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SPEECH BY THE RT HON MARGARET THATCHER OM FRM MP TO THE ECONOMIC
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Mr Chairman, ladies and Gentlemen.

It is a great honour to be asked to address this distinguished audience - and a great pleasure also to be back in New York which never ceases to astonish, delight, intimidate, inspire, elevate, and widen one's horizon's.

Mr Chairman, New York remains the economic and financial capital of the world's greatest military power, the world's greatest defender of liberty and, despite your real but short-term difficulties, the world's greatest economic power.

So this is the right place to discuss the future direction of economic policy and, following the great victory of Desert Storm, the right place to discuss the economic aspects of President Bush's "New World Order".

INFLATION AND THE ECONOMY

It is also the right time to do so.

For, after a decade of rising prosperity, both our countries are suffering from a recession that has been more prolonged than some expected.

I am delighted to hear that some economists are forecasting a speedy recovery - and even some central bankers have been detected smiling in private.

But many of the businessmen I meet are more cautious.

Recovery will, of course, come - and with it revived investment and higher living standards.

Let us hope it will match the long period of growth of the 1980s. But there is bound to be another recession in the course of time.

For the trade cycle is a permanent fact of economic life, which politicians can ameliorate by sensible policies, or aggravate by foolish ones, but which they can't abolish altogether.

It should be the aim of a prudent government to improve the nation's general economic performance at all stages of the cycle by removing obstacles to enterprise and mobility.

In that way, growth will be more sustainable, the inevitable setbacks less painful, and inflation less of a temptation to short-sighted administrations.

What government should not do is attempt to compensate for the trade cycle by fiscal and monetary manipulation.

This policy has been likened to bringing out "sunshades in October", either stimulating the economy when recovery is already under way, or pushing an incipient recession even deeper.

The facts of financial life make this a hopelessly hit-or-miss affair.

A central bank inevitably has difficulties in controlling money supply growth, principally in predicting the demand for money. This is extremely difficult to achieve in the very short term. But over a period of three or six months - and certainly on an annual basis - it is much easier and, indeed, can be done.

So there is a strong case, as Milton Friedman has long argued,

for a regular and predictable increase in the money supply calculated on a long-term basis.

And there is no case at all for any attempt at "fine tuning".

What, then is the proper role of government in a free enterprise economy?

Government has the fundamental duty to provide a sound financial framework by controlling monetary growth in pursuit of a currency which holds its value.

It must control its budget deficit so as not to build up debt for future generations.

And it must do so mainly by controlling its expenditure.

These are not truths of merely temporary application. They go to the root of government's fundamental tasks at all times and in all places.

As soon as politicians, economists or bankers devise ways to try to circumvent them - the trouble begins.

It is no good departing from financial orthodoxy when political pressures mount.

That is precisely the time you must stick to it.

If you tolerate a little inflation, it quickly leads to a lot of inflation.

As with any addictive drug, increasing the doses is required to achieve the same results.

If you ease up in the battle to curb public spending and allow

government budget deficits to rise, you put an unnecessary interest burden on business borrowers and starve the wealth-creating industries.

Or if your response to increased public spending is to put up taxes, you lose out even sooner, as talent departs, investment is postponed and hard work discouraged.

BRITAIN IN THE 1980S

Britain was a perfect demonstration of that lesson.

For most of the post War period the British economy had been in relative decline.

Some argued that this was inevitable, that it reflected fundamental weaknesses in British society or even the British character.

Government intervention was therefore regarded as the answer to these alleged weaknesses.

It only slowly dawned on people that the exact opposite diagnosis was the correct one.

Government was doing too much, and the wrong things.

It was stoking up the money supply and therefore inflation in order to prop up companies that otherwise would have priced themselves out of the market.

And when inflation took hold, it then intervened ad hoc to fix specific costs and prices and to bail out particular companies.

Whitehall - not the British people - was to blame for the

resulting stagflation.

We had to reverse all that.

We provided a sound financial framework to beat inflation.

We cut back government borrowing.

