PO-CH/NL/0075

PART B

Part. B.

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Begins: 22/5/84.
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PART B

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PART B

Chancellor's (Lawson) Papers:

MINISTERIAL SPEECHES AND SPEAKING ENGAGEMENTS FOR 1984

Disposal Directions: 25 Years

25/7/95.

FROM: MS P M LEAHY
22 May 1984

Mr Peretz

MR BOARD

You may have a more specific idea of what the Chancellor has in mind, but para 2 needs to be borne in mind. Sir Peter Middleton has no particular comment on what is suggested below.
J Board 22/5

ccPs/Chancellor
Mr Mountfield
Mr Kitcatt
Mr Robson

CHANCELLOR'S CBI SPEECH: CONTRIBUTION ON OIL MARKET DEVELOPMENTS

You asked me to provide you with a short piece on the oil market for you to work into the Chancellor's speech tomorrow.

2. I have spoken to DEn who said they would not object to the inclusion of a short piece in the speech aimed at reassuring the markets provided it fitted in well with the rest of the speech. They also insisted that anything that was to be said should be cleared at Ministerial level with them, FCO and MOD because of the sensitivities involved and to make sure that what we were saying did not conflict with anything that was being said or taking place elsewhere.

3. In view of the nature of the rest of the speech it will probably be best if this part of the speech is very short and general. When we spoke about this earlier we decided that it would probably fit best in the section on the exchange rate. Something on the following lines might be sufficient,

" Foreign exchange markets coping very well with strong dollar and recent disruption in the Gulf. International financial and commodity markets must necessarily live with doubts and tensions if they are to function at all in today's troubled world. I am pleased to see that they are cpping calmly with the current upheavels across the globe without indulging in the taste for sensation which seeems to appeal to some commentators. I am sure that this must be right. "

P M Leahy

P M LEAHY

C

I'd suggest, at most, putting something at the end of the first para on p4, like:–

"Recent events in the Gulf serve as a reminder of a different kind of economic hazard from abroad. But the reaction of financial markets so far suggests that it is the US budget deficit that remains the greater risk." ~~[illegible]~~

[initials]

CHANCELLOR OF THE EXCHEQUER

c/

Comments on first section below.

We haven't had time to correct the rest for typing errors but will do that while you're talking to Peter.

Mary

23/5

RESTRICTED

FROM: DAVID PERETZ

DATE: 23 May 1984

MR FOLGER

cc Sir P Middleton
Sir T Burns
Mr Bailey
Mr Littler
Mr Monck
Mr Battishill
Mr Evans
Mrs Lomax
Miss Peirson
Mr Makeham
Mr Portillo

CBI ANNUAL DINNER

.. I am circulating herewith the first few pages of the Chancellor's speech to be made this evening, for rapid checking and clearance. Further pages will follow shortly.

2. Could we have any comments as soon as possible please. In particular, I should be grateful for comments from those concerned on the proposed reference (on page 2) to the forecast front-loading of the PSBR for this financial year.

DLCP

D L C PERETZ

Mr Peretz

cc as before + self

Some comments on page 2 - reflecting thoughts from Sir T. Burns, Mrs Lomax and myself. Also a small suggestion on page 3. I understand Miss Peirson may be submitting separate comments on the PSBR aspects

MJF

23.5.84

Not Holy Writ, not even the Budget Speech, but the ipsissima verba of the CBI. Not that I always agree with every word the CBI utters. Indeed, you would find it embarrassing if I did. But on this occasion you will be glad to know that I do agree with both these texts.

Inevitably, since they were first voiced, some weeks ago, there have been a number of alarums and excursions. But it is important to see these in their proper perspective. Inflation is firmly under control, and monetary growth remains within the target ranges set at the time of the Budget. There are, of course, bound to be fluctuations

T Burns

of monetary growth within the year, not least because of uneven movements of the PSBR. The pattern of government spending and receipts is such that the PSBR is ~~always~~ usually much higher in the first half of the financial year than it is in the second half. Over the past five years it has been, on average, twice as high in the first 6 months as in the second. This year, the front-end loading is likely to be even more pronounced, with more than 90 per cent of the PSBR for the whole year occurring in the first 6 months. The growth of

T. Burns

£M3 ~~will~~ should be rather smoother than this after allowing for normal seasonal variation. But we may well see a repeat of last year's pattern when it ran relatively high early on but finished, for the year as a whole, well within the target range.

And the effective exchange rate, a far better guide than the dollar rate, has remained remarkably steady. Private sector credit has been growing fairly rapidly, which is only to be expected as the recovery broadens out. But unlike the United States, whose massive Budget deficit is the root cause of the recent rise in interest rates throughout the world, a low level of public sector borrowing leaves ample room for increased private sector borrowing.

The recovery continues at a healthy pace, with capital investment moving ahead particularly briskly. Overall, the Treasury forecast of 3 per cent growth this year, regarded as wildly optimistic when it was first published, has now become the generally accepted view. And those who peer into the entrails in search of secret signs of reflation do so only because they still cannot bring themselves to recognise the awful truth - that it is possible to achieve growth without indulging in monetary and fiscal irresponsibility.

We are now a little more than 3 years on from the trough of the last business cycle and the start of the recovery. It has been ~~become~~ fashionable to describe that recovery as modest and fragile. But in fact, although unemployment remains stubbornly high, the rate of growth of output since the 1981 trough is little different from the average experience of previous economic cycles - and the signs are that, on this occasion, the upturn still has a good deal further to go.

And in a sharp contrast to previous recoveries, inflation remains low. The normal pattern of the past has been for inflation to rise once a recovery was fairly established, and indeed that is what has often been instrumental in bringing previous recoveries to an end. It is the favourable prospect for inflation today that provides the strongest basis for expecting the recovery to continue.

Disappointing though the recent rise in interest rates undoubtedly was, this too needs to be seen in perspective. They are still lower than they were a year ago, and although, as recent events have shown, we cannot insulate ourselves entirely from events overseas, it says a lot for our policies - and the confidence they inspire in the

Public spending and tax cuts

~~16.~~ But to achieve our objectives it is essential that we maintain firm control of public expenditure. Control of public spending is central to the task of reducing Government borrowing and maintaining the downward path of inflation; central to our chances of getting taxes down; ~~to an acceptable level;~~ central to our drive to stimulate initiative, incentives and sustained growth; and central to our determination to halt the steady encroachment of the public sector on the rest of the economy. Some people have said that our aim of holding public spending constant in real terms is unambitious. Those who say that are out of touch with reality. Over the last 20 years public spending has risen on average 3 per cent a year in real terms. And the pressures that caused this - political, demographic and technological pressures - have not gone away.

