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Following for Whitmore, Prime Minister's party, from Scholar, 10 Downing Street:

MIPT: Note by Alan Walters on the Heath Speech

(Text as per attached paper)

CONFIDENTIAL

NOTES ON THE HEATH SPEECH

THE VICIOUS CIRCLE

The easiest way to see that Heath's vicious circle is a piece of preposterous nonsense is to reverse it. He says that completing the vicious circle is that "prices have increased, the rate of inflation has gone up, the money supply has increased, unemployment has gone up, the rate of bankruptcies have increased, industrial base has been further eroded, the Government's borrowing requirement has increased and as a result there is more pressure to raise interest rates again - to be followed inevitably by the same vicious circle, it is this that must be broken."

It follows, therefore, that all we have to do is have a tiny decrease in interest rates and then we are locked into a wonderful virtuous circle because, symmetrically, prices will decrease, the rate of inflation will go down, the money supply will decrease, unemployment will go down, the rate of bankruptcies will fall and the industrial base will expand, etc onto another fall in interest rates to be followed inevitably by the same virtuous circle. But of we didn't observe any such virtuous circle when interest rates fell in 1975, 1980 or even 1981.

The Heath dogma is quite remarkable. Surely those countries with high interest rates such as the United States, France, etc should realise that the only thing they need to do is bring interest rates down and then happily swing around Mr. Heath's virtuous circle. Are they too stupid to realise that there is such a wonderful virtuous circle just below their 20% rates? But perhaps Mr. Heath's virtuous circle only applies to Britain, just as his vicious circle may be thought to be appropriate only for the UK. But the points he makes are perfectly general and must be applicable to all other similar Western economies. I conclude therefore that they must all be stupid, at least that must be Mr. Heath's implied view.

THE YEARS OF MONETARISM, THE METHODS AND THE MISTAKES

Heath's description of the monetarist experiment as though it began with the International Monetary Fund and the Labour Government is a travesty of the facts. He says the attempt was

/"to run a

"to run a complicated, sophisticated economy purely by monetary means and the present Government has tried to manage the economy solely by the use of interest rates...." This is of course rubbish. The various budgets and particularly the one in March 1981 were thought to be a very significant squeeze on the economy and indeed was widely resented by many of Mr. Heath's persuasion. But in addition the point is that the new monetary arrangements introduced from April this year do not use administered interest rates, but allow interest rates to be determined very largely by market forces.

Heath claims that the oscillations in sterling were exacerbated by the decision not to use exchange controls. Does this mean then that the fall of the pound to $1.50 in 1976 was saved from falling even further by the existence of exchange controls? He also states that as a result of the rise to $2.43 firms found their profits disappear and their export markets lost never to be regained. The evidence contradicts this. Exports remained high and indeed expanded in value terms over this period. Presumably he has never looked at the statistics but has proceeded from dogma.

There is a confusion throughout. He says that a fall in the level of sterling will add 3% to our rate of inflation. What he means is that it will add 3% to the price level. This sort of confusion persists throughout the whole paper.

Heath attributes all bankruptcies to high interest rates. He doesn't mention high real wage rates which were a consequence of the wages explosion of 1979/80. Wages are a far more important item in any firm's accounts.

He says that it is not surprising last year the United Kingdom was at the bottom of the growth table in the West. As far as I am aware it has been at the bottom of the growth table of the West during the last 30 years. I believe that only the Republic of Ireland has managed to do worse. So that is certainly nothing new and cannot be attributed to the present Government's policy.

/He fails also

He fails also to mention the expansion of the service industries. He singles out only agriculture which he believes the expansion was due to the lack of unrestrained market mechanisms!

He says that profits declined and the fall is continuing this year. I believe this is untrue and is contradicted by the evidence in the recent Financial Times Review.

The quotation from The Times is interesting but if we take the period from the peak output in 1973 March to the low in 1975 December we find that the decline was rather more than nine percent points. This seems to be a little more than the seven and three-quarters from 1979-1981. So Mr. Heath's policy in 1973/74 followed by the Labour Government in 1975 managed to secure a decline which was rather greater than the one we have seen recently.