But in the words of my friend and colleague, Keith Joseph, contained in a lecture at that time, we realised that "monetarism is not enough".

So we also set out to create a framework favourable to enterprise:

We cut penal rates of income tax and the tax on companies and we abolished some taxes altogether.

We slashed burdensome regulations to encourage small businesses, the seedcorn of economic growth.

We restored the balance in law both between trade unions and employers, and between unions and their members.

We embarked on a vigorous programme of privatisation - forty-four major businesses so far - spreading ownership of capital and property ever more widely.

These policies were dramatically successful.

The performance of the British economy was transformed.

And in spite of the difficulties of our present recession, the great gains made in the 1980s are not being lost.

Britain now has a soundly based free enterprise economy.

EXPERIENCE - THE NAME WE GIVE TO OUR MISTAKES.

But how, if we learned those lessons in the 1980s, did we allow the renewed inflation - which prompted this recession - to occur?

Why was money supply allowed to grow too rapidly?

Part of the explanation lies in the general response of all Western countries to the collapse of the Stock Market in late 1987.

Some people were talking of a Great Depression on the scale of the 1930s.

It seemed imperative that all Western countries should respond by making sure that the financial market and the banking system were not short of liquidity.

And we did.

But though this may have contributed something to the inflationary pressures we have seen, I do not believe it accounts for them fully.

For the real explanation, we must go back to first principles. We must rethink the basis of coordination of policies within the G-7 -and especially the coordination of exchange rate intervention.

With the Louvre and Plaza Agreements in the mid-1980s, we sought to put the objective of greater stability of international exchange rates above that of the control of inflation.

In Britain, we compounded this error when in 1987-88 we tried to shadow the deutschmark.

Again the objective of a stable exchange rate was pursued at the expense of monetary discipline.

These policies led to falls in interest rates to artificial and unsustainable levels, which in turn prompted excessive monetary and credit growth.

That produced the inflation with which we are all too familiar, and which is the underlying cause of the present recession.

"Experience," said Oscar Wilde, "is the name we give to our mistakes."

And the conclusion to be drawn from our experience in both the 1970s and the 1980s is that governments should commit themselves to price stability - which can only be achieved by reduced monetary growth - and leave it to companies and individuals in the marketplace to calculate the various other risks in the business of wealth creation.

Targeting exchange rate injects excessive monetary pressure when central bankers "guesstimate" the wrong rate and, like fine-tuning, can produce wild swings towards inflation or deflation when the rate is either undervalued or over-valued" as East Germany is currently discovering.

When that happens, the "Stability" that makes fixed exchange rates superficially attractive to businessmen is either abandoned in dramatic devaluation or maintained at the cost of far more damaging instabilities like rapid inflation and higher interest rates.

In the ERM Britain is fortunate to have a margin of six per cent

to accommodate variations in the exchange rate.

In general, however, I recall the words of Karl Otto Pohl, former governor of the Bundesbank: "Interest rates should be set according to domestic monetary conditions and the exchange rate should be left to go where it will".

To which I will add: if you fix the exchange rate, then interest rates and domestic monetary conditions go where they will.

And finance ministers are left like innocent bystanders at the scene of an accident.

INTERNATIONAL ORDER

Let me now attempt to draw from the economic experience of the past fifteen years four broad lessons.

They are: -

- 1). An economy will work best when it is built on a framework of clear and predictable rules on which individuals and companies can depend when making their own plans.
- 2). Government's primary economic task is to frame and enforce such rules.
Its own discretionary interventions should be kept to a minimum.
- 3). Within such rules individuals, families, companies, and other social organisations should be free to pursue success at the risk of failure.
And -
- 4). Although governments will sometimes break the first three rules, public opinion should as far as possible make them ashamed of doing so and eager to return to observing them.

But do not the same rules - or something very like them - apply also to the "New World Order" envisaged by President Bush in the aftermath of America's two great victories in the Cold War and the Gulf War?

For make no mistake: America now has a unique, even awesome, responsibility.

