents justify some working up in preparation for your return.

My perception is that we have not yet effectively enough persuaded the country that the rise in unemployment is largely due to the level of unit labour costs and that the prospects for employment in the future depend mainly upon recovering competitiveness, particularly in these same unit labour costs.

My suggestion is that you should authorise an approach to Tim Bell - the best presenter known to me of a case - about the best way we should intensify our efforts. My hope is that you will give him free rein to propose what should be presented, by whom, by what methods, on what occasion and with what follow-up.

The subject lends itself to visual aids: possibly to an intellectual confrontation: possibly to trade union participation: on no part of this have I opinions worth having. But Tim Bell would.

Tim would require an intellectual background.

> He would need to have the distinction drawn between the impact of the £ on the one hand, and the impact of rising unit labour costs over recent years, and particularly in 1980, on the other. You used some of the key figures very effectively yourself in the recent censure debate.
>
> He would need to be careful not to exonerate management, which ranges from brilliant to poor: bad design, weak marketing, sloppy production control have been, and are, important factors - but the confidence and the scope of management, and the profits they need for expansion, have all been hammered over recent years by much trade union short-sightedness.
>
> We would need to identify for him the remorseless rise of the wages share and the consequent fall of the profit share of company income - and the effect this has

had on labour costs, competitiveness and management scope, and therefore the effect on jobs.

(Please note that the raw statistics do not show profits being raided by labour costs in the way that we know has in fact happened: Department of Industry statisticians have however explained why it is still true that profits have been raided by earnings, in an answered prepared at my request to a question from Mickey Grylls).

He will need to be given our unit labour costs in comparison with those of our competitors.

It seems to me that we would want to stress that management defects need to be reduced as well as excessive unit labour costs, but we can surely explain that the defects of management cannot be cured overnight - marketing and design and development failings take time to correct - whereas unit labour cost excesses can be cured overnight, or can at least be prevented from getting overnight even worse.

We surely should not flinch from the fact that we stressed unemployment under Labour as one of our election themes. How could we be expected to have known that the £ would rise so sharply: that there would be another oil hike: and that, above all, there would be the job-annihilating pay increases of 1980. To add that massacre of jobs, on top of those already destroyed by the increase in unit labour costs of previous years, was the responsibility of the trade unions, who were warned by us - and who are now leading the complaints.

It is my hope that if Tim Bell were given the material he would be able to suggest how best to present it to secure interest, understanding and follow-up. Provided that we do not flinch from management's role, and our own part where relevant, we have an impeccable case.

In putting the argument for a new presentation to John Hoskyns there has, however, been revealed a difference of emphasis. He accepts the main thesis, but he argues that our stress should be on keeping future pay settlements moderate, while I would prefer to stress reduction in unit labour costs. He argues that reducing unit labour costs will involve higher productivity, which will increase unemployment over and above that which is already spontaneously emerging. I argue that only to the extent that, for instance, Merseyside or Glasgow proclaim themselves convincingly as areas of sustained low unit labour costs would employers be attracted to them. I note this disagreement for what it is worth: the two purposes of moderated settlements and lower unit labour costs are of course mutually consistent.

Lastly, I turn to an aspect which is right outside my detailed knowledge, but I get the impression that very few television interviewers and very few news presenters show any interest in, or understanding of, cause and effect in connection with unemployment. This has often been deplored by us, but surely we should try to do something about it. My necessarily - because I am so ignorant in this area - feeble suggestion is that we should seek the advice of those who do have interest and do have understanding, such as Robin Day - and there may be others - on how an increase in interest and understanding could be achieved among other interviewers and presenters. Efforts would have to be made one by one, and any gain in interest and understanding would be worth having. I know that Aims has given study to this subject, and might be able to give us some analysis.

I am sending this to you unpolished in order to reach you before you go off. I am copying to Geoffrey Howe, Norman Tebbit, Ian Gow and John Hoskyns, to each of whom I have to varying extents exposed the ideas for what they are worth.

S.K.J. R H

cc: Mr Gow
Mr Hoskyns

10 DOWNING STREET

From the Private Secretary

7 August, 1981

As you know, the Prime Minister has left for Cornwall this morning. She has asked me therefore to thank you for your letter of 6 August about publicity.

The Prime Minister was interested in your proposal that Tim Bell should be asked to help in the presentation of the reasons for the rise in unemployment, but she would rather not reach a firm view on this until she returns.

I am sending a copy of this letter to the recipients of yours.

T. P. LANKESTER

The Rt Hon Sir Keith Joseph, Bt, MP

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

Keith Joseph has sent me a copy of his letter to you of 6 August, proposing an approach to Tim Bell on presentation of economic facts.