Understandably he does not refer to this in what he calls the myths of the 1970s.

THE MYTHS OF THE SEVENTIES

This is mea non culpa at its very worst. He says that none of the doctrinaire monetarists explain how inflation was caused by a rise in external commodity prices in late 1973. This is simply not true. Indeed it was explained in a letter to the Prime Minister signed by Professor Harry Johnson, myself and a group of other economists. Mr. Heath claims he was importing inflation. I showed in an article published in an International Currency Review, which was appended to the letter to Mr. Heath, that Britain was in fact exporting inflation. The fact of the matter is that the rate of inflation in Britain in 1974 was 14.7% and at the same time the balance of payments deficit was nearly £4 billion, which was more than sufficient to finance the increased cost of imports. We were living on tick and having an inflation as well. The analysis is all set out in the ICR paper.

Furthermore we show how they could have avoided the price increases of imports having any substantial effect on inflation. Its easy to see how this was done. After all Switzerland, Germany, Taiwan and many other countries did it much more successfully. The claim that Britain kept the rate of inflation down in the early seventies

/more successfully

more successfully than any other Western country is, of course, ludicrous. Just quite wrong. The Treasury will supply evidence.

NEW DIRECTIONS, THE INTERNATIONAL POSITION

Heath assumes that the high interest rates in the United States will continue for many years - "over a long period of time". He must therefore know much more than any of the experts. Historically high interest rates of the order we are experiencing today have rarely, if ever, persisted for more than a few months. Recall the situation in the end of 1974 early 1975 when interest rates in the UK were at all time highs and the yield on consuls was equal to its price. Within a few weeks, however, the stock market had experienced the steepest rise in its history and almost doubled, and interest rates tumbled and finally, in 1975 and 1976 they were at very low rates. American interest rates have been high only for about three months. And there are already signs of their easing. The banks cut the US prime rates today to 19%. Yet Heath suggests probably the most far-reaching drastic structural changes to cut ourselves off from the great leader of Western democracy.

HOW TO REGAIN CONTROL OF OUR SITUATION

Heath doesn't understand what determines interest rates. He says that the Community must be able to adjust and coordinate their interest rates without having to elevate them to American levels. But the Community do not have interest rates which are anywhere near the American levels. The West German mark for example is at a little more than 11% and is falling. Outside the Community the Swiss franc is about 7% and also falling. The point is that the expected rate of appreciation of the currency, which is related to the expected rate of inflation, also very much affects interest rates. The low Swiss and German rates and the low Japanese rates, at about 6½%, reflect the low expected rate of inflation in Germany, Switzerland and Japan. The reference to the EMS is garbled and might mean anything or nothing.

ACTION BY THE EUROPEAN COMMUNITY

The misconceptions here are very numerous. Heath wants a vast exchange control system within the Community and this to be used to stop "hot money pouring in or capital flowing out".

/Our exchange

Our exchange control system applied only to residents of the United Kingdom. The amount of hot money or cold money owned by them was very small compared with the amount owned by non residents who were not subject to such control. Even with the full panoply of exchange controls in 1967/68 and in 1976 there was the most enormous capital movements which the reserves could not bear. Heath seems to think that exchange controls within a country, that is applying to residents, will somehow stop non-residents speculating against that currency. This is demonstrably false. Heath's ideas about Euro-currencies are, to put it mildly, naive. If you try to impose controls on the Euro-banks in London, for example, they will simply move elsewhere. Heath's recipe is one for abolishing our most successful industry, the banking business. It would flee quickly to Switzerland, Singapore and other areas outside the reach of Mr. Heath's regulators. I would guess that the United States would very much welcome the Euro banking industry into New York and othe great cities in the United States. It has already passed legislation that makes it much easier for Euro banks to operate Stateside.

Finally, Heath suggests that if the Community cannot reach agreement on this (and who can imagine that it ever would!) then Britain should go it alone. This is a policy which puts Heath firmly in the role of the Conservative Benn. A little Britain insulated from the outside world with regulated low interest rates. It is only a short step to instituting import controls and the rest of the Benn apparatus.