It alone occupies the position of the three wartime allies in 1944 and 1945 when the blueprints for the great international

institutions like the GATT, the IMF, the World Bank, and the U.N. were laid down.

It will be an American President and Congress who will have the dominant voice in drawing up any new blueprints.

Some of those institutions are flourishing - notably the U.N. now that the automatic Soviet veto has been removed.

Some, like the International Atomic Energy Agency, will need strengthening to take on a greater role in combatting nuclear proliferation to "rogue" states.

And some face the challenges of new organisations - like the GATT facing the erosion of free trade as regional economic blocs attempt to assert their identities.

And what is true for organisations is also true for the rules of world order laid down in 1945.

One of those rules - that states should not commit unprovoked aggression against other states - has just been triumphantly vindicated by President Bush's successful liberation of Kuwait. So triumphantly, indeed, that it is unlikely to be challenged in any clear-cut way for some considerable time to come.

But should there perhaps be new - and more ambitious - rules in the future?

Must we continue to turn a blind eye to utterly appalling violations of human rights provided that they are confined within a country?

Even if those violations send thousands of people like the Kurds fleeing into neighboring states as refugees, destabilising those neighbours in the process?

And if we are to have such wider rules - which would surely be a step towards a more civilised world - who is to enforce them? And under what authority?

Then there is the erosion of existing rules - principally in the field of trade and economics.

Can GATT be given a new lease of life?

Does it need strengthening?

Or the support of new organisations committed firmly to free trade?

And if so, what?

And perhaps the biggest question of all: will the American people be prepared to undertake the role of Atlas holding up this new world order? Or, as in the 1920s, will the ingratitude of the rest of the world persuade them to retreat into a hemispheric economic isolationism?

Let me answer that last question at once!

I believe that the American people will be prepared to accept this burden of world leadership and to act as the international community's enforcer of last resort - but only if the United States can rely on the support of its allies, not only in ad hoc military coalitions but in a wider alliance encompassing trade and economic relations as well as the occasional rare military action.

I think you know I am not a Marxist! So I do not think that economics determines everything.

But I do believe that you cannot have political and diplomatic unity in a West that is bitterly divided over trade and economic

relations.

TRADE POLITICS

Let us remember that the world order established in 1945 was sustained on the basis of Western economic cooperation. The West's military alliance and post-war prosperity could never have been achieved without, first, the Marshall Plan, and, later, the growth of trade within the orderly framework of rules provided by the GATT, the IMF and the World Bank.

However, that picture has to be qualified.

Since the mid-1970s the volume of trade has continued to grow - but at a slower rate in relation to total world output than before.

This is in part, because there has been a growth in covert forms of protection.

Our current challenge is to prevent the world slipping back into protection and instead to give a new momentum to freer trade.

How is this to be done?

WE must honour the rules of the GATT and, where possible, widen their application.

We must ensure that the problems over agriculture, services and intellectual property rights - but above all agriculture - are resolved.

And that the Uruguay Round is thereby salvaged.

For thee is a harsh rule of politics to which international bodies are not immune.

If things are not going forward, then they are going backwards.
At present in trade they are going backwards.

Other moves toward free trade - provided these conform to GATT rules - should therefore be encouraged.

I welcome the creation of a US-Canada free trade area and the prospect of its extension to Mexico.

These reforms should strengthen the economies of your two neighbours and hold down the cost of living for Americans.

It is vital, however, that these should not be steps towards a world of three protectionist blocks built around the US, the European Community and Japan.

There are those in Europe who regard the prospect of two such blocs, engaging in managed trade with a new European Superstate, with apparent equanimity and even enthusiasm.

I am not among them.

Nor, I believe, should anyone who has at heart the interests of America or the West as a whole.

For it would undermine the sense of Western solidarity under American leadership which is the only sure foundation of any new world order built to last.

So these new blocks must be steps not towards protectionism but towards a world of freer trade.

When the Uruguay Round has been successfully completed therefore - and that will require the full cooperation of the European Community - we must take the next step towards wider economic integration.