2. I am sure that we have not done enough yet to put over the basic reality of poor competitiveness as the key weakness in the British economy. The present is a good time to start planning a campaign because of the recent fall in the exchange rate. For British industry cannot easily use the argument that Government policy has pushed up the exchange rate to a level at which de-industrialisation is unavoidable - and thus avoid their own responsibility for the level of costs. Indeed, in the present situation I believe that the CBI could play a valuable part in getting all these points into the minds of TV and radio participants. I am encouraging them to think of ways of doing this.

3. On the particular difference of emphasis between Keith Joseph and John Hoskyns, I do not think we should flinch from arguing on the basis of unit labour costs. Certainly, in the first instance, higher productivity can mean fewer jobs. But one would be taking a very pessimistic view of the working of the market if one did not see beyond that the certainty that reduced unit costs would lead to enhanced competitive power and a consequent revival of activity. We must not subscribe to the favourite trade union thesis that there is only a limit amount of work to be done and that it therefore has to be shared round.

4. It would be most interesting to have Tim Bell's advice on presentation, ready perhaps for consideration at the beginning of September.

5. I am copying this minute to Keith Joseph, Norman Tebbit, Ian Gow and John Hoskyns.

Peter Jenkins

for (G.H.)

11 August 1981

(Approved by the Chancellor of the Exchequer and signed in his absence).

SKJ

On course for a competitive trade base

In a speech on government and industry in London on 2 April, Secretary of State for Industry Sir Keith Joseph described the government's diagnosis of industry's problems and its aims, drawing attention to the achievements and setbacks of its first two years in office and outlining the strategy for the rest of its term. The text of the speech is reproduced below.

Nearly two years after the election it seems sensible to try to assess the government's policies towards industry, where we are, the gains and the losses. The conclusion to which my analysis leads me can be put simply: progress from where we were to where we want to be is even more difficult than we had expected. But we are still on course and we are determined to stay on it.

Where was industry?

When we came to office the relative performance of our trading base – particularly our manufacturing trading base – had for years and years been deteriorating: in many sectors we were no longer able to compete with our major competitors and survived only by successive devaluations of the pound with the consequent successive increases in inflation. Our lack of competitiveness arose partly because of years of high inflation – well in excess of our competitors – caused we believe by government over-spending and over-borrowing; partly because of patchy management; partly because of trade union working practices and over-manning; partly because of government controls and interference; partly because of violent swings in government policies; partly because of tax and other discouragements to enterprise and effort; and partly because as a nation we seemed to have lost much of the entrepreneurial edge which once made us the wealthiest country in the world. We had higher inflation, higher unemployment and a lower standard of living and of public services than many of our neighbours. We had become a poor man among the advanced nations.

Our diagnosis

In opposition we saw the facts and we looked for the causes of our national industrial malaise, not just at its symptoms. We rejected the fashionable remedies, which tended to focus around even more public spending and even more government intervention. These remedies might have very briefly abated one of the main symptoms – unemployment – but they would have made us even more uncompetitive and unemployment would, after a short time, have risen even more. We were convinced that our economic decline was due above all to a widespread misunderstanding – among the public at large and trades unions in particular but also indeed among policy makers and communicators – of where jobs come from, where rising standards of living come from and where improved public and social services come from. The basic fact is that all these prizes come from customers: no customers, no jobs. This is obvious in the case of manufacturing and commercial jobs since if there is no payment there will not long be jobs. But it is also true for public service jobs, pensions and benefits since they are paid for largely by taxes, direct and indirect, on trading companies and those who work in trading companies – and trading companies depend upon customers.

We were convinced that winning and satisfying customers means beating increasingly fierce international competition, sometimes unfair, and beating the competition means that managements and workforces need continuously to adapt their products and their methods.

We were convinced that at the heart of competitiveness lie the skills of entrepreneurial and professional management and the cooperation of well-trained and willing workforces. It is competitiveness alone that can create prosperity, sustain fuller employment, increase standards of living and secure decent pensions and public services. Being competitive involves good design, marketing drive and the profitable harnessing of research and development: but it also involves keeping unit labour costs relatively low. Low unit labour costs do not necessarily mean low wages – far from it. High productivity can translate good earnings into low unit labour costs.

We were convinced that our economic performance has been undermined by inflation. For the past 20 years or more businesses, and those who work in them, could not rely on the money they earned or the money they invested in manufacturing retaining its value. So workers neglected the need for their firms to be competitive and profitable and concentrated on demanding higher money wages. And investors and managers took fewer risks than they would if they had the confidence that tomorrow's pound would be worth the same as today's. Inflation widens the margins of error and discourages risk-taking. Unless inflation is brought down nothing else which we can do to encourage enterprise is going to be effective. That recognition lies at the heart of our medium term financial strategy and of Geoffrey Howe's courageous budget measures against inflation and in favour of declining interest rates.