~~17.~~ But the climate has changed. Since cash planning was introduced, three years ago, we have kept our cash spending within the totals we then set ourselves. Since the peak of 1982-83, public spending has gradually begun to decline as a share of GDP. That decline will continue.

~~18.~~ No category, ~~element~~ of public expenditure can be immune from the constant search ~~stanch~~ for savings (and value for money) - not even capital expenditure. There is nothing intrinsically virtuous about capital spending. ~~or intrinsically sinful about current spending.~~ Current expenditure on repairing our infrastructure may provide the quality of services we need just as well as building from scratch and may well do so at a lower cost.

Supply side

~~19.~~ We must also take every other opportunity to oil ~~aid~~ the creaking joints of the economy. The privatisation programme is now returning important sectors of the economy to market discipline, while making the remaining nationalised industries more efficient - and that includes the coal industry. As the all-party Select Committee Report on Pit Closures said in 1982

> ".... the Board must take steps to bring its capacity more into line with existing and expected demands for coal. This is bound to entail the closure of some of the industry's highest cost collieries, for there is no sense whatsoever in continuing to mine, at considerable expense and some danger to life, substantial quantities of coal in excess of the country's domestic requirements and limited export opportunities."

20. We are reducing monopoly ~~powers~~ wherever we can. Our employment legislation and competition policies are providing business with a freer and more competitive environment. We have abolished regulations and controls, reduced or removed subsidies and started to tackle the distortions created by the tax ~~and social security~~ systems.

21. The tax strategy I announced in the Budget is an important part of this process. Poor returns on investment have been at the heart of Britain's problems. Our pre-tax rates of return on fixed capital in manufacturing have been consistently lower than our competitors' - only a third of the return achieved on the United States, for example. The problem has not in general been that we invested too little, but that our investment was not of the right quality. Consistently, we have been producing in this country significantly less output per unit of capital than the Americans, Germans or Japanese. Of course there are many reasons for this; but no-one can reasonably doubt that a tax regime which subsidised and encouraged projects with poor pre-tax returns - which in some cases even turned a pre-tax loss into a post-tax profit - has been a contributory factor.

22. The corporation tax changes I announced in the Budget, not just for the year but for the remainder of this Parliament, coupled with the abolition of the National Insurance Surcharge, will discourage the substitution~~s~~ of capital for labour unless it is genuinely economic to do so. But most importantly, they will encourage the search for higher quality investment with better pre-tax returns, and at the same time greatly reduce the bias in favour of debt rather than equity as a means of company finance. In three years' time, when the transition to the new system is complete, our rates of capital allowances in the UK will still be broadly comparable to those in most other countries but our rate of tax on company profits will be lower than in any of our main competitors. As your President-elect pointed out to the House of Commons Treasury Select Committee, the 1984 Budget changes will make the UK an increasingly attractive country in which to work and invest.

Profits

23. "Profits" used to be a dirty word in politics. But the only way in which a free enterprise economy can succeed is by encouraging profits and rewarding them properly.

24. The poor profitability of so much of British industry has been one of our major problems. So I am greatly encouraged by the sharply improved financial position of the corporate sector which has been the outstanding feature of the recovery so far. Between 1981 and 1983 gross trading profits of industrial and commercial companies rose by over 40 per cent, and they are still rising. Retained profits have been rising even more strongly. Company liquidity has improved substantially. I note that the CBI now expects real rates of return on industry to reach 8 per cent this year. Higher profits provide the basis for greater investment and new jobs. ~~But~~ Of course, profits need to be higher still - even now they have not yet recovered to the levels of the late 'sixties. But the trend is firmly on the right direction, and the insidious anti-profit culture is at last in retreat.

Productivity

25. Higher profitability reflects the success of British industry in adapting and responding to the challenges of the world recession. In particular, it reflects your achievements on productivity, most notably in manufacturing, ~~where the scope for improvement was greatest.~~ Over the past two years output per head in British manufacturing has been rising at an unprecedental 6 per cent a year, and there is little sign of this ~~slacking~~ slackening off. In the short run, productivity increases on this scale may look like bad news for jobs. But in the longer run it is the only route to faster growth, lower costs and more jobs.

"Britain Means Business"

26. Mr Chairman, in the dark days of 1977 you in the CBI had the excellent idea of inaugurating an annual Conference. For that first-ever ~~annual~~ CBI Conference you produced a booklet entitled "Britain means Business". I have been taking a look at that booklet. And I see that on it you set out what you saw as the ~~first~~ five prime objectives for Government. The first was "defeat inflation". To all intents and purposes, we have done that.

27. The second was "cut taxes". Where the shoe pinched hardest - and I think in particular of the high marginal rates of income tax and the National Insurance Surcharge, not to mention the (late and unlamented) Investment Income Surcharge - we have done that, too. And we are now firmly on course to complete the job.

28. The third objective you set was "lighten Government load on business". That, too, we have done. Apart from the tax measures I have just mentioned (and abolition of the National Insurance Surcharge alone is worth £3 billion a year to British industry), We have abolished controls on pay, prices, dividends, hire purchase, bank

lending, foreign exchange and industrial development. And at the same time we have~~, incidentally,~~ reduced the size of the Civil Service to the smallest its been since the war.

~~29.~~ The Fourth was "restore profitability". That's something no Government can guarantee, of course. But I've already referred to the dramatic improvement that has occurred here - and which is still in ~~track~~ train.

And the fifth objective for Government was "reform our pay determination system". What Government can do, we have done. The legal framework and balance of power within industry have been improved. Low inflation has helped to reduce the pressures, while the consistent pursuit of firm financial policies ~~have knowledge~~ has made it clear that excessive pay claims will not be underwritten by the Government. And management has been allowed to manage.

pmp

CHANCELLOR OF THE EXCHEQUER

David

Malcolm thinks you ought perhaps to be putting pressure on PS/Gov. about this.

Richard

DRAFT 21 May 1984 1800 hrs.

SPEECH BY THE GOVERNOR AT THE NORTHERN CONFERENCE OF THE STOCK EXCHANGE IN LIVERPOOL ON 23 MAY 1984

23/5/84.

On 27 July last year, the Secretary of State for Trade & Industry announced in the House of Commons an agreement on the basis of which the Stock Exchange might be removed from the ambit of the Restrictive Practices Court. On 12 April this year, the Stock Exchange published a Discussion Document outlining possible new trading systems and other changes in its rules, all of which flowed from the key element in the agreement with the Secretary of State, namely the abolition of minimum commissions. To the future historian, these two events will doubtless seem as one and the interval between them of no great account. You and I know better. There can be few, if any, comparably short periods in the history of the Stock Exchange, perhaps even of the whole financial services industry in this country, which have witnessed such rapid development of thinking and the inauguration of a process of such far reaching structural change.