We must begin to lay the foundations of an Atlantic Economic Community - embracing Europe (namely the European Economic Community, EFTA and the new democratic states of Eastern Europe) on the one hand and North America on the other.

This proposal has all the merits which are attached to any extension of free trade - greater economic efficiency leading to greater wealth, benefiting all those taking part. But it has two other important advantages, as well.

Given the liberal economic tradition of the US, Britain and several European Community countries, and given the fierce commitment to free market economics of the former communist states - such a block would be imbued with the philosophy of free trade.

And because it would account for no less than fifty-eight per cent of world GNP, other trading blocks and potential trading blocks would have to follow its lead in such matters. It would give the GATT real clout - halting and reversing the drift towards a world of protectionist blocks.

The second advantage is that, by moving in this direction, it would strengthen the vital ties of defence and culture which link America and Europe, and which the drift to protectionism and trade wars threatens to undermine.

It would, in effect, be the economic underpinning of NATO - and make a great deal more sense than the various half-baked schemes for giving a defense identity to the European Community.

This proposal is only the beginning of what would be a very long road.

It certainly needs close and detailed study.

We would need to lay out very carefully the steps to merging a European Single Market and a North American Free Trade Area and what mechanisms would be required to settle disputes over obstacles to trade.

No one with experience of negotiating the Single Market in Europe would pretend that will be easy.

We would need also to work out transitional arrangements for some industries, particularly steel, agriculture and some services.

But none of those need be insuperable obstacles.

I hope that in the months ahead a group could be formed to look at all these matters with a view to a practical time-table for such a scheme.

Because, to repeat the political law I quoted above: if things are not going forward, then they are going backwards.
And in matters of free trade they are going backwards.

THE FUTURE

But I am encouraged, Mr Chairman, by remembering the role that America and Britain played at the end of the Second World War at Bretton Woods in laying earlier foundations for the Free World's economy.

Our countries were both closely involved in setting up the IMF, the IBRD, the OECD and, of course, the GATT.

Like NATO, these international institutions have stood the tests of time and stress.

Like NATO, they have always depended on trust and on common goals.

And no matter how many institutions you create - or how elaborate their acronyms - if they do not have such a basis they will not long endure.

One such basis is provided by the special relationship between the United States and Britain.

Our shared commitment to free enterprise capitalism, to free trade and to liberal democracy - will be tested in many ways in the years ahead.

So let us now resolve that the triumph of these Western values should not be some transient phenomenon.

Let us hold fast to the truths by which we set our compass.

And let us extend a helping hand to those who follow us on the glorious trail to a freer and more peaceful world.

*Economic Club of New York
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MRS THATCHER'S NEW YORK SPEECH

It is a great honour to be asked to address this distinguished audience. The United States of America is today, without question, the world's greatest defender of liberty and its greatest military power. And, in spite of your real but short-term economic difficulties, also the world's greatest economic power. So this is the right place to discuss the future direction of economic policy.

Recession and Recovery

It is also the right time. For, after nearly a decade of rising prosperity, both our countries are suffering from a recession deeper and more prolonged than many expected. Moreover, whereas much of the restructuring and de-manning of the early 1980s was a long overdue necessity, that is not the case in the present recession.

I am delighted to read that some economists and even central bankers here are now forecasting a speedy recovery. However, many of the businessmen I meet are more cautious.

But economic recovery will come. Consumer spending will start rising. And companies will once again find it worth their while to invest.

Our economies have always been affected by the trade cycle. But our task is steadily to improve our economic performance whatever the stage of the cycle. In that way, setbacks will be less painful and growth more sustainable.

To achieve that, we have to do three things.

First, we must hold on to the fundamental principles which underpin our free enterprise system.

Second, we have to be prepared to learn the lessons of past successes - and past mistakes.

And third, we have to grasp new opportunities for prosperity.

I want to say something about each of these topics today.

But on the old principle of "know your enemy", I would like to say a word about socialism first.

Mr Chairman, we live in the Post-Communist Era.