We were convinced that the economic and cultural climate over the past 30 years has kept the birthrate of new businesses and the growth rate of existing small businesses below that of our competitors – indeed far lower than is socially as well as economically desirable.

We came to office convinced that inflation, high marginal rates of personal taxation, pervasive controls, expanding employment in the public sector, obstruction by the trade unions

Sir Keith: 'No customers, no jobs.'

of the higher productivity and the competitiveness necessary to fulfil their members' aspirations, and rising levels of real wages even when real profits, particularly in manufacturing industry, were already low and were declining further had all contributed to the decline of our trading performance.

And we came to office convinced that the structure of the nationalised industries contributed to the national malaise. We realised that the nationalised industries had talented and devoted people and that a number of nationalised activities were pursued with enthusiasm. But we also realised that in all too many cases, particularly when the nationalised industry commanded a monopoly, those concerned did not see themselves as living under the healthy necessity of satisfying the customer in order to survive; they had no incentive to cut costs to beat competitors; they were free of the risk of liquidation. Regardless of the mistakes they might make, regardless of whether they satisfied their customers or not, regardless of whether they improved their productivity or performance or not, those employed in nationalised industries could be confident that their employer would not disappear tomorrow and that they could put up their prices with almost no risk of losing jobs.

Our aim

Such was our diagnosis: what was and is our aim? Our aim is to abate inflation and to create a prospering social market economy – that is, a mainly free-enterprise economy, competitive enough to support as full employment as possible in both the trading sector and public services within a civilised framework or laws, public services and safety nets.

The proper economic task for any society is to reconcile the interests of the people as producers or workers with the interests of the same people as consumers – in conditions of freedom. It is this task which is best done by the pursuit of profit within the law and subject to competition – that is, by a market or please-the-customer approach. People as producers of goods and services are led in their own interest to search out what people as consumers at home and abroad want to buy and to provide it at a profit. People as consumers seek out the best buy – the goods which are best value for money – and reject those that are priced too high, have poor quality or which they do not hear about.

It is competition which forces producers to give value for money. It is competition in pursuit of profit but at the risk of loss which harnesses the self-interest of people as producers to the interests of people as consumers. It is competition which makes the pursuit of profit and the fear of loss the best way yet discovered to raise the standard of living and the level of employment and public services. Compare what has been achieved in America, Switzerland and Germany which allow decisions to be taken by the free play of competitive market forces with the backwardness of the eastern bloc and the other countries which suppress competition. It is competition in conditions of freedom which makes profit morally defensible.

The significance of the social market economy is that the market approach – the please-the-customer approach – is set within a social framework with such laws and services and regulations as are at any time judged proper – social security benefits, preferably not at levels to dilute incentives; environmental regulations related to pollution, for instance, and noise; safety regulations, and the like, but subject always to the proviso that the trading base should be able to afford the level of services and regulations involved.

It is the social market economy approach which embodies the best hope of a humane yet prospering society with fuller employment, individual freedom and decent public services.

Our policy

Our policy to bridge the gap from where we were to where we aim to be did not involve an attempt to alter industry by direct government intervention. Instead we set out to alter the framework within which industry operates by creating an economic climate encouraging to enterprise and effort, reducing controls, denationalising, improving and where practicable demonopolising the nationalised industries and fostering the birthrate of new businesses. We aimed to move towards monetary continence in order to abate inflation. We recognised that monetarism would not be enough and that it would also be necessary to reverse the growth in public spending and borrowing in order to reduce the growth in money supply without the need for higher interest rates.

Our policy was to move as fast as practicable – taking into account the roadblocks of trade union immunities and attitudes; equivocal public attitudes towards wealth creation; the immunities of nationalised industries; and the momentum of government spending – towards a more adaptable, social market economy, which would be competitive, profitable and therefore able to generate fuller employment, rising living standards and improvement of public services with a high birthrate of new viable businesses. And we aimed that all this should be within a civilised framework of laws, services and help for those who could not help themselves or who needed cushioning against the effects of change. We saw as one of our main tasks the removal of obstacles to enterprise and effort.

We always realised that the transition from a high inflation, uncompetitive economy to a soundly-based internationally competitive economy would be difficult: deeply entrenched attitudes and structural weaknesses in the economy would have to be overcome and that would require more than the lifetime of one parliament. We realised that our aims would be difficult to achieve; they have in fact proved even more difficult than we anticipated because we did not get the full measure in advance of three factors that have sharply influenced events. We could not have guessed that oil prices would rise so fast and so soon with consequences that have slowed down the growth of world trade, contributed to the rise in sterling, helped abate inflation but put great pressure upon much of our industry. We underestimated the extent to which nationalised industries and government-owned companies could impose obligations on the taxpayer as owner and the additional costs imposed on these industries by the recession. And we underestimated the momentum of the growth of government spending, largely caused by spiralling public sector pay.