Few of us who were involved in the discussions leading up to the Secretary of State's announcement were in any doubt about the extent and importance of the changes that would eventually result from the agreement reached. At that time, we recognised the possibility that events might snowball, in the sense that there might be a rush by non-member institutions to seek participations in members in anticipation of changes assumed to be inevitable. But it was possible to hope that we might be able to edge towards negotiated commissions in a way which would enable us to observe the effects at each stage. Once the proposal was open to public debate, however, it was clear that this was not going to be practicable. It was then that the term "Big Bang" entered the vocabulary of the Stock Exchange.

The prospective size of the bang also increased, as voices in favour of the case for introducing a new trading system, at the same time as the move to negotiated commissions, began to gain strength. There remained, however, a body of opinion which held that the jobbing system could be preserved and which by implication rejected the inevitability of the link argument. Some of the proponents of that view added a qualification - the jobbing system could be preserved, despite the advent of negotiated commissions, provided the Bank of England were formally to state that it wished the Stock Exchange to retain it. This however we believed we could not and should not do - for two reasons. In the first place, it would seem inappropriate to attempt to replace a judgment of the Restrictive Practices Court by an edict from the Bank of England. And, in the second place, we were not certain that it was right to want to preserve the jobbing system as the only trading system, at all costs or in all circumstances. Not that we were then or are now unalive to its manifest virtues. It is certainly arguable that the jobbing system and separation of capacity provide the best mechanism for a domestic securities market that can be devised: liquidity is assured, the investor is protected and the whole possesses an elegance not to be found in any alternative.

However, it is not open to us simply to choose the best market system for our domestic purposes, without regard to the realities of the outside world. These realities are - and have been for some time - intruding most insistently. The inescapable fact is that securities trading is now an international activity and if we in this country wish to play any significant role in the world securities market, we must be equipped to compete. There must, however, be doubts over our ability fully to meet international competition, if our central market for securities conducts its trading in a way which is unique to this country and which thereby may handicap its members in regard to its non-member competitors at home and overseas. It is rather like sending the principal players in the UK team onto the international playing field bound by the rules of rugby league when the rest of the team and all the opposition are in fact playing association football. And we must not allow ourselves to be misled into thinking that it is possible to play rugby at home and soccer away, since important parts of what we might regard as the home pitch are, in fact, now part of the international playing field.

In my estimation, the mounting pressure of international competition would by itself eventually have brought about the demise of the jobbing system as the exclusive or principal trading system of the Stock Exchange, even if there had been no Restrictive Practices Court case and hence no agreement with government to abolish minimum commissions. Be that as it may, as the Consultative Document makes clear, the Council of the Stock Exchange has concluded that the dealing system as it now exists will not be sustainable once commissions are negotiable.

If we in the Bank were unwilling to attempt artificially to preserve the jobbing system by edict, it was not because we wanted to impose a particular alternative trading system. On the contrary, it seemed to us essential that any new system should be proposed by the market itself and should emerge from a consensus among members, reached in the light of a full debate, in which all interested parties would participate.

The Discussion Document now represents the focus of that debate but, of course, a ferment of ideas and a great upsurge of discussion started the moment the Secretary of State made his announcement in July. One of the great advantages of removing the Stock Exchange from the Restrictive Practices Court was that new ideas, all shades of opinion, heresies even, could then be openly discussed without fear of prejudicing the case for the defence.

We in the Bank came to that debate armed with no blueprints but with some clear broad objectives. We were at the outset and have since remained quite clear that our wish is to see a Stock Exchange which offers maximum liquidity and investor protection; and which plays its full part in a vigorous, competitive UK securities industry, capable of gaining a significantly larger share of the total world market. These objectives were of course shared not only by government but also by the Stock Exchange itself.

In adopting such general objectives, we were consciously underlining that our concern was with ends rather than with means. Provided liquidity and investor protection were secured, we were open minded about the precise structure of the trading system. Naturally, we had particular ideas we wanted to discuss but in a spirit of learning rather than in an attempt to make converts to some preconceived master plan. To this end, we have had extensive discussions with a large cross-section of member firms individually and in various committees and I know from my colleagues how patiently and helpfully member firms have responded to this persistent catechism. In return, we have endeavoured to explain our own attitudes and the way in which our thinking was developing, much as I am doing now. From our point of view, it has been an invaluable dialogue.

When we first embarked on this programme of intensive discussion, it was possible to believe that, as it proceeded, we would be able to identify with growing confidence the particular characteristics of a market system necessary to achieve the objectives which I have mentioned. We certainly now have a clear idea about the nature of the future gilt market and I will come to that in a moment. The equity market, however, demands much more difficult judgments. We are convinced that a central market, that is to say one in which all orders are able to interact, offers the maximum degree of liquidity. We also think that ability to deal continuously in reasonable size is an important attribute of liquidity. That suggests the need for committed market makers ready to make continuous prices and trade in foul weather as well as fair.

But what is to compensate those who undertake the hazards of that role? One possibility is a system of order exposure, which allows the market maker to see the total order flow, rather as the jobber does now. But there is an understandable reluctance in a market which has abandoned obligatory single capacity to see arrangements which compel customer business to be revealed to competitors. As regards investor protection, we are convinced that an important contribution will have to come from arrangements for disclosure. This could, and I believe in time inevitably will, involve contemporaneous publication of the size of deals and the prices at which they have been transacted. This is said, however, to make the flesh of some prospective market makers creep (if that is an appropriate expression to use of men of such undoubted mettle). Instant transparency, it is argued, will make it possible to infer the shape of the market maker's book and, as a consequence, no one will be prepared to commit himself to making continuous prices.

American experience suggests that these fears may not be wholly justified, but, if they are, we have the paradoxical situation that what protects the investor in one way does him a disservice in another. And it is not only the interests of the investor which are damaged by an impairment in liquidity. The other side of that coin, and every bit as important, is that the interests of the company coming to the market for money are also damaged, since, if there is no certainty of a liquid aftermarket, the cost of raising capital will be greater.

None of this means that liquidity and investor protection are necessarily inconsistent objectives. A more liquid market is likely to be a more competitive market and competition itself provides significant protection to the investor. These are nevertheless difficult matters for judgment and it is not for me to anticipate the outcome now. What is important is that the right questions should be squarely addressed and I am confident that this is what the Stock Exchange Council, with its London, country and lay members, is now doing. The debate is a very important one, for members of the present market, for those who will become more significant players in the future and for the nation as a whole. This being so, it seems to me both natural and desirable that the debate should be a vigorous one. We in the Bank remain open minded about the future trading system in the equity market, or perhaps I should say "systems", since we recognise the possibility that two or more may need to coexist. We shall, of course, subject the proposals which ultimately emerge to critical scrutiny, as will the Government, but we recognise that the ultimate test is that the system must be one which the members accept as technically workable and as capable of offering them the opportunity of operating profitably.