The freedom revolutions of 1989 in Eastern Europe,

the slow but inevitable replacement of communism in the Soviet Union,

the spread of democratic governments in Latin America,

and the conversion of Third World regimes to ideas of privatization and market economics

- all these testify to the collapse of the Marxist ideology which has so destructively dominated world politics since 1917.

Socialism, the half-way house to communism, was badly damaged by that collapse. For socialists shared the basic idea that the State, not the individual, was the fount of all values and the solution to all problems. And the failures of communism undermined the appeal of its first cousin, socialism.

In its strict ideological form - the notion that the State should control and regulate all aspects of life - socialism is in retreat.

But in practice, it returns in many different guises.

For example, in my country with rising unemployment, it comes in demands for subsidies and other intervention to save jobs. But saving yesterday's jobs only delays the creation of tomorrow's.

We see the "green socialism" which takes environmentalism to extremes, ignoring both scientific evidence and human welfare in its determination to halt growth.

We see a kind of "consumer-socialism" that by law suit after law suit has taken product liability beyond all rhyme and reason and distorted the interest which real consumers have in good quality products and services.

And then there is fanatical feminism - a kind of "socialism-in-drag" - which seeks to determine jobs, salaries and promotions not on the basis of merit but on the the basis of gender.

The common theme underlying all these and other forms of socialism is no longer the greater efficiency that used to be their own yardstick.

They now claim that their particular form of socialism will produce a fairer and more decent society, while capitalism offers no more than an efficient but soulless and inequitable one. And their claims are increasingly heard, listened to and acted upon for one simple reason: they are rarely contested.

We must contest them.

THE ETHICS AND PRINCIPLES OF CAPITALISM

That brings me to my first main theme, the ethics and principles of capitalism.

We must proclaim both the moral virtues that underpin capitalism, that capitalism requires, and indeed that capitalism fosters -

as well as the clear benefits which capitalism brings.

For let us recall that economics is not some dessicated science, devoid of human content: it is about politics, and it is about human nature.

Adam Smith realised that. He was not just the founding father of free enterprise; he was also a moral philosopher. The Wealth of Nations was not his first book; before that, he wrote The Theory of Moral Sentiments. So when he talked about self-interest as the great force for economic progress, he was not just talking about selfishness.

It included things such as self-reliance: indeed that is the first duty we owe to other people. There is far more moral virtue in working to be self-reliant and actively taking responsibility for your own family than there is in being reluctant to take advantage of opportunity and becoming dependent upon others - a new dependency culture.

But some have played upon the word self-interest, deliberately distorting it. People may have many reasons for wanting to get ahead and become wealthy. But the state has no right to prevent them from fulfilling their talents in their chosen way.

Of course, some people may behave badly and misuse their wealth. But, as John Wesley put it, "the fault does not lie in money but in them that use it".

The fault will also lie in us, Ladies and Gentlemen, if we fail to explain the great benefits which capitalism brings.

First, it is said that capitalism is only interested in individuals and not in the community. But businesses can only survive and prosper if people work together at every stage of production and distribution and if they provide goods and services of the price and quality customers want. And most people are both consumers and producers.

Second, capitalism is economic democracy. Every time individuals make a purchase they are casting a cash vote, registering a preference. And capitalism is a necessary - though not sufficient - condition for political democracy: it gives people the financial independence to stand up to the State.

Third, free enterprise gives people a potential choice of jobs in a great variety of companies: they are not just restricted to working for the State or a huge monopoly employer. Either of which would severely curtail their freedom.

Fourth, private property is a pillar of free enterprise - indeed of freedom. People have the chance to save and pass on property to future generations, again encouraging a long term interest. Where there are no property rights, there are usually no human rights. And our privatization programme, now being followed the world over, has been used to give employees a special preference in purchasing shares. So earners have become owners.

Fifth, capitalism produces profits. Profits show that the product and price are right. They provide investment for the future. And taxing them provides resources to pay for such things as education and social services.

Sixth, successful companies are of necessity committed to the long-term view, to research and developing new products. They show a lively interest in improving the environment and the life of the local community. They have real concern for the welfare and training of their employees.