Where we are

We came to office at a time of oil shock, rising underlying inflation, low real profits, excessive union power, high wage demands after the shattering of pay controls and unemployment twice as great as that which Labour inherited.

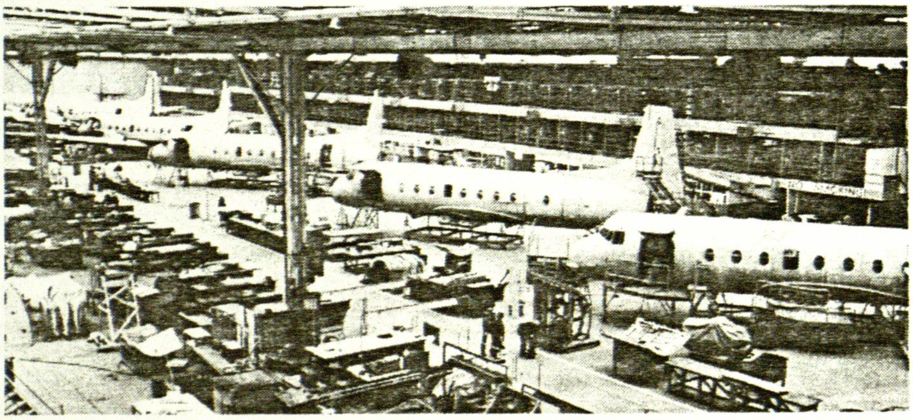
Achievements

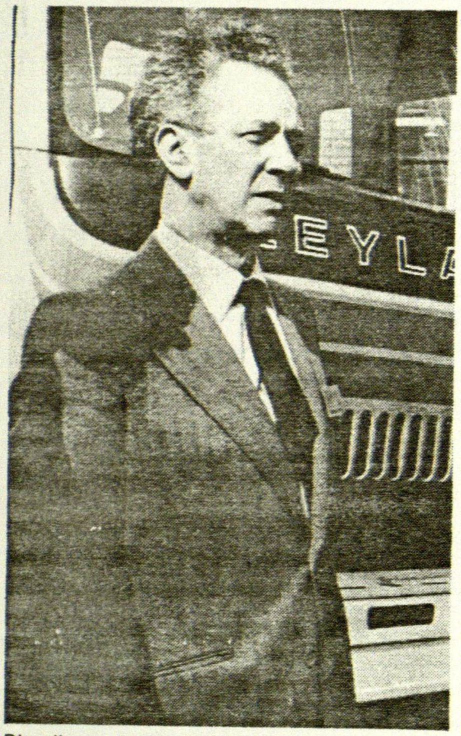
Inflation, which was rising fast when we came in has been brought sharply down and is falling: interest rates, after rising, are now declining: tight financial conditions have forced the trading sector and increasingly though, to a lesser extent, the public sector, to slim and to become more efficient: overmanning has been cut: there is therefore latent productivity improvement for when the economy picks up. Management reports greater co-operation from workforces, greater realism. The government has reduced marginal income tax rates, has abolished direct controls on pay, prices, dividends and foreign exchange; industrial development certificate controls have been cut; control systems such as planning and building regulations that had grown excessive and obstructive are being pruned: regional policy has been concentrated on the areas of most economic weakness; incentives for the birth and growth of small businesses have been provided; the shortage of small factories is being made good; the expansion of over-seductive public careers – civil service, academic, local authority, social services – has been reversed. We have cut back the role of the NEB, requiring partnership with private enterprise for new ventures. We have made some valuable changes in trade union law which make a start in correcting the balance in the labour market. We have denationalised British Aerospace; announced decisions to denationalise Cable and Wireless, British Airways, British Rail's subsidiaries and the British Transport Docks Board; set in hand a liberalisation of the telecommunications, and bus monopolies. We have moved part of British Steel's activities – Allied Steel and Wire Ltd – back into the private sector; we plan to move more of BSC's activities into the private sector and we are seeking powers virtually to liquidate BSC if it should become clear that it could not become profitable; and we have set BL on the way to profitability, partnership, sale or, for any parts which ultimately fail to make good, liquidation.