Heath never faces a number of very important issues behind this barrier of controls on foreign exchange etc. It is not clear whether he intends that interest rates be determined freely by domestic markets. If he does then he certainly cannot guarantee low interest rates. Since low interest rates are the sine qua non of his virtuous circle, it seems that Heath wants regulated low interest rates. But if we have regulated low interest rates then there must be also controls on credit since the demand for credit will exceed the supply available. With regulated low interest rates as well there will be, of course, a reduction in the supply of credit available. If this is the Heath scenario, we can observe many examples of the disastrous consequences of such a system throughout the whole world. Many

/third world

third world countries have regulated low interest rates and credit rationing, usually by political favour, and the result is virtual disappearance of credit markets. Khomeini's Iran is an example. The discrediting, in a literal sense, of Britain is the ultimate of Heath's proposition.

MAJOR, INDEED DRAMATIC CHANGES IN POLICY

Here is an explicit statement of the virtuous circle discussed above. Once interest rates fall we are in perpetual motion and the virtuous circle goes on and on. However, there is a mite of sense on page 7 in his discussion of the NIS. Of course he never says where the undoubted loss of revenue is to be made up. But that is just another loose end of Heathonomics.

CREATING THE DEMAND

This is again economics without price or perhaps priceless economics. Demand is always effective and apparently never related to price. He never discusses that the vast enormous increase in demand is taken up in price increases and not in quantity change. "The Government selected capital investment for productive purposes" - I presume Mr. Heath is thinking of the great expansion of the steel industry, much of which took place under his administration in 1970-1974 at enormous cost. We are now paying an enormous price in order to reduce that stupid expansion.

WORLD DEMAND AND INTERNATIONAL TRADE

This is a plug for Brandt. The vast majority of international trade occurs between developed Western countries. Heath's argument implies here that we should supply international institutions with funds so that they can channel them to countries such as Tanzania etc and they will help Britain pull herself out of the recession. The point is that in the developing world the main engines of growth are the free enterprise economies, Taiwan, Hong Kong, Brazil, Mexico, etc. The provision of funds for Tanzanians will be more likely to inhibit growth and trade rather than promote it. The subsidy for overseas students appears to be another bit of Brandt's special pleading.

/SUSTAINING RECOVERY

SUSTAINING RECOVERY

The first point is, if not an obvious error, then at least very misleading. The process of recovery in Britain has been associated with a very rapid increase in imports of manufactured goods. This has caused the balance of trade to deteriorate. A tariff on imports of manufactured goods is the basis of the Kaldor/Benn proposals for a siege economy. The second point seems to imply that we are joining EMS in order to devalue the pound. This may well be firmly in Heath's mind. But it has its own rather vicious little circle of devaluation leading to an increase in the price level which again causes another devaluation etc. On his third point I think he has some substance, but again it is economics without price. He does not mention the importance of adequate rewards for skills and the importance of expanding differentials. And finally we come to that dreadful vicious circle again. He seems to have got this concept from reading about the nonsense purveyed in development economics as "the vicious circle of poverty". This concept was destroyed utterly by Peter Bauer in 'Dissent on Development' page 31 et sequenta.

CONSENSUS POLITICS

This is altogether strange since Heath earlier said that the Callaghan administration had carried on monetarist policies which were followed by the present Government. Does this not show a high degree of consensus? It is also odd indeed to see France, over the past 30 years, referred to as a consensus country. It nearly had Civil War and the fourth republic fell over this period.

THE ANSWER TO THE MAN IN THE STREET

These are more like red herrings from the man in the dock. We ought to utterly refute the proposition that increasing direct taxes increases inflation. It doesn't. It increases the price level. If indirect taxes increased inflation, then reductions of indirect taxes should decrease inflation "at a stroke". Then on Heath's recipe all we need to do to decrease inflation is to decrease indirect taxes and go on doing so until inflation is out of the system. In principle one could not merely decrease indirect taxes but supply their corollary subsidies to ensure that inflation was zero or even negative. To say this is simply to demonstrate that it is a nonsense. Interestingly, Heath never mentions real wages

/as the cause

as the cause of unemployment nor does he talk about the low rate of return on capital. Also there is no mention of an incomes policy. But just as clearly as he was driven to one in 1973, so would he be by any of the measures he has outlined, supposing one could make sense of them, in this paper. As a final matter of fact, as a proportion of the GDP the last Labour Government ran the biggest Budget deficit in history.