I was struck by the contents of a speech of a leading Swiss industrialist which summed up so eloquently what real capitalist ethics are about:

"No industry and no company can successfully do business in the long run against the prevailing public opinion. Doing business efficiently and effectively in a mere technocratic sense is no longer sufficient to preserve the acceptability of business by society....in order to regain trust and acceptance we must demonstrate the highest professional competence in all areas.....

"We are committed to a policy whereby we regard long term economic success, recognition of the needs and values of society and the respect for the environment as three equally important entrepreneurial responsibilities."

Seventh, socialists have always pretended that capitalism just relies on the law of the jungle. But capitalism is not unfettered, unchecked competition. It is based on a rule of law. There are laws to protect the customer, the investor and the worker. There are laws to ensure fair competition. And, of course, in modern capitalist economies there is a safety net of benefits - paid for by the wealth which free enterprise capitalism generates.

The people in the former communist countries know that socialism - whatever its original design-serves the elite and not the ordinary citizen. It is free enterprise capitalism which serves the masses.

Why is all this worth restating?

Because we have to be utterly certain about the morality and the fundamental principles of capitalism and its practical benefits.

But what precisely is the task of government in a modern economy?

It is to help create the conditions for enterprise to flourish. It has to set the rules: sometimes it must act as umpire: but it is not a player in the game. And all our experience is that once it gets onto the pitch, it is extraordinarily difficult to banish to the sidelines.

With free enterprise capitalism, the State, therefore, has a limited role - but a vital one.

It sets the legal framework within which business is conducted.

And it has the fundamental duty to provide a sound financial framework by controlling monetary growth, by controlling public spending and by keeping down budget deficits.

However tempting the short-term options may seem, they have a habit of turning into long-term headaches.

If you tolerate a little inflation, it quickly leads to a lot of inflation. As with any addictive drug, increasing the doses is required to achieve the same results.

If you ease up in the battle to curb public spending, catering for an endless stream of deserving causes, budget deficits will rise and you will put an unnecessary interest burden on business borrowers.

Or if your response to increased public spending is to put up taxes, you soon lose out, as talent departs, investment is postponed and incentives diminished.

Mr Chairman, that brings me to my second heading:

LEARNING THE LESSONS OF THE PAST

All experience shows that holding to the principles of financial orthodoxy and taking the longer view are difficult tasks. They may be unpopular. But in the end the policy works.

As soon as politicians, economists or bankers devise ways to try and circumvent them, the trouble begins. It is no good departing from financial orthodoxy when political pressures mount. That is precisely the time when you must stick to it.

And when government neglects its own tasks and instead takes on the duties which are properly the role of private enterprise then economic policy is in trouble.

Lessons of the Past: Britain

Britain was a perfect demonstration of that lesson.

For most of the post War period the British economy had been in relative decline. Socialists argued that this was inevitable, that it reflected fundamental weaknesses in British society or even the British character. Government intervention was therefore regarded as the answer to these alleged weaknesses.

Gradually it dawned on people that the opposite diagnosis was the correct one. Government was doing too much; its priorities were wrong; and it was policy rather than the British people that was to blame for our economic problems.

So we had to reverse all that and provide a sound financial framework.

But in the words of my friend and colleague, Keith Joseph, contained in a lecture at that time, we realised that "monetarism is not enough". So we also set out to create a framework favourable to enterprise:

- cutting tax rates
- slashing regulations
- encouraging small businesses
- restoring the legal balance between trade unions and employers.

These policies were dramatically successful and the performance of the British economy was transformed.

In spite of the difficulties of the recession, the great gains which were made in the 1980s will not be lost. Britain now has a soundly based free enterprise economy.

And although we now have a modest budget deficit, it follows three years of surplus which have enabled us to redeem debt.

The lesson is clear: low inflation and maximum freedom for enterprise is a winning combination. If countries in the Third World and countries throwing off the shackles of communist command economies wish to enjoy Western standards of living they

too must concentrate on making capitalism work - on financial orthodoxy and free enterprise within a rule of law. There are increasing signs that they are determined to do so.