Setbacks and problems

Unemployment. Unemployment has risen sharply: it has risen in all industrial countries partly for reasons outside the control of anyone, such as the oil shock and the slow-down in world trade; but unemployment has risen more here because we were so over-manned; because for many years we took soft options and deferred difficult decisions, failing to improve productivity; and because unions insisted upon and management allowed high wage increases without commensurate productivity increases. It has not been lack of

British Aerospace – now denationalised.





BL: slimmed down.

consumer spending at home that has caused unemployment: demand here has kept pretty steady. It is destocking and a cut-back in investment that caused the fall in manufacturing output.

The rise in unemployment is not the result only of present pressures. For many years, long before we came to office, there had been weaknesses of management in many companies: long before we came to office unions were demanding excessive wage settlements, raiding the funds needed for investment and crippling productivity, competitiveness and profitability by overmanning and restrictive practices. Companies have been weakened over many years: many managements say that they are now doing what they should have done years ago.

Government spending. Despite our original cuts in Labour's planned expenditure – and our cuts since – we have not managed to avoid a rise in government spending. As a result government borrowing has remained high and this in turn has caused interest rates to be higher than we would have wished. High government spending has been partly caused by the unpredicted depth of the recession and the degree of extra unemployment but other important factors have been rising money earnings in the public service – now slowing down – and increased losses in some nationalised industries. We are taking steps to bring these industries nearer to profitability and are denationalising where we can. But taxpayers cannot escape funding loss-making industries which they own – except as such industries become profitable or are sold or liquidated. Money used to fund nationalised industries and publicly owned firms like BL is largely taken from the private sector by one means or another – higher taxes or higher borrowing that pushes up interest rates all round: it saves one lot of jobs at the cost of another lot of jobs. To liquidate the loss-makers is in itself very costly for the first year or two both in money and jobs: moreover, in order to liquidate it may be necessary to change the law and we do not shrink from that: a bill to make it possible virtually to liquidate British Steel has just been introduced.

Please note particularly that taxpayers' money is not being spent to keep BSC and BL as they were but to slim them and make them viable. BSC shed 52 000 jobs in the last year – nearly one-third of its workforce. BL has lost a third also – 57 000 jobs – over the most recent three years. Drastic reductions in manpower as in both these organisations impose intense social and emotional strains, particularly because in many cases whole communities are involved. The government has thought it right to spend heavily to mitigate the social and human implications in such cases.

Investment. Investment has fallen – and this must have implications for the upturn. Much of the investment we have is world class but much of our investment is still over-manned or inappropriate. Investment in Britain produces far less per unit than abroad because patchy management, over-manning and restrictive labour practices are so widespread. Our unit labour costs are therefore higher than our competitors. Our position would be transformed if existing investment were used more effectively.

International competitiveness. A massive loss in international competitiveness has imposed an immense burden on manufacturing industry. We always knew that the process of transition from a deteriorating trading base to an expanding social market economy would be difficult for industry: years of overmanning, patchy management, restrictive practices and the cosy insulation from reality provided by a combination of inflation and persistent devaluations could not be ended without some pain: ending bad habits is never easy. But the transition problems have been compounded by a savage deterioration in industry's international competitiveness: up-to-date statistics are not available but for example sterling rose by 9 per cent against the Deutschemark over the two years to the third quarter of 1980 and at the same time our unit labour costs rose 20 per cent more than in Germany. This has squeezed British manufacturers; a typical British manufacturer selling goods to Germany would have needed to raise his prices by 9 per cent in Deutschemark terms in order to receive the same number of pounds and by a further 20 per cent to recover his additional unit labour costs, making a total increase of 29 per cent. A Germany manufacturer selling goods in this country would have been able to cut his prices significantly in sterling terms while not affecting his profits. Faced with this competitiveness gap, which has worsened over the past year to well over 30 per cent, industry has suffered acute pain; it has been unable to put up its prices abroad and it has faced intense prices competition at home.

Energy prices. Energy pricing has emerged as a problem. We are well aware that industry with high energy dependence is under acute pressure from international energy price differences. Geoffrey Howe made possible some relief in the budget: any further government financial relief would increase the borrowing requirement and affect interest rates. We stand by our commitment to economic pricing but energy prices are being kept under active consideration.

Impact on manufacturing industry

This combination of factors – the oil price shock, the slowdown in the growth of world trade, the rise in the pound and inflation causing the massive adverse swing in our international competitiveness, the continued high level of public expenditure and consequent level of interest rates, the increases in nationalised industry charges particularly for energy and local authority rates – have combined to throw an immense burden on manufacturing industry. What is more, these changes have impacted on industry with unprecedented speed. As I have said, we never expected the transition from a high inflation, uncompetitive economy to a soundly-based internationally competitive economy to be easy and we knew that manufacturing industry would have to bear some of the brunt. What we did not anticipate was the additional cumulative intensely severe impact on industry caused by the factors I have described. Moreover, as a government we must accept the criticism that, so far, the major burden has been borne by the private manufacturing sector and that the public sector has been largely cushioned from the full effects of current circumstances. The government has not cut its manpower at anywhere near the rate of the private sector, nationalised monopoly industries have put up their prices in ways not open to private industry and local authorities continue with inflated pay rolls paid for by higher rate demands. The government recognises the indignation with which industry views the massive burdens imposed upon it.