Let me now turn to the gilt-edged market. Our general objectives in this area are no different from what they are in the rest of the market. We wish to see maximum liquidity and suitable investor protection and we think that the new structure outlined in the Discussion Document provides an appropriate basis for achieving our objectives.

With the Stock Exchange, we will now develop the structural features of such a market in more detail, including our criteria for the commitments we shall expect from the market makers with whom we shall conduct our own operations. These will certainly include a commitment to making continuous two-way prices and a capital base appropriate to the intended scale of operations in the gilt-edged market. We would expect to monitor compliance with such conditions and to exercise close and continuous supervision over the activities and financial condition of the market makers.

The number both of member firms and of institutions which are not yet members which have expressed serious interest in participating in a restructured gilt-edged market on this basis suggests that ample liquidity should be generated. Moreover, the prospective level of competition promises a high level of market efficiency. In our discussions with prospective market practitioners, we are paying particular regard to these features. But we shall also make sure that the needs of the small investor in gilts continue to be properly catered for and that adequate arrangements are in place to assure investor protection.

It is implicit in this model for the gilt-edged market that some potential market makers which are not at present members of the Stock Exchange should be able to participate. At the same time, we want to see the gilt-edged market retained within the administrative and regulatory framework of the Stock Exchange, rather than conducted outside it, though I do not mean by this that dealing would necessarily have to take place only on the floor of the Exchange. We therefore welcome the consideration which the Council proposes to give to the way in which outside interests can be brought into the Stock Exchange. Indeed, I cannot see that there is any sensible alternative policy. It is not possible to guarantee the Stock Exchange a monopoly of dealing in its listed securities and, if the market is not to be fragmented, the competing outside institutions, both British and foreign, must somehow be brought in. Even so, the Stock Exchange will remain the central market, as we would wish it to be, only if it offers the best prices and the best service. I have no doubts about its capacity to do so.

Hardly surprisingly, some outside observers, and perhaps even more within the Stock Exchange, have expressed unease about the pace of change. They have a sense of decisions being taken overhastily and of the market being rushed into new situations before anybody is ready to deal with them. I well understand that feeling, though I do not altogether share it. It is noteworthy that none of the changes within the Stock Exchange that have been implemented so far could be described as either excessive or insufficiently considered. The two most important have been the addition of lay members to the Council - and even the most hardened opponent of that move would, I hope, concede that it has been beneficial - and the decision to allow the formation of international dealers. This latter decision is, I understand, the product of ideas which have in fact been debated for more than a decade. What has perhaps contributed most of all to the impression of constant change is the number of participations taken in various member firms by outside institutions. Most of these have been announced since the Stock Exchange's agreement with the government, although the rules which made them possible were in place long before.

It seems to me cause for satisfaction that many of the associations which are being formed represent British groupings backed by substantial capital resources and ready to take up the competitive challenge. We in the Bank can certainly claim to have contributed to a climate of opinion favourable to the development of proposals for groupings of this sort but those which have been announced represent the considered judgment of the participants as to their mutual commercial advantage and owe nothing to intervention by the Bank. They seem to me to represent a resounding vote of confidence in the future of the Stock Exchange, in particular on the part of people who are at present outside it.

The prospective appearance on the scene of these and other powerful players has given rise to anxiety that the Stock Exchange of the future might consist only of a relatively few very large member firms, sharing all available business between themselves. This seems to me an extremely unlikely outcome. The securities industry in this country has always been characterised by a wide diversity of needs and interests, many of which have become the specialisations of smaller member firms. I do not believe that this diversity will be any the less in future or that large corporate securities houses will invariably be able, or will indeed seek, to satisfy specialised requirements with the same success as the existing smaller firms. The provincial and country members have a particular strength in this respect, in that they know far better how to service the needs of the local communities in which they operate than any outsider can ever hope to do. They are also particularly well placed to take advantage of any return of the smaller private investor to the Stock Exchange, about which I seem to detect a certain quiet optimism among a number of member firms. The same, of course, is true of the smaller London firms who serve the needs of the private investor. Most important, it cannot be too strongly emphasised that, if the Stock Exchange adopts a form of dual capacity, it will be permissive and not compulsory. There will, I am sure, always be a need for the member firm which does agency business only and the opportunity that goes with this may be still greater for many individual firms in future.

The feeling that everything may be moving too rapidly is doubtless fostered also by growing awareness of the many complex issues which need to be resolved before we reach what might be regarded as a steady state. There are first the questions of trading structure and membership that I have already discussed. Until firm and fairly detailed decisions are taken on these matters, only limited progress can be made in providing the appropriate technological infrastructure, without which an efficient trading system will not be possible. Indeed, such is the importance of technology that it is the lead time for designing and testing new systems that is the principal determinant of the timetable for prospective change. That alone prevents a headlong rush into unfamiliar situations.

In addition to these structural and technological questions, there is a range of regulatory matters which are certainly of direct concern to the Stock Exchange but which do not lie totally within its competence to resolve. I have principally in mind, of course, the conflicts of interest to which reference is made in the Discussion Document and about which I have also spoken recently. It will not be possible to identify precisely every circumstance in which abuse can arise from conflicts of interest until the new trading system has been determined. The principal dangers, however, become evident the moment one postulates the formation of financial groups which, in one manifestation or another, will be able to act as issuing house, market maker, investment manager and broker. These conflicts of interest are of course not new. Some participants in the Euro-bond market are already confonted with them. But in the market for most domestic securities, such conflicts have hitherto either been avoided altogether, or have existed in much more limited form. It is clear that the whole question of actual and prospective conflicts of interest now needs to be examined in some depth. Whatever solutions are reached, it is essential that the means by which abuse is to be avoided must be made public and must conform to an agreed minimum standard.

Where conflicts of interest occur within a Stock Exchange member firm, ultimate responsibility for ensuring that the client is suitably protected must rest with the Stock Exchange. Various forms of exposure and disclosure, about which I have already spoken in the context of the trading structure, constitute some of the possible means of providing that protection. Others involve different degrees of separation of the activities which give rise to conflicts of interest. The obvious case where some sort of separation is necessary is between principal and agent activities in a broker dealer. The circumstances in which the broking arm can place agency business with the arm which deals as principal must be clearly defined. Doubtless, an appropriate mixture of all three, that is to say exposure, disclosure and separation, will provide the eventual solution to conflicts of interest within member firms. Whatever is decided cannot help but affect the fundamental design characteristics of the new trading system.