Lessons of the Past: The World Economy

But how, if we learned those lessons in the 1980s, did we allow the renewed inflation - which prompted this recession - to occur?

Why was money supply allowed to grow too rapidly?

Technical difficulties in controlling the money supply do not explain the rise in inflation.

Part of the explanation lies in the general response of all Western countries to the collapse of the Stock Market in late 1987.

Some people were talking of a Great Depression on the scale of the 1930s. It seemed imperative that all Western countries should respond by making sure that the financial market and the banking system were not short of liquidity. And we did - which in itself showed that we had learnt an important lesson from the experience of the 1930s.

But nor do I believe that this can account for the inflationary pressures which we have seen - though it may have contributed something to them.

For the real explanation, we must go back to first principles; we must rethink the basis of coordination of policies within the G-7 - and especially the coordination of exchange rate intervention.

We had already learned the lessons of international attempts at a co-ordinated reflation in the 1970s. We knew that the result of such policies was both higher inflation and higher unemployment.

So in the 1980s our economic summits were rightly dominated by discussion of how to make markets work better, how to curb government budget deficits and how to boost small businesses.

But we did fall into one trap: and we are still suffering the consequences. With the Louvre and Plaza Agreements in the mid-1980s, we sought to put the objective of greater stability of international exchange rates above that of the control of inflation.

In Britain, we compounded this problem when in 1987-88 we tried to shadow the deutschmark: again the objective of a stable exchange rate was pursued at the expense of monetary discipline. These policies led to falls in interest rates to artificial and unsustainable levels, which in turn prompted excessive monetary and credit growth. That produced the inflation with which we are all too familiar. And it is mastering this inflation which is the reason for today's deep recession.

The conclusion to be drawn from our experience in both the 1970s and the 1980s is that governments should commit themselves to price stability: and this can only be achieved by reduced monetary growth. Targetting exchange rates puts excessive monetary pressure on some countries. Although superficially attractive, that policy is no substitute for explicit monetary control.

I recall the words of Karl Otto Pohl, former governor of the Bundesbank: "Interest rates should be set according to domestic monetary conditions and the exchange rate should be left to go where it will".

I would add: I don't believe that you gain confidence in your exchange rate by going contrary to the monetary signals. We in Britain in the ERM have a latitude of 6 per cent which with firm financial policies should be sufficient in present circumstances.

I believe that reflection on both the considerable successes and the limited - though real - failures of the 1980s can help us create a better framework for prosperity, not only in the next decade but in the century which opens up before us.

THE BENEFITS OF FREE TRADE AND THE COST OF PROTECTION

My third theme today is the need ceaselessly to promote international prosperity through free trade.

The West's post-War prosperity could never have been achieved without free trade within the orderly framework of rules provided by the GATT.

The world's response to the Stock Market Crash of 1929 was to put up trade barriers in an attempt to protect industries and employment. But the effect was to transform that crisis into a catastrophic economic depression. The world's trade in manufactured goods slumped by some 40 per cent.

Our response to the world recession of the early 1980s was different. We struggled to resist pressures for protection. And when the recession ended, our economies, enjoying the benefits of open trade, entered upon a long period of sustained growth.

However, that picture has to be qualified. Since the mid-1970s the volume of trade has continued to grow - but at a slower rate in relation to total world output than before. This is, in part, because there has been a growth in covert forms of protection. We can argue about where the blame for this should principally lie. But the challenge is to prevent the world slipping back into protection and instead to give a new momentum to freer trade.

How is this to be done?

We have to restate with conviction the case for free trade.

Free trade offers the best hope for low cost producers in the Third World to improve their lot.

What folly it is for Western countries to keep Third World countries in poverty by excluding them from our markets! Is it not hypocrisy then to provide billions of dollars worth of aid to palliate the consequences?

These countries need trade as much as aid.

With the crumbling of communism and the newly independent Eastern European countries are in danger of receiving a large influx of immigrants from the Soviet Union which their economies can ill-afford to sustain. Free trade with the Western European countries would offer their people new hope and would enable them to build up the resources to deal with the problem.

But free trade also benefits rich countries because it increases the total amount of trade between them to the advantage of all.

Perhaps the main victims of protectionist measures are the consumers in the country which is imposing tarriff or other barriers. Their living standards are reduced.

Even the industries on whose behalf protection is practised are damaged in the long run. They are shielded from competition. So they rely on their protected home market, and become inefficient. Although there may be tactical advantages in

threatening protection in order to open markets which would otherwise be closed, protectionist measures, if actually implemented, in the longer run benefit noone.

But we have to do more than argue this case. We have to act on it. That means that we must honour the rules of the GATT and, if possible, widen their application.

We must ensure that the problems over agriculture, services and intellectual property rights - but above all agriculture - are resolved.

There can be no doubt that agricultural subsidy and protection practised on the present scale in America, Europe and Japan are wasteful and unwarranted.

We must restore international confidence that the richest countries are genuinely committed to free trade.

But other moves towards free trade - provided these conform to GATT rules - should be encouraged.

I welcome the creation of a US-Canada free trade area and the prospect of its extension to Mexico. These reforms should strengthen the economies of your two neighbours and hold down the cost of living for Americans.

It is vital, however, that these should not be steps towards a

world of three protectionist blocs built around the US, the European Community and Japan, but rather steps towards a world of free trade.

Progress consists of enlarging our ideas and our understanding.

There are those in Europe who regard the prospect of a new European Superstate, engaging in managed trade with two such blocs, with apparent equanimity. I am not among them. Nor, I believe, should anyone be who has at heart the interests of America or the West as a whole.

How can that outcome be avoided?

First, the Uruguay Round must be successfully completed and this will require the full cooperation of the European Community.

Then we should begin to lay the foundations of an Atlantic Economic Community - embracing Europe (namely the European Community, EFTA and the new democratic states of Eastern Europe) on the one hand and North America on the other.

This proposal has all the merits which are attached to any extension of free trade - greater economic efficiency leading to greater wealth, benefiting all those taking part. But it has two other important advantages, as well.

Given the liberal economic tradition in trade of the US, Britain

and several European Community countries, and given the commitment to market economies of the former communist states - such a bloc would be a strong force for free trade. And because it would account for no less than 58 per cent of world GNP, other trading blocs and potential trading blocs would have to follow its lead in such matters. And it would give the GATT more clout. It would halt and reverse the creation of a world of protectionist blocs..

The second advantage is that, by moving in this direction, it would strengthen the vital ties of defence and culture which link America and Europe, by underpinning NATO economically.

This proposal certainly needs close and detailed study. We would need to consider how to merge a European Single Market and a North American Free Trade Area and what mechanisms would be required to settle disputes over obstacles to trade. We would need also to work out transitional arrangements for some industries, particularly steel, agriculture and some services. But none of those need be insuperable obstacles. I hope that in the months ahead a group could be formed to look at all these matters with a view to a practical time-table for such a scheme.

THE FUTURE

Mr Chairman, the international economic institutions of the post-War world have proved their worth. And I am proud of the role that America and Britain played at the end of the Second World War at Bretton Woods in laying the foundations for the Free World's economy. We were both closely involved in setting up the IMF, the IBRD, the OECD and, of course, the GATT.

Like NATO, these international institutions have always depended on trust and on common goals. And no matter how many institutions you create - or how elaborate their acronyms - if they do not have such a basis they will not long endure.

One such basis is provided by the special relationship between the United States and Britain, so important and so beneficial to the modern world. Our shared commitment to free enterprise capitalism - to its continued health and to its spread - will be tested in many ways in the years ahead.

We have to provide selected help to the former communist countries in Eastern Europe and to the Soviet Union, not to shore up their old system but to reform it.

We have to do this while keeping our own economies and defences strong.

So let us make this resolution.

Let us ensure that the triumph of our Western way of life is not some transient phenomenon.

Let us hold fast to the truths by which we set our compass.

And let us extend the hand of friendship to those who otherwise risk stumbling on the glorious trail to freedom.