ALAN WALTERS

6 October 1981

Conservative Central Office

NEWS SERVICE

Release time: 13.45 Hours/WEDNESDAY 27th October 1982 697/82

Extract from a speech by The Rt Hon Edward Heath MBE MP (Bexley-Sidcup), speaking at the Annual Luncheon of the Kent section of the London Chamber of Commerce and Industry, at The Great Danes Hotel, Hollingbourne, Nr Maidstone, Kent on Wednesday 27th October 1982.

We are meeting here today in my own County of Kent against a background of economic depression uparalleled since the Second World War. The economies of significant countries in the Soviet bloc and the Third World are teetering on the brink of collapse. Consequently, the World Banking System which recycled OPEC surpluses to the developing countries throughout the 1970s is stretched to the full. The OECD countries are experiencing record levels of unemployment, combined with a low or even negative rate of growth. In Britain, unemployment has climbed beyond the three million mark, investment has stagnated and industrial production is declining. Our Government is confronted with problems on a terrifying scale which are requiring action at both national and international levels.

The fundamental cause of the world's present recession is that international demand for manufactured goods has collapsed. Because of the problems at home which you have described so clearly, Mr Chairman, we are unable to command the size and share of this shrunken cake that we should. Our problems are thus twofold, firstly to improve productivity in our industry at home, but secondly and perhaps more importantly to recreate demand in the world economy.

Even at the quickest glance it is easy to see something serious is wrong in the world economy. There is more than five-hundred billion dollars worth of unused industrial capacity in the OECD countries. Over twenty-eight million people are unemployed there. Yet at the

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same time, underdeveloped countries are desperate to purchase manufactured goods from the industrialised world but are paralysed by high interest rates, lack of demand for their own raw materials and high oil prices. Simultaneously, the massive OPEC surpluses which have been accumulated since 1974 wash through the international capital markets wreaking havoc with monetary and exchange rate stability.

No suitable agreement has yet been reached as to how this mismatch of means and resources is to be corrected. Yet I believe it to be the most crucial element in our fight to re-establish full employment and to bring new prosperity to Britain. This is no small task, indeed it is of the magnitude of that faced by the Allies at Bretton Woods. If successful, the prize would repay the effort - the creation of conditions for stability and renewed growth.

The Bretton Woods System with its institutions, including the International Monetary Fund and the World Bank, was conceived against a background of the dark memories of the slump in the 1930s and of the immediate problem of post-war reconstruction. The IMF and the World Bank were created to assist in the reconstruction of Europe and to order the post-war economic world. The role of the Bank was to make available funds for investment in vital projects and infrastructural development. The system served us well for nearly thirty years.

Equilibrium was maintained until the Vietnam War so increased dollar liabilities abroad and shrunk gold reserves in the United States that doubts were expressed about America's ability to redeem its obligations. As a result, the existing system of global economic management began to break up. The ending of dollar parity with gold brought an end to fixed exchange rates and ushered in a period of instability with all the concurrent difficulties for business.

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When in 1974 the US balance of payments moved into surplus, America ceased to be the provider of liquidity in the world economy. At the same time, it became ever more clear that never had an effective system been more needed to facilitate and smooth the way for adjustments to those very economic and political factors which had contributed to the overthrow of the Bretton Woods System. The world economy was beginning to run into serious problems in the aftermath of the oil crisis of 1973-74.