Means of dealing with conflicts of interest which involve discretionary investment management seem to me to depend less on arrangements affecting the basic trading mechanisms and I note the strength of the view reported in the Discussion Document that discretionary fund management should be seen to be entirely independent of any principal dealing functions in the future. Regulation inevitably becomes more difficult, for the dual capacity firm which also undertakes investment management is effectively operating in triple capacity. I am quite clear in my own mind that, if Stock Exchange members are to be allowed to be both principals and investment managers within the same firm, the most convincing of Chinese walls must be erected between the two functions. Professor Gower, as you may know, is apt to say that there are often grapevines trailing over Chinese walls. Be that as it may, I think it unlikely that we shall be able to devise a regulatory structure which does not include as a prominent feature arrangements for separating various activities within institutions or groups. It will therefore be up to the Stock Exchange, or rather the financial services industry as a whole, to convince the public that Chinese walls do make a significant contribution to client protection. If necessary, arrangements will have to be instituted to make sure that both sides of the wall are policed. Beyond this, and whatever the precise trading system, the Stock Exchange will no doubt continue to protect the investor in many other ways, ranging from the imposition of listing requirements to the provision of compensation arrangements, all of which will remain of great importance.

The capacity of the Stock Exchange effectively to regulate its members will I am sure be greater if, as is proposed in the Discussion Document, member firms are required to be constituted as separate entities, even when wholly owned by non-members. But, of course, such a requirement cannot by itself solve all regulatory problems. How should the Stock Exchange deal with conflicts of interest which arise between two firms of a group, one of which is a Stock Exchange member and the other not? The answer might vary with the precise circumstances. Where there are only two firms in a group, one of which is a broker dealer and the other a non-member investment management company, the answer might be relatively straightforward. It would be bound to be less so, if the group were a highly diversified financial services group with a worldwide network and the Stock Exchange member firm were only a minor component part.

Even here, the Stock Exchange can doubtless reasonably hope to exercise some influence over the non-member parent and the non-member siblings, at least with respect to their dealings with the Stock Exchange member. But it would be unreasonable to suppose that the Stock Exchange could undertake sole responsibility for the regulation of all conflicts of interest, where it had direct jurisdiction over only one end. And, of course, potential conflicts of interest extend into many parts of the financial services industry where there may be no Stock Exchange involvement at all. Emerging conflicts of interest therefore represent a problem for the financial services sector as a whole and a challenge for the entire regulatory edifice. I would now like to turn to that wider scene.

There are many uncertainties about a practicable self-regulatory structure for the future and time is running short. I know that some of the potential conflicts of interest will not become actual until the Stock Exchange changes its rules on the ownership of member firms and, as I have said, some of the obvious conflicts will necessarily be dealt with by the trading structure. Others may fall comfortably within the regulatory competence of the Stock Exchange. But coming events cast their shadows before them and it will be understandably supposed that the activities of different parts of a prospective integrated financial services group will be increasingly influenced by what will be seen as a fast approaching identity of interest. The City cannot afford to let it be thought that it is passive in the face of these developments or indifferent as to whether or not there are arrangements in place to prevent abuse. If the opportunity to develop a more vigorous and competitive British Securities industry is to be fully exploited, users of our markets - including those overseas - must be assured that our trading arrangements are fairly and reasonably, though not intrusively, regulated.

As you know, the regulatory system has been the subject of a searching analysis by Professor Gower. His recommendations, together with comments from a wide range of interested parties, now lie before the Secretary of State for Trade & Industry. The responses that I have seen show, as one might expect, many shades of opinion. There is a general, although certainly not universal, belief in the advantage of significant practitioner involvement in the regulatory process, with favour widely found for channelling this through some structure of self-regulatory groupings. There is however no common view about what particular groupings any such structure should comprise; and there is still a rather sharp divergence of opinion on how far the activities of self-regulatory groupings would require co-ordination and how this might best be provided. I think that provision for appropriate oversight of the activities of self-regulatory bodies is not only a very difficult issue but also one of great importance. A particular consideration will be the relationship between any overall co-ordinating body and what must after all be acknowledged as the senior self-regulatory institution in the financial services industry, namely the Stock Exchange. In this context, I was impressed to see the comments submitted by the Stock Exchange on the Gower report, for these display the readiness of your Council to collaborate in arrangements under which the Stock Exchange would, as a self-regulatory association, be subject to a newly constituted overall supervisory body.

The Stock Exchange has, of course, long been an important contributor to the wider framework of self-regulation, where the City has an enviable record. The Take-over Panel, for example, whose code the Stock Exchange helps to enforce, is now admired internationally for its speed and efficiency in handling take over disputes. The CSI, which originated in an initiative taken by my predecessor, also has very substantial achievements to its credit and has steadily gained in authority under its distinguished Chairman, Sir Patrick Neill.

With this record of successful self regulation in mind and because I believe that the time is now ripe to move ahead from discussion on concepts to specific action, I have decided to constitute an advisory group of senior City figures and practitioners to advise me as a matter of urgency on the structure and operation of self-regulatory groupings which they would feel confident could in practice be formed in the near future; and on what form of co-ordination and supervision of such groups might be necessary. The precise terms of reference are as follows:

"To advise on the structure and operation of self-regulatory groupings that would most appropriately cover all types of securities activity (including investment management) together with commodity and financial futures, and which would, in the view of the group, attract sufficient support from potential participants to be capable of early implementation; on how, and over what time period, the formation of such new groupings as are needed might be brought about; and to tender advice to the Governor within three months."

I am happy to say that Mr Martin Jacomb, a Vice Chairman of Kleinwort Benson has accepted my invitation to act as Chairman of the group and that your own Chairman, Sir Nicholas Goodison, together with Mr John Barkshire, Chairman of Mercantile House, Mr Brian Corby, Chief Executive of the Prudential Corporation, Mr David Hopkinson, Chairman of M & G Investment, Mr Mackworth-Young, Chairman of Morgan Grenfell, Sir Jeremy Morse, Chairman of Lloyds Bank, Mr David Scholey, Joint Chairman of Warburgs, Mr Mark Weinberg, Chairman of Hambro Life Assurance and Mr Richard Westmacott, Senior Partner of Hoare Govett have agreed to serve on it. I should emphasise that there are no presumptions on my part about the answers to be reached and, indeed, with so well-qualified and distinguished a group, it would be presumptuous for any of us to anticipate their advice. There will be nothing to inhibit the group from giving whatever advice about the regulatory structure their consultations and deliberations lead them to consider appropriate. But while it is strictly an advisory group, my intention is that its advice should be formulated on the basis of what its members, by virtue of their respective positions in the City, judge to be capable of implementation.

