10 DOWNING STREET

PRIME MINISTER

Sir Alan Walters thought you might like to see the attached article in today's Daily Mail.

Elizabeth McFarlane

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These hard facts refute Mr Lawson

By ANDREW ALEXANDER

IT'S NOT very often that I ask you to study a graph. But please look at this one. As you will see, there appears to be a reasonably close relationship between the two lines over the last decade.

Observe what they represent. The dotted line shows the rate of inflation, the thick one the exchange rate for the pound against the mark.

Hang on (I hear you cry). Something wrong here, surely?

Nigel Lawson's excuse for hitting us over the heads with 15pc base rates is that a falling exchange rate *causes* inflation or at any rate significantly adds to it. (And yesterday, calling on businessmen to resist wage claims, he was effectively advancing another old chestnut: that industry not the Government causes inflation).

What the graph suggests is that inflation falls as the pound falls!

Now, I am not going so far as to suggest that this is the real cause and effect. Exchange rates move against each other for complex reasons which may turn on productivity differences and sources of raw materials.

But what *is* clear from the graph is that the Lawson excuse — accepted far and wide throughout the media — is backed by no evidence. Moreover that can be argued from theory as well as practice.

The Prime Minister's personal economic adviser, Professor Alan Walters, made the point in a book on his Downing St experiences. Poor man — he must be feeling . . .

Well, perhaps you remember the film 'Ice Cold in Alex'? At one point, John Mills and his friends have managed to wind their truck up an enormous sand dune. Exhausted but triumphant, they step away to look at the view — and the truck runs all the way down to the bottom again.

For economists like Sir Alan and even for humbler creatures like me, who have been arguing for two decades or more that wages do not cause inflation, that the exchange rate does not cause inflation and that the pound should float freely, these can only be utterly dispiriting times.

Not only has the Chancellor behaved like the dimmest of his predecesors but — with the assistance of some Treasury briefing — the media have swallowed all his out-of-date arguments.

It is as if the last 25 years had never happened — as if Jim Callaghan was still Chancellor, as if Kaldor and Balogh were still the Government's advisers, as if we were still locked into the pound equalling $2.80 and there is only amused contempt for those free-marketeers who claim that currencies can float without causing a collapse in international trade.

What can one do now? I suppose we must follow the example of John Mills and Co, struggle back to the truck and start the uphill struggle all over again. But what a task!

Mr Lawson of course is the basic trouble. The Good Fairy gave him many gifts in his cradle. But she denied him intellectual humility and the simple capacity to listen and learn.

Rising interest rates in May did not stop him having another exchange rate crisis in October. Now he says that he hopes that 15pc is enough. Of course he does. But with the pound a fraction weaker yesterday, he can guarantee nothing.

Mrs Thatcher made a mistake in the summer reshuffle by saying to Mr Lawson that he had got us into this trouble, he must get us out. That left Mr Lawson free to insist that he must be allowed to do it on his terms.

She should have sacked the so-and-so then.