The IMF and World Bank did attempt to fill the gap by the crisis of confidence in the dollar. When dollar convertibility ended, the IMF increased its special drawing rights to assist liquidity. But in the main, such adjustments as took place to deal with the effects of the oil crisis were left to the commercial banks in an ad hoc and unplanned manner. It was the commercial banks who were left to provide liquidity via the Euro markets, recycling the ever increasing OPEC surpluses. With the current banking crisis it is clear that these ad hoc adjustments have failed to stimulate the demand necessary to pull the world economy out of recession and have instead further threatened it by bringing a number of countries to the brink of bankruptcy under the crippling burden of high interest rates. Many lesser developed countries are faced with massive energy bills, huge debt burdens and a collapse in demand for the commodities that they export due to contraction in the Western economy. Yet the capital is available to invest in such projects as would improve the plight of people in these countries and simultaneoulsly increase the demand for manufactured goods in Britain and other Western countries produce.

The commercial banking system has failed in this regard. Oil prices quadrupled in 1973-4 and doubled again in 1978-9; these crises plunged the current account of both OECD countries and underdeveloped

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countries into deficit. The latter were worse affected since OECD countries were able to improve their current account position by increasing exports to OPEC which pursued ambitious development plans. The poorer countries were caught in two ways, firstly by the price increase itself and secondly by deflation in the West which was the main market for raw materials.

This may seem remote, but it is crucial to recognise that lack of purchasing power in the Third World has depressed demand for industrial goods produced in Britain and elsewhere. This has exacerbated the depression at home. It is clear that new ways of recycling surplus petro dollars need to be found. The remnants of the Bretton Woods System are in some aspects frustrating efforts to this end. The problem rests around the position of the United States dollar as the primary currency in exchange. The American government is anxious to maintain OPEC's demand for United States government paper otherwise the government deficit will have to be financed more and more from within, thus squeezing the private sector out of the market. and forcing up interest rates. This goes a long way to explain American hostility to the plans at Cancun for an energy affiliate, the purpose of which was to help the underdeveloped countries achieve independence in oil supplies by aiding development of indigenous energy resources. The implications of this might have been far reaching in reducing the demands on the balance of payments in these countries, thus leaving room for growth which would in turn have manifested itself in orders for the West.

The challenge that faces us is both a moral and a political one. We are concerned to create a new order to replace the earlier Bretton Woods System that will alleviate the misery of famine and poverty among huge sections of the world's population and bring renewed growth so vital to the world's economy. By fostering the welfare of the

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Third World we also foster demand for the products that we need to sell to pay our way in the world.

It may be asked what is wrong with the existing supranational bodies. Whey cannot they create the new order?

The answer is that they were constructed in a period of unquestioned American hegemony when the United States had the resources to finance reconstruction in Europe and single-handedly manage the financial affairs of the free world. Now, the United States economy is in secular decline but the supranational bodies still reflect American and Western pre-eminence in their power structure. The resources that are needed to finance a Marshall Plan for the Third World are no longer in the hands of the Americans but are the property of the OPEC countries whose participation and influence in the IMF and World Bank are limited by an anachronistic political framework. The attractions for OPEC are clear - greater influence together with a proper return on investment rather than the negative real interest rates earned on deposits in Western commercial banks.

I should like to see our Government taking the initiative in this, particularly in view of American ambivalence. It is the epitome of enlightened self-interest in response to a moral imperative and a critical need to stimulate and expand the industries which provide the jobs we so badly need.

But an expanding world economy is not sufficient in itself. Even if world demand for the goods produced in the OECD should expand, we would still need to ensure that British industries are in a condition to compete with other supplies for a slice of the orders.

....

This means improving our own productivity and it means that we cannot continue to pay ourselves more than we earn. There will be no recovery if Trade Union leaders do not accept the need for restraint in wage demands and the need to increase productivity by accepting appropriate working arrangements.

Also, we need to ensure that we are prepared to grab our share of world trade when an upturn comes. This means encouraging industry to invest, ensuring that our young people are properly trained and that our infrastructure is prepared to meet demands upon it. I believe that there is a very legitimate distinction between capital and current public expenditure and that the indication that the PSBR is about to undershoot by some £1.5 billion should be heralded as an opportunity to undertake necessary public investment that will stimulate the private sector and increase our preparedness for the fight to export. I do not call for wholesale reflation, that is an economic nonsense. It is irresponsible for the Labour Party to suggest that this would solve our problems. Last time Harold Wilson attempted that approach we ourselves had to crawl to the IMF to be bailed out.

Nevertheless, I would urge that any relaxing of constraints on public borrowing be used not to cut taxes which would simply result in an increasing flood of imports, but to invest in the roads, sewers and other capital works that are so vital to the success of industry.

End.

DAILY Mirror

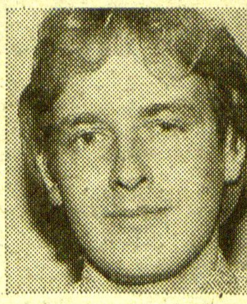
Wednesday, November 3, 1982 16p

WORLD EXCLUSIVE

HOW I SMASHED SECURITY AT BUCKINGHAM PALACE

by JOHN MERRITT

Daily Mirror reporter



ENTRY PERMIT: The car sticker that got Mirrorman John Merritt through the "tight" Palace security screen.

BUCKINGHAM PALACE security, supposedly sealed tight after the Michael Fagan affair, is still wide open to penetration by intruders.

Today the Daily Mirror reveals how a gaping hole was blown through the police net around the Palace.

It was done by two Mirrormen using an official parking permit obtained from a Palace gateman over a few pints in a local pub.

The Mirrormen were able to park a car inside the Palace grounds, walk around unchallenged, and look over the priceless Royal coaches.

One of the coaches was the Irish State Coach which will take the Queen to today's State opening of Parliament.

Mirror reporter John Merritt and photographer Peter Stone were invited to sit in the coach by a Palace worker. He thought the newsmen were simply visitors to London.

They could just as easily have been terrorists carrying explosives.

In the past few months, following the Fagan intrusion and other alerts, millions of pounds have been budgeted for improving Palace security.

Alone

Yet over a three-day period the Mirror investigators were virtually able to come and go as they pleased.

They were left alone, completely unsupervised. Not once was the boot of their car searched.

And from the point of entry—the Royal Mews behind Buckingham Palace—they could have got into the Palace proper, including the Queen's private garden.

Photographer Stone carried his camera—the sort any tourist might use—in his jacket pocket. At no time was he searched or asked to identify himself.

Buckingham Palace insist: "There are policemen at the gate to ensure that nobody unauthorised gets through."

But on the evidence of the Mirror's investigation, the thorough and immediate security clampdown ordered in the wake of the Fagan scare simply is not doing the job.

The Mirror disclosures will confront the new Scotland Yard chief, Sir Kenneth Newman, with his first major security headache. How was this serious flaw exposed? The full story is on the Centre Pages.

PLEASE TURN TO CENTRE PAGES

HEATH

UNEMPLOYMENT

‘It is a social evil. It deprives men and women of their dignity. It threatens the basis of our society’

HEATH SPEAKS OUT

WE CANNOT delude ourselves any longer. We have NOT just turned the corner. There is NO light at the end of the tunnel. Everything will NOT work out all right in the end.

The latest report from the Confederation of British Industry on the state of industry in this country puts paid to any other thoughts.

We Conservatives must not only pay attention to the information which the CBI gives but to the conclusions it draws.

It would be as foolish for us to accuse the CBI of switching its support to the Labour Party as it would be for the opposition parties to use it as a propaganda stick with which to beat the Government.

The role of the CBI is to be as impartial as it can, respected by political parties and trade unions alike.

What is the situation which confronts us—politicians, employers and workers?

Unemployment is going to continue to rise, especially the numbers of those unemployed for over a year.

As production falls and productivity slightly increases, it is inevitable that the number of workers required will decrease.

This is quite apart from unemployment caused by the running down of the world economy.

The United States is now moving headlong into depression, following Europe. As it does so, it will buy fewer goods from Europe and fewer raw materials from the developing countries.

They in turn will buy less from us and we less from them. Unemployment in Britain, already nearly four million if you include those temporarily taken off the labour market by Government schemes, will rise further.