Some of you may wonder why I did not entrust this task to the CSI but I think a moment's reflection will show you that it would have been unreasonable to do so. The CSI produced a most impressive analysis of and commentary on Professor Gower's recommended structure and has formulated its own carefully thought out and cogently argued proposals. Its studies have quite properly approached the question of regulatory structure from the point of view of what it sees as desirable. But what I am most immediately concerned with is what arrangements are capable of being put in place in the fairly early future, the good so to speak rather than necessarily the best. Whether strengthened regulatory arrangements that might in practice be put in place fairly soon will be regarded as sufficient over a slightly longer time-scale remains to be seen. But I am clear that early initiative is needed to equip us better to address the new conflict of interest situations that are beginning to emerge. It is for this reason that I am setting up this advisory group now with particular emphasis, in its terms of reference, to what is "do-able" as distinct from what may ultimately be regarded as "ideal". I know that the chairman and members of the CSI recognise that this is, in present circumstances, much more a task for an ad hoc group of the kind that I have described than for the CSI. But I would like to take this opportunity to pay tribute to the quality of the work that has been undertaken by the CSI and its staff in this area, and I have no doubt that the advisory group will find it to be a very significant input to their deliberations. I am glad to say that the Chairman has agreed to place at the disposal of the Advisory Group, as required, the services of the senior executive staff who have been most closely involved in the work. The functions and composition of the CSI in the longer-term will of course need to be reviewed in part in the light of the advice that I receive from the advisory group, and decisions that are reached, including those reached by government, in due course. But the CSI remains in being in its present form in the meantime; it has a continuing job to do and it has my support in doing it.

I have of course discussed this initiative with Ministers and I know that the Secretary of State for Trade and Industry welcomes it as a means of testing how far strengthened non-statutory arrangements can meet the challenge of the fast-changing securities scene. Neither Mr Tebbit nor I can of course be bound by the eventual proposals of this group, though I hope that their advice will commend itself to us and provide the recipe for strengthening of the regulatory structure in the securities area in a way that will command respect and confidence both at home and abroad.

Even stout hearts may falter slightly when they contemplate the difficult terrain that must be negotiated before we reach that as yet only dimly perceived state in which a regenerated Stock Exchange is smoothly functioning within a suitably regulated financial services sector. But we must not let ourselves be daunted. We have already travelled far since July of last year and many troublesome issues which seemed intractable in prospect now lie behind us and no longer represent problems. The knowledge of progress already made reinforces my conviction that, however difficult the remaining questions may now seem, we shall find good answers to them within the time that is available to us. I am equally confident that this process of change which we are undergoing, uncomfortable though it may be in some respects, offers many opportunities for growth and development, which I know you and your fellow members of the Stock Exchange will not be slow to identify and grasp.

C
Do you want anything more? Enough on the world?

MOM 15/6

FROM: P MAKEHAM
DATE: 15 JUNE 1984

CHANCELLOR OF THE EXCHEQUER

Thanks. N.

cc Miss O'Mara
Mr Battishill
Mr Culpin
Mr Portillo

THIRTY CLUB: 19 JUNE

You asked for a "State of the nation and world" theme for this occasion. I attach draft speaking notes.

Peter Makeham

P MAKEHAM

Thirty Club: 19 June

Introduction

1. Delighted to be here. As a former journalist, I am more than most politicians aware of the relationship between politicians and the media. It's very similar to that between the crocodile and the bird which lives off the crocodile by eating its parasites - the question is, who is the crocodile!

2. We live in a society very dependent on mass communication - perhaps I should say non-communication as it's amazing how often things are misunderstood. Sometimes they may be deliberately misunderstood - I'm reminded of the story of the English Archbishop visiting the US for the first time. He had been warned of the dangers of being misquoted by the tough press reporters of that country. So he was determined to guard his tongue and when upon arrival at New York Airport he was presented to the throng of reporters in a V.I.P. room, he braced himself for the first question. This came from a tough Brooklyn-speaking reporter, who asked if the Archbishop intended to visit any of the famous New York clubs with their strip tease dancers.

The Archbishop thought carefully for a moment and replied with a little smile: "Are there any such clubs in New York?"

Everyone laughed and applauded, and he was still congratulating himself upon his clever reply the next morning when the newspapers were delivered.

There, staring from the headlines was the bold caption:

Limey Bishop's First Question: "Are there any strip tease clubs in New York?"

3. Every politician (and even bishops can be politicians) runs the risk of misreporting and misunderstanding. What interests me more is the perception of changes in our economy. Take the recovery.

UK recovery

4. For nearly three years, economic growth running at an average of 3 per cent a year. Fastest growing member of European Community last year. Will be near top of the league again this year. One of the longest recovery periods in post war history.

5. Growth now spread widely through economy. As is usual, consumer spending important role in initial stage of recovery. Now seeing substantial increase in investment - manufacturing investment up 9½ per cent in latest six months, DTI Investment Intentions Survey points to a 12 per cent increase in 1984 as a whole. Exports are increasing too - non-oil volumes up 8½ per cent over the year to this spring, including a 9 per cent increase in manufactured exports. Recovery now being increasingly reflected in labour market - estimated 200,000 new jobs between March and December last year.

6. Major underlying changes in economy occurred too - tend to be gradual but nonetheless crucial. Not the stuff headlines are made of - you will allow me to give them rather more prominence

- Profitability. Gross trading profits of industrial and commercial companies up more than 40 per cent between 1981 and 1983, and still improving. CBI expect real rates of return to be over 8 per cent this year (compared with low of 4 per cent in 1981.)

- Productivity. Productivity in manufacturing up by around 6 per cent in both 1982 and 1983 and still increasing. Now at record levels.

7. All adds up to a winning combination - steady growth and low inflation. Such a contrast to previous economic recoveries which were so often choked off by inflation - inflationary pressures subdued and favourable prospect for inflation underpins outlook for sustained economic growth.

8. Are inevitably month to month blips in statistics - which do get the headlines - but they should not be regarded as portents of economic doom. This recovery apparently "peters out" or "falters" whenever there is a hiccup in retail sales or manufacturing output. Sometimes reports on the latest economic statistics remind me of the cable sent by a correspondent to his editor "Almost impossible to exaggerate the gravity of the situation here - but I shall do my best."

World background

9. The world economic background is also encouraging. World recovery broader and its benefits spreading more widely. Output in major industrialised countries expected to grow by 4-4½ per cent this year, and about 3-3½ per cent next. Inflation likely to remain around 5 per cent. World trade recovering and expected to rise by around 6 per cent this year and next.

10. Even so, wrong to be complacent. We confront problems of high interest rates, international debt, protectionsim and high unemployment in many countries. Economic Summit showed widespread agreement in strategy to tackle such problems. Common belief in basic policy objectives.

Policies

11. Two elements essential for sound sustainable growth - firm macro economic policies and the encouragement of efficient market economies, adaptable to change.

These objectives common to Summit countries and are twin pillars of this Government's strategy.

12. Objective of macro-economic policy to reduce inflation. Requires continued monetary control and financial discipline ie keeping tight rein on government borrowing. Control of public spending central to task of reducing borrowing and tackling inflation, central to drive to reduce taxation, and central to determination to halt encroachment of public sector. Aim of holding public spending not unambitious - risen on average 3 per cent a year in real terms over last 20 years - witness all pressures on US to continue to increase spending.

13. Lesson of experience that so called "expansionary policies" not the way to sustain growth and tackle unemployment. Need to encourage efficient working of our economies and in particular the removal of ridigities and distortions which prevent markets working. Lesson of progress in US and Japan in reducing unemployment. Much greater flexibility in attitudes (and in wage response) and many fewer obstacles to change.

Competitive markets and technical change

14. Competition the key to growth and wealth creation. Embarked on vast number of changes to oil creaking joints of economy. Privatisation programme returning important sectors of economy to market discipline. Remaining nationalised industries becoming more efficient. Monopoly being reduced. Employment and competition policies providing freer and more competitive environment. Controls and regulations abolished. Subsidies reduced and removed. Distortions created by tax system being tackled.

15. Aim to create competitive environment in which British industry can adapt and respond to the demands of consumers and challenge of competitors overseas. The pace of economic change fast - particularly in communications industry where micro electronic revolution taking place. Gives an opportunity to raise productivity -changes on this scale may look like bad news for jobs in the short run. But such gains in productivity raise whole nation's income and help create the jobs of the future. In long run, rapid technical change creates more jobs than it destroys - lesson of automation some decades ago. Lesson of US and Japan now. Achieving this the only route to faster growth, lower costs and more jobs. That is a task in which your employees need to be convinced - and your listening public.

Peroration

16. Three messages

On economy - economic growth soundly based and set to continue against background of falling inflation

On government - committed to sound financial policies and spur of competitive markets

On industry - with these conditions you have the opportunity to increase productivity, win the markets, create jobs and earn profits.

FROM: M D X PORTILLO
DATE: 22 JUNE 1984

PS/CHANCELLOR

I attach speaking notes for the Chancellor's two engagements next week. For Benton and Bowles I am told that all that is required is a five minute piece of scene-setting and that the bulk of the time will be spent on questions and answers. For the Basil Feldman dinner twenty minutes is required.

MP

M D X PORTILLO

NOTES FOR BENTON AND BOWLES (MICHAEL MORRIS) 27 JUNE

Economy at home

There's a lot of good news about the economy to report:

- Our GDP growth rate was the highest in the EC last year. We shall be at or near the top again this year.

- Inflation is low, and should fall further by the end of the year.Recent CBI survey showed manufacturers' price rises decelerating.

- Investment strong - up by between 7% and 9½% in 6 months to March (depending on sector) and recent survey shows it should rise by 8% - 12% in 1984 as a whole, and continue to rise in 1985.

- Productivity very good. In manufacturing 23% better than at end of 1980.

Extraordinary that some people now asking whether government's priority is defeat of inflation or growth and defeat of unemployment. That question based on a misunderstanding. We are pursuing simultaneously macro policies to beat inflation; but removing controls and taking other micro measures to make the economy work better so that new jobs can be created. I set that out clearly in a speech last week.

World economy

Growth of world economy also strong,but there are a few clouds, as we all know.

a) US interest rates The Americans now admit that markets take the view that the US deficit is key factor. US Administration moving in the right direction with Down-payment legislation. Very determined to avoid recurrence of inflation. But long haul and re-emphasises need to pursue sound policies at home.

b) International debt Need for summit communique to strike balance between sounding alarmist or complacent. The fact is that we need to tie further assistance closely (through IMF) with adoption by debtor governments of sound economic policies. Some already doing so. With others, agreement still some way off.

The Strategy

- Continue fight against inflation.
- Continue with removal of controls and other obstacles to jobs.
- As economy grows, keep tight control on government spending.
- That will provide us with the room for tax cuts, which in turn will improve the dynamism of the economy. A virtuous spiral.
- [This serves to emphasise importance of now holding government spending in check].

CHANCELLOR OF THE EXCHEQUER

c Mr Monck
Mr Battishill
Mr Culpin

CORPORATION TAX

Miss O'Mara asked for comments on the handout you are planning for your dinner with Exxon on Monday.

2. I think it could be useful to add "They also gain from the abolition of the National Insurance Surcharge" at the end of the first paragraph.

ICB

I C R BYATT
29 June 1984

10-4a

FROM: P MAKEHAM
DATE: 29 JUNE 1984

1. MR BATTISHILL

2. CHANCELLOR OF THE EXCHEQUER

cc PS/Chief Secretary
PS/Financial Secretary
Sir Peter Middleton
Mr Byatt
Mr Cassell
Mr Monck
Mr Batishill
Mr Monger
Mr R I G Allen
Mr Culpin
Mr Monaghan
Mr Portillo
PS/Inland Revenue
Mr McConnachie - IR

C
Press Notice OK?
Do you want speech on cards? Joke at ball
MoM
29/6
Mr Forster's speech has just arrived - below

CORPORATION TAX: EXXON SPEECH

I attach draft speaking notes for the Exxon dinner on 2 July together with a further draft press notice on corporation tax and the IFS estimates. You asked for some reference to changes in behaviour. Paragraph 4 reflects this but does not explicitly criticize IFS on this point: this avoids encouraging discussion on our own assumptions.

2. The speeches are expected to be about 8 to 10 minutes long. The draft speech includes only a short reference to the corporation tax proposals in paragraph 11 and this could be replaced by the press notice wording if necessary.

Peter Makeham

P MAKEHAM

FROM: G W MONGER

DATE: 12 July 1984

MR PERETZ

cc PS/Financial Secretary
Sir T Burns
Mr Cassell
Mr Battishill
Mr Griffiths
Mr Reed

PS/Inland Revneue
Mr Beighton
PS/Customs and Excise

FINANCE BILL: THIRD READING SPEECH

I attach as requested a new draft of the section on changes made during the passage of the Bill.

2. In view of the shortage of time I have not been able to clear the draft as a whole with the Revenue Departments, although we have consulted on the telephone those who are mainly concerned with particular passages.

G W MONGER

In my Budget speech I said that the tax reformer's path is a stony one, since any change in the system is bound to bring disadvantages to some, at least in the short term and complaints from them are more audible than praise from those who benefit.

I was therefore greatly encouraged by the response to the tax reform proposals in the Budget. It shows that people generally have seen the need for a simpler and more neutral system of taxation. They appreciate the advantage to the nation as a whole of moving in that direction. I am encouraged to continue to do so in the future.

The general strucutre of the reforms has stood the test of the detailed examination in this House of the Finance Bill, and has not changed. But we thought it right to make detailed changes to take account of representations received, or points made in the debates, about the effect on particular industries.

In considering such representations one always has to strike a careful balance. On the one hand, it may be right to allow for the special difficulties some industries may face in making the transition to the new system. On the other hand it is essential not to jeopardise the general structure of the reforms, since one of the defects of our taxation system has been the proliferation of special exceptions and concessions over the years. A careful judgement was therefore involved. I am satisfied that we have got it right, and that the Bill has been improved as a result.

I should now like to describe briefly some of the main changes which have been made during the passage of the Bill.

First, indirect taxes, I see the extension of the VAT base as an essential part of the Budget strategy, and a necessary counterpart to the reduction in income tax. Moving from direct to indirect taxes gives people more freedom to decide how to spend their own money.

But we recognised the special difficulties that the standard-rating of alterations would carry for listed buildings. An amendment on report therefore provided for the zero rating of alterations to listed buildings where they require and have received listed building consent from the planning authority. I believe that this measure to protect the heritage was widely welcomed in the House and in the country.

Secondly, we have made a number of changes in the new rules governing capital allowances. They are broadly designed to help with the transition to the new system and to allow greater flexibility in the use of the allowances.

These changes will therefore be of benefit to all industries, but perhaps I should in particular say a word about the effect on shipping. This industry operates in a specially demanding international environment. It will now enjoy free depreciation on new ships. This continues into the new regime the special treatment it received under the old.

Thirdly, I should mention the concerns of the film industry, which have received some publicity. This industry will, as a result of amendments during the passage of the Bill, be able to choose between getting capital allowances, on the new basis, and writing off costs

On revenue account against income as it accrues. Investment in British film companies will also be eligible for the Business Expansion Scheme.

Fourthly, I should mention a major change in the treatment of furnished holiday lettings. As a result of amendments made during the passage of the Bill, these lettings will if they satisfy certain conditions receive tax treatment similar to that given for trades. We have also relaxed the conditions. These changes will bring considerable benefit to a large number of people and have been widely welcomed, especially by Hon and Rt Hon members representing holiday areas.

The last set of changes I want to mention now are those in the provisions on controlled foreign companies. These important measures cover a wide range of circumstances and we had to ensure that they were well-targetted. We welcomed the comments from industry and made some significant changes in the light of them, the main one being to give companies doing business in non-havens an assurance that they will not be subject to the charge. I am now satisfied that we have got these provisions about right.

10 DOWNING STREET

From the Press Secretary

CH/EXCHEQUER
REC. 12/7 12 JUL 1984
ACTION Mr S. Webb
COPIES TO CST, FST, MST, EST
Sir P. Middleton
Mr Monck, Mr Burgner
Mr F. K. Jones
Mr Ridley, Mr Lord
Mr Portillo, Mr Makeham

12 July 1984

Dear Mr Peretz,

The Lord President has asked me to send you the attached Speaking Note on the coal strike, law and order and democracy, and the implications for our way of life.

Lord Whitelaw hopes the Chancellor of the Exchequer and his Ministers will mount a determined effort this weekend to put over to the public these points.

He has asked me to send copies, with a similar request, to the Private Secretaries of the Home Secretary, the Secretaries of State for Northern Ireland, Energy, Scotland, Wales, Trade and Industry, Employment and Transport.

Yours sincerely,

R Packard

pp BERNARD INGHAM

Mr David Peretz,
PS/Chancellor of the Exchequer,
HM Treasury,
Parliament Street,
London, SW1.

Note
At the Chancellor's request I've warned all other departments not to use these words, to avoid any risk of Ministers being quoted as making the same speech!
DLCP

The coal strike, now heading for its 19th week, has had little or no impact on the availability of fuel and power to the public. Stocks of coal remain high and will last for many months.

But for the media, the strike might never have happened for millions of people.

However, the media - and especially television - have brought the dispute right into our living rooms. And what the British people have seen and heard of it has revolted them.

According to a Gallup Poll last week, 79% disapprove of the methods being used by the miners and think they are irresponsible.

They may well think, too, that those who fail to condemn these methods are no less irresponsible - and, bearing in mind the positions they occupy, unfit for office. At the very least, their silence demonstrates just how insecure, not to say palsied, is their grasp of democratic principles.

What I want to do today is first to examine the background to the violence, thuggery and intimidation that has been our staple television diet these last few months; and second to look at their implications for our society and way of life.

It used to be the accepted wisdom that the NUM was among the more democratic of our unions. That is no longer the case and the NUM, or some of its leaders, have only themselves to blame for this loss of reputation.

You will recall that this current strike is not the product of a national ballot. The NUM have continuously runaway from a national ballot even when they reduced the majority required for a strike from 55% to a simple majority.

This strike is the result of an attempt to secure a rolling national strike, regardless of the expressed and balloted views of individual coalfields, on the basis of intimidating picketing.

To the eternal credit of those areas of the NUM who have some regard for its democratic traditions, the strike is far from solid. Roughly a third of the coal industry is at work.

This gives hope that the NUM might yet be saved from the fascist Left.

But let none of us underestimate the lengths to which the Left will go to get its way. Only this week for example, the new moderate branch delegates in the Nottinghamshire coalfield were prevented from mandating their representatives to this week's NUM conference by the occupation of the union's headquarters.

Sad to say, however, this is but a tame example of the way in which this strike is being sustained.

The British public knows, because they have seen evidence of it, that fists, feet, running jumps, sticks, stones, bricks, lumps of concrete and assorted barbed missiles, can - and do - accompany abuse of those exercising their right to work and the police whose sole duty is to keep the peace.

We know what cruel obstacles have been thrown under the feet of police horses. And we know the kind of barricades that have been ercted and set on fire.

We know the mob is not above taking over a town - Selby - beseiging a police station, or generally running riot.

All this is not of course to mention the horrifying reports of intimidation of miners' families, and damage to property, in the pit villages.

Is this the trade unionism of which the TUC and its political arm, the Labour Party, are proud to acknowledge?

Well, we know one miners' leader at least, with an effrontery which sickens rather than deceives the public, is prepared to load all the responsibility for intimidation and violence on to the police.

And we also know the silence from Congress House, Walworth Road and the office of the Leader of the Opposition is deafening.

You may well ask why?

First, why when more investment than ever before is being poured into the coal industry; when the pay offer before the miners is better than many other groups have settled for and keep the miners 25% ahead of average earