BOX.

AMERY MP

18th September 1980

The Prime Minister has just left for Paris, and so I am writing to thank you very much for your letter of 17th September addressed to her.

The Prime Minister will see your letter on her return to London.

Thank you very much for having taken the trouble to write.

It was good to see you again on Tuesday evening.

Ian Gow MP

The Rt Hon Julian Amery MP

FROM: THE RT. HON. JULIAN AMERY, M.P.

112, EATON SQUARE,
SWIW 9AA
TEL: 01-235 1543
01-235 7409

Personal + Urgent

17th September, 1980.

Dear Margaret,

When I came to see you on 3rd June we talked mainly about defence and foreign affairs. I mentioned then that I would welcome the chance of a word with you on the Home side.

Since that time economic and financial policies have come increasingly under fire and I have thought it might be more helpful to let you have a short note of what I wanted to say to you rather than bother you with a meeting during the recess.

I believe our policies are on the right lines but, in spite of considerable preparation, we had not hitherto taken sufficient account of how little control we have over the local authorities and the nationalised industries and how impossible it is, even with high interest rates, to prevent enterprising individuals meeting their own borrowing requirements outside the system. As a result we have lost time and - here I may be wrong - failed to arm ourselves with a sufficiently strong control over industrial relations.

I conclude from this that we may well not be able to live up to our prospectus by the time the election comes along and that we shall be lucky if we don't have to face the kind of confrontation with the TUC which effectively broke the Wilson, Heath and Callaghan governments.

My recommendation - I daren't call it solution - is that we should begin quite soon - i.e. before we are too obviously pushed onto the defensive - to bring forward an additional prospectus based on policies for increasing productivity. These should not be seen as replacing present policies but as running alongside them structurally and holding out some promise of the rewards which could attend sticking to our guns.

It is a good maxim of war that if you can't ~~scare~~ secure a decisive victory soon enough on the main front you should consider opening a second front and throw the enomy on to the defensive there.

Yours ever,

Julian.

Julian Amery

The Rt.Hon. Mrs. Margaret Thatcher, M.P.

P.S. I have marked this 'urgent' as I gather all this is very much on your agenda.

Notes on Economic Policy

The problem of inflation is essentially a problem of imbalance. As David Hume wrote in the 18th century: "Encrease the commodities, they become cheaper; encrease the money , they rise in value". The cure for inflation should therefore lie either in reducing the supply of money available or in stimulating the supply of goods required to mop up the money, or in a judicious mixture of both. The last or third remedy is perhaps the best since if in reducing the supply of money the output of goods is also reduced by closures, short time etc. the inflation continues.

1. Previous attemps at an Incomes Policy

Roughly speaking 50% - 70% of the cost of production of manufactured goods arises from wages and salaries. Material prices are largely outside Government control. One approach, therefore, to controlling the money supply has been to control incomes. The theory has been that, if incomes are restricted, production costs and thus price increases would be held down correspondingly. A higher proportion of profits would then be diverted to modernisation; and employees would discover that the only way to achieve an increase in real wages was by genuine higher productivity. Three successive governments have attempted just this. Whatever the merits of the theory, all three attemps - Wilson's "In place of strife", Heath's statutory policy, and Callaghan's voluntary "concordat" - foundered in practice on the rock of Trades Union Opposition.

2. "Monetarist" policy

The present Government instead of selecting wages as its target (other than by exhortation) has sought to attack the problem of the money supply on a broader front. In the private sector their principle instrument has been high interest rates (and until recently physical restriction - the "corset" - in bank lending.) In the public sector it has been "cash limits".

For a number of reasons control of the money supply itself has been less effective than expected. Nevertheless high interest rates have enabled some firms, especially small non-unionised firms, to settle wage claims well below the rate of inflation. But a larger number, rather than face crippling industrial disputes, have met inflationary wage claims by cutting profits to the bone, running down stocks, putting up prices, postponing modernisation and increasing overdrafts. It has been much the same in the public sector.

There previous commitments to "comparability" and the absence of detailed Central Government control over the budgets of local Government or the nationalised industries have led to a series of inflationary wage settlements again at the expense of capital programmes and useful services. These inflationary wage settlements in turn have had a destabilising effect on wage negotiations in the private sector. As a result it has been the producers of wealth - perhaps one third of the employed population - who have suffered most compared to the distributors and sepnders.

3. The Prospect

Given the high level of most current wage settlements (and increasingly the reduced expectations of most employees) there is not much likelihood of a "winter of discontent" this year. Such discontent as there is is more likely to be among employers and the unemployed than among employees. But it will not be so easy next year and still more difficult in 1982 to meet increased wage claims by cutting down profits, running down stocks, putting up prices, postponing modernisation or increasing overdrafts. There is not much left to scrape out of the bottom of these barrels.

Accordingly continued high interest rates must lead to more unemployment, more closures and wage settlements below the rate of inflation and so to real cuts in living standards. It may be that, even then, divisions in the Labour Party and the general mood of the country will spare us from another "winter of discontent" in 1981/82 or worse still 1982/83. But it would be rash to count on this. The Trade Unions are now in disarray but genuine economic hardship coupled with increased unemployment - and both are virtually inevitable - may give them back some unity and strength. Moreover the mildness of our Trade Union legislation gives us few weapons with which to meet an industrial confrontation; not that legislation is in itself the answer but it does give moderate Trade Union leaders and shop stewards a useful weapon against the militants.

We should, therefore, reckon that we may have to face serious discontent in the winters 1981/82 or 1982/83 and make plans accordingly.

What will be the policy of the official Opposition and the Liberals? The signs are that they will seek to propose a return to neo-Keynsian reflation combined with some form of agreement with the TUC on incomes policy. The Left will no doubt go for protection, more nationalisation and disarmament.

What is to be our answer? Is it enough to say that, once inflation has been squeezed out of the system, interest rates will come down, taxation can be further reduced, Trade Unions will learn the immportance of improved productivity and we can all look forward to renewed growth and prosperity? If we had 7-year Parliaments we might need do no more than stick to our present policy. But with 5-year Parliaments (in effect probably 4½)-and the possibility of being forced to the country by industrial action, our present policy may not yet be bearing fruit sufficiently to sway the electorate. Something more may be needed to convince the mass of the electorate of the wisdom of the "social market" philosophy.

Can we find that something ~~the answer~~ in the other aspect to the cure of inflation i.e. in positive policies for producing more goods at competitive prices to mop up the excess of money?

4. Policies to improve productivity

At the moment our policies lack credibility. The money supply seems to be out of control. Public expenditure has not been cut by anything like as much as Healey cut it in 1977 on the orders of the IMF. Inflation is still raging. Unemployment and closures are on the increase.

To attempt a U-turn would be disastrous psychologically as well as economically. Expectations are crucial to the operation of market forces. The first essential is to show confidence in our own policies. Otherwise we shall get no cooperation from business or indeed the unions. How is this to be done?

The most obvious step would be to secure urgent and effective cuts in public expenditure, especially the local government wage bill. Whether this can be done without further legislation is not clear. If legislation is needed it will take time but will at least show the public that we mean business. The same would be true if we had good reason to introduce tougher legislation on industrial relations.

Still more impressive would be (pace Enoch) further substantial cuts in direct taxation on individuals and companies. Such cuts might, indeed, entail a higher PSBR, if public expenditure could not be reduced enough, and hence would tend to keep up interest rates. This seems at first sight contradictory to assumed monetary precepts. But debt can be positive -

starting up growth - or negative - reflecting decline. If the Government's overall policy is being continued, e.g. by high interest rates, tax cuts could well enhance confidence without stimulating inflation. Besides, the relative size of the total budget expenditure is more important than the deficit.

But the most important thing is to find a way of convincing employees that they are much more likely to earn higher wages, work shorter hours and produce more competitive goods by adopting the "social market" philosophy than by any alternative the Left has to offer. It is a fact that a high proportion of existing industrial plant is not in use or industrialised underused and that there has been insufficient investment in many of the new technologies that could so radically increase productivity in a number of industries. We are entering on a new industrial revolution which could be exploited to transform people's lives for the better beyond anything yet imagined.

It is, of course, difficult to proclaim the rewards of investment in new technologies when interest rates are high; or to denounce overmanning when unemployment is on the increase; or to talk about profit sharing when firms are going bankrupt. But "where there is no vision the people perish". If we are to succeed in our policies and that means winning the next election - especially if we have to face a confrontation with the Trade Unions - we must be able to at least point the way towards the uplands of prosperity which could lie at the end of the rough road immediately ahead.

Overmanning in manufacturing industry is the main though by no means the only obstacle (- restrictive practices are only overmanning by another name -) to the full utilisation of existing plant and, even more than high interest rates, to investment in new technology. It is thus the main obstacle to higher pay, shorter hours and cheaper goods. Given rational manning levels and full exploitation of the machine a revolution in living standards could be rapidly achieved in many industries. The results should then spread through the economy as a whole, so mopping up the initial unemployment created by modernisation. But how are we to overcome the current Trade Union fixation on overmanning against the background of mass unemployment?

The answer may well lie in associating the workforce more closely both with the success of an enterprise - bonuses, profit-sharing, employee share-holding etc. - and also with the decision making processes - works councils and, in appropriate cases, workers directors.

Far from following the Bullock Report which sought to associate the Trade Unions as such with decision making, the aim should be to associate the shop floor in individual firms with it. Their representatives might sometimes be Trade Union nominees. But they might as often be individuals well regarded by their fellow workers.

The essence of the matter is to promote participation at plant level. But there will also be a need to tackle the problems of modernisation industry by industry. Here the "little Neddies", working under Government chairmanship, might prove useful so long as their deliberations were public and well publicised. Publicity is essential so that the glaring abuses of some Trade Union practices can be exposed.

Hitherto the real issues underlying disputes have been largely concealed from the public. This is because they are discussed behind closed doors. Such public statements as are made by Unions and Employers are largely incomprehensible to the ordinary layman. Yet the more public debate there could be of the opportunities which the modern machine could offer in terms of higher wages, shorter hours and more competitive prices, the more public opinion could be mobilised in the cause of productivity. Here is the case for turning NEDC into some kind of Economic Consultative Assembly where economic issues, including legislation, could be debated in public before submission to Parliament. If the problems of say Fleet Street or the Isle of Grains were publicly debated in such a forum, the Chapel Fathers in one case or the rival Unions in the other would be laughed out of court.

The Chancellor of the Exchequer has made a beginning here in the encouragement given to wider shareholdings. The Secretary of State for Employment has also called on industry to do something now by way of participation, though less for its own sake than as a way of avoiding having to do more later in obedience to EEC directives.

Hitherto the whole emphasis of our argument has been on the negative side of our policies - curbing the money supply and cutting public expenditure. And, unfortunately, we have not yet been able to deliver on either. Has not the time come to shift the emphasis to the other aspect of anti-inflationary policy namely to increasing productivity? The steps needed to achieve this may not bear much practical fruit before the next election. But the launching of them would reveal a prospect of the kind of prosperous and cooperative free enterprise society to which present policies of austerity are intended to lead. It could provide an important plank in our next Manifesto and a positive answer to the criticisms and nostrums of the Opposition.