This is the vicious circle we have to break.

THERE is too much talk about unemployment in terms of its effect upon the fortunes of political parties either at by-elections or in the General Election when it comes.

But unemployment is wrong in itself.

It is a social evil. It deprives men and women of their dignity. It causes unbearable tensions in the home. It threatens the basis of our society.

It removes any purpose in life from the young. And it creates despair in the hearts of those over fifty who find themselves—perhaps after thirty or thirty-five years' efficient service with a firm—thrown on the scrap-heap.

They have a growing fear that they will never get a job again.

Some people say that this is to become a permanent state of affairs for the rest of this century. That because of world conditions and the development of new technology in Britain there is no alternative.

To accept this is to accept economic collapse and social chaos.

I repudiate it completely—just as after the Second World War my generation repudiated a return to mass unemployment, the personal hardships which it caused and the damage it did to industrial relations in the Thirties.

Instead, we achieved, by international agreement, a period of twenty-five years of the greatest stability, prosperity and social progress which the world has ever known. And the new technologies contributed to this by creating more jobs, not fewer.

Action is now needed on two fronts, national and international.

The international problem is simply described.

In the developed industrial countries there are 30 million unemployed.

What a waste of skill and energy that is!

There is 500 million dollars' worth of unused factory capacity.

What a waste of production!

This at a time when the developing countries are crying out for the goods which we can produce.

How can we match these two situations for our mutual benefit?

The answer sounds dull and undramatic. It is, in brief, that we have to use the International Monetary Fund and the World Bank—because they were created for this very purpose.

They must be given the resources they need and they must be allowed to handle the debts of those countries plunged into difficulties because of the world crisis.

The British and American Governments must agree to do this. I would like to see the British Government take the lead.

We in Britain have certain advantages which we must not underestimate.

The fall in inflation is welcome. North Sea oil has given us substantial financial reserves. This Government does not have the anxiety of the balance of payments which so plagued its predecessors.

The recent fall in interest rates is helpful. But with borrowers still paying over 10 per cent the rates are much too high for a depression.

If the American rates rise again after yesterday's Congressional elections and our rates follow them, then the situation will deteriorate still further.

The CBI is right. Lower inflation and the current level of interest rates are not enough to reverse the trend into deeper recession.

Businessmen cannot build up stocks if they have to pay such interest rates. Nor will they invest in new equipment unless they can see a demand for its products.

That is not at present in sight.

Protection—either by tariffs or quotas—of our own products is not the answer, not even in the short term.

It would make the world situation worse and bring retaliation against us from the countries affected.

The solution is to expand demand internationally by agreement, and at home by Government action.

IF the Government finances the modernisation of Britain in the spheres where it is responsible, it will create a demand, first for capital equipment and later for consumer goods.

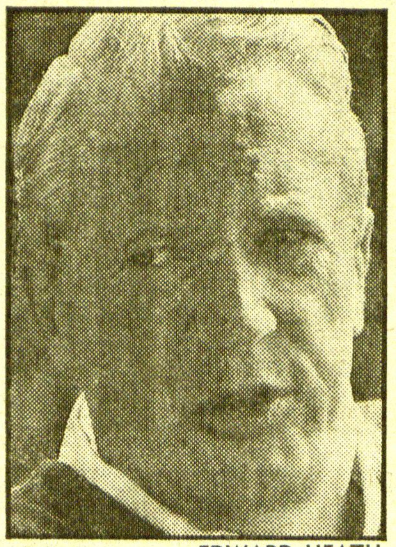
Once industry sees the economic trends are being deliberately reversed then its confidence will return and the change will gain momentum.

If necessary, we must work with our partners in the European Community to insulate ourselves from American interest rates and then reduce our own.

It is important that the British Government should now give a lead, first within the EEC and then, with its support, to the world community.

We have to defeat the depression. We did it in the Forties with conspicuous success. Then Europe's economy, including our own, was rebuilt.

We must now do it again in the Eighties. Britain must lead.



EDWARD HEATH

‘Action now is needed. I would like to see the Government take the lead’