Our reaction to industry's difficulties

At this point I should emphasise that there is no painless escape from our largely self-imposed problems. It would be wrong to imagine that the government can spend our way out. The money spent by government would have to be raised – and raising extra money to spend would itself involve higher taxes or higher borrowing paid for by higher interest rates. Each of these courses would destroy jobs. Though there can be much debate the broad truth seems to be that government cannot reduce the exchange rate without consequences – particularly in higher inflation that might make pressures worse.

Equally we have never pretended that industry could make the transition from where it was to where it needs to be without some transitional help. There is a popular myth – peddled by some leading commentators – that the government attempted to jump overnight to complete hands-off policy of non-intervention: we are criticised for failing to do what we neve said we would attempt. Our critics should read our manifesto. Of course we realise that industry wants help to survive: and that is why we focus on trying to secure declining inflation and declining interest rates.

For those who measure help by the size of direct and indirect government payments to industry it is worth moreover remembering just how much has been spent on industry over the past two years. In 1980-81 the taxpayer spent over £700 million on regional and general industrial support – including £470 million on regional development grants for investment in the regions and £135 million on selective financial assistance for investment. In the same year the taxpayer spent £150 million on scientific and technological assistance and a further £600 million on support for aerospace, shipbuilding, steel and vehicles. This totals £1.5 billion. On top of this there have been subscriptions of capital to BSC (£1,233 million) and to British Shipbuilders (£147 million) as well as 100 per cent first-year depreciation allowances for investment and massive stock relief. Expenditure on industrial support, including much of the expenditure on BL and steel, will have been spent by recipients on investment goods produced by the private sector. The money spent will therefore have spread widely through manufacturing industry.

The government does understand manufacturing industry's massive problems in these difficult times. In addition to spending so much of the taxpayers' money on industry the chancellor's whole budget stance was adopted to ease industry's burdens. Of course, we would have liked to have done more about energy prices where they hurt most but we could not afford to do so. What we did do, however, was to take painful and politically unpopular decisions to increase taxation and not to index income tax relief simply and solely to provide industry with what help we could manage on stock relief, energy prices and above all interest rates. This point needs to be stressed: we deliberately took politically unpopular decisions in order to reduce our borrowing requirement so that what was done for industry could be done and so that there was room for interest rates to fall. The 20p per gallon increase in the price of petrol and the decision to hold the PSBR at £10.5 billion were the price paid to ease industry's burdens.

The dilemma is that the reliefs industry sought – a cut in the NIS and a bigger reduction in energy prices – would have increased public expenditure and the government's borrowing requirements. This in turn would have forced up interest rates, imposing fresh burdens on industry, greater perhaps than the burdens we would have relieved though differently distributed.

Since we accept that industry does have genuine needs, since we recognise the unfairness of the burden which industry is carrying while the public sector is as a whole relatively much less affected and since the public expenditure constraints are so tight, the government recognises very well the need to slim public sector manpower. The task is slower than in industry, to some extent because of legislative and contractual barriers, but much has been done in BL and BSC. In the Department of Industry manpower will fall by 23 per cent by 1 April 1984 and the civil service is shrinking by 14 per cent by that date. The growth in local authority manpower appears to have peaked and Michael Heseltine's measures are aimed at securing a reduction in numbers. The unpopular decisions taken by the chancellor in the budget in order to ease interest rates for industry are surely the best evidence that the government will strive in every way we can to ease industry's burdens further in the future.

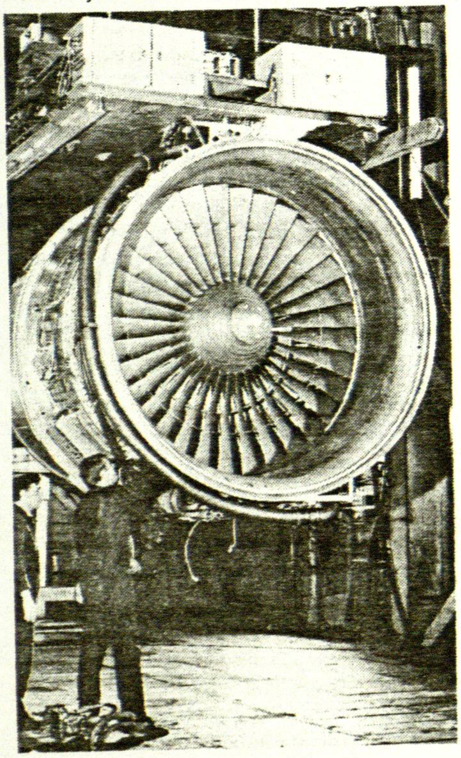
But is there an industrial strategy?

The phrase carries overtones from the past unintended I am sure by many of those who use it: it was the magic password brandished by those who believed in government intervention in industry for its own sake, who believed that an NEB and planning agreements could solve our problems. Let us try to distinguish between different meanings of the phrase.

There are many who would like to see government picking and backing winners. But in this country it seems that the losers pick ministers – the pressures seem to force ministers to back losers rather than winners. Anyway winners do not need subsidies: they may need pilot orders – and that is one legitimate use of the new public purchasing policy we have initiated.

There is already vast taxpayers' investment in the nationalised industries and in publicly owned firms like Rolls-Royce and BL – and the benefits of this investment as I have already mentioned largely flows through in orders to the private sector. Certainly there should be scope in addition for some privately financed, risk-taking but potentially profitable investments in nationalised industries. Perhaps some of those who urge an industrial strategy seek this.

Rolls-Royce: 'vast taxpayers' investment.'



Some who urge an industrial strategy in fact want investment regardless of prospective profit: they want it for industries which they think may grow or which they call 'strategic' or for industries which are big employers or industries which are in decline. We have had experience in this country of subsidising industries for one or more of these reasons – and not much good has it done us or them.

We are often urged to copy Japan, but Japan succeeds not primarily because of government guidance but because of the drive and quality of management, the education, work ethic and productivity of their workforces and the cultural homogeneity of their society. We are urged to copy France – and there is much to admire in the industrial successes France has achieved in 20 years of government by one party with the time to carry through its policies.

Of course the argument for more investment by government could be based on a disagreement with the chancellor's judgment that £10.5 billion is the most he can borrow at declining rates of interest and declining inflation. Some say that government should borrow a yet higher figure; they might urge perhaps an extra £1.5 billion for more investment. If not £1.5 billion why not £2 billion or £3 billion? Those who argue in this way can give no real explanation of how they could avoid pushing up either interest rates or inflation. The fact is that someone has to make a judgement on borrowing and the chancellor is entrusted with the job.

Some go further – as Mr Shore says he would – and ignore the rate of interest and the trend of inflation and set virtually no limit to the amount we should borrow and invest – but they would create an inflationary inferno and rocketing rates of interest.

Some pray in aid North Sea oil, arguing that this revenue should be used to back industry. But it is already used. It is one of the streams of revenue which the government mingles together and allocates to different purposes including industry and nationalised industry. Of course we could pluck out North Sea oil revenue and use for additional industrial investment but then we would have to cut existing government spending be it for industry or whatever which is now being financed by North Sea oil revenue or we would need to borrow or tax more, destroying in the process private sector jobs and investment. The North Sea oil line of argument all too easily becomes an argument for reflation – that is, for re-inflation and for higher rates of interest.

So we reject these versions of an industrial strategy but we do have an industrial strategy: it is the basis of policy-making to be adhered to as closely as we can achieve.

Our industrial strategy is to create a climate or framework encouraging to enterprise and effort. This is no mere slogan. We have already done much to move towards an encouraging climate; such a climate involves sound money: personal freedom under the law: stable and encouraging fiscal policies: good industrial relations and company law: effective competition policy: freedom to set prices and wages: good education: choice in housing: sensible environmental and safety codes; and safety nets for those who are casualties. We know we have much still to do on several of these and on ensuring good skill training. It is part of our industrial strategy to identify and, where possible, remove obstacles holding back enterprise and effort: and do not underestimate the importance of the identification and removal of obstacles in our relatively immobile economy: this is what we are now doing for instance in connection with telecommunications and with information technology.

The main plank of our industrial strategy is to abate inflation and enable interest rates to fall by steadily reducing government borrowing – as in the chancellor's budget. Our strategy provides taxpayers money for industry to encourage investment: to help research and development: to help promising new products and processes that might not otherwise be launched: to assist the worst-off regions: to facilitate the awareness and adoption of new techniques such as microcircuitry or biotechnology or robotics: to encourage small businesses: to use effectively the buying power of public agencies: to make the best of the skills in the nationalised industries but to denationalise or demonopolise wherever practicable: to provide credit and aid to help exports, particularly in big capital projects overseas: and to encourage overseas investment here in those cases where it helps the economy.

Let no one scorn the pursuit of the encouraging climate or framework. While we have parts of it, we lack others: indeed we have actively perverse elements in our economic climate. Given the right framework – including sensible decisions in connection with nationalised industry investment, public purchasing and the range of help still available – winners will pick themselves and in nearly all cases finance themselves too.

In brief we have not changed our diagnosis or our aims. Some unpredicted factors have made the transitional stage more difficult. We have already taken many of the critical steps to pave the way to a more competitive economy. The relative decline of decades has not been reversed in a couple of years but the change of direction has been begun.

Progress is necessarily patchy. The limelight focusses on the difficulties. But progress there is, masked by the recession and its side effects. Attention should not be diverted from this by the spending of large amounts of taxpayers' money on slimming some nationalised mammoths so that they have the chance to become competitive nor by a temporary guarantee to see a key government supplier, ICL, over a hump. They are not critical setbacks on the road towards an economy living within its means, leaner manned, internationally competitive, and encouraging enterprise and effort.

Towards fuller employment

And how, we are asked, will we ever return towards fuller employment? I stand by the analysis in a lecture I gave in 1978 on 'conditions for fuller employment'.

The way to fuller employment is to allow jobs to occur as they will if allowed. The government, except in its role as remover of obstacles and creator of framework, can only create or support industrial jobs by spending money which would otherwise have created or supported other jobs. Jobs and employment arise when entrepreneurs are able to produce goods and services which customers at home and abroad want and can afford to buy and when the trading base so created supports a public sector which it can afford and which does not overload or stifle it. The government's task is to create the climate in which this spontaneous creation of jobs can occur.

Many new jobs will be provided by larger firms as they identify unfilled needs. These investments and purchases will provide work for a host of smaller firms and, as industry and commerce become more sophisticated, more people will be needed to service and support them. Service industry employment will continue to grow. The international record shows that industries that are efficient in that they benefit from lower unit labour costs in fact provide more jobs because they grow at the expense of other industries and other countries. But we see a growing role for smaller and medium-sized firms.

We see the government's role as encouraging fuller employment by promoting competitiveness and adaptability throughout the economy and by encouraging a higher birth rate of viable new businesses.

The chancellor has just in his budget provided a further crop of measures to foster a higher birth rate of viable new businesses, but they will take time to be effective. New businesses and expanding existing small businesses will provide many new jobs.

As for competitiveness, the more competitive our trading base the larger and the more numerous will be the markets it will profitably serve, the more the people it will need, directly or indirectly, to employ and the larger the public services which it will be able to afford to finance. The key is competitiveness and the keys to competitiveness are good management, adaptable workforces, good design, good marketing and low unit labour costs by way of rising productivity.

Rising productivity does reduce jobs in the short term but it does increase jobs over time. My colleague Peter Walker put the dilemma well. 'Increased productivity', he said recently, 'results in unemployment. A refusal to improve productivity results in unemployment.' Precisely so. Unemployment results from either course but the unemployment that results from increasing productivity is transitional – because the more competitive economy that emerges will generate and sustain more jobs, whereas the unemployment that results from a refusal to improve productivity could be permanent.

Provided only that productivity rises continu-


'Winners will pick themselves . . .'

ously, we can look forward over the years not only to fuller employment but also – to the extent we want them – more public services and more voluntary paid leisure including longer holidays. But we can have these prizes only if productivity rises.

Conclusion

We recognise the immensely difficult task of management particularly during this transition stage with all the cumulative pressures that there are. We hope that people will come more and more to value the skills of entrepreneurship and management in relation to so much that people want.

This is a country full of talent: as inflation comes down – and it has and will: as the upturn comes – and it will: as more and more firms are forced by the need to survive to trade up and to go for premium products: as higher output allows the latent increases in productivity to come through: as people and money move from declining to growth industries: as the birth rate of new businesses rises, the benefit that will come from this painful first stage of the period of transition from decline to renewal and expansion will emerge. Before our eyes the balance of the economy is shifting to become more competitive.

The aim of a social market economy is noble and humane, combining prosperity and fuller employment and decent public services with personal freedom all within a civilised framework of laws and services and safety net. But there needs to be a vigorous, adaptable competitive, profitable trading base upon which these admirable objectives rest. Without a competitive trading base there is no hope of moving on towards full employment nor of rising prosperity nor of improving conditions for the elderly and the disabled and the hard pressed and those in need.

The course to that thriving trading base is winding and a difficult one, even more winding and even more difficult than we anticipated. But our vision of business skills and vitality supporting a civilised society is practicable and humane. We are on course, despite the occasional detours, and on it we are determined to remain until we have released the trading potential of this great people from the obstacle and illusions which have held us back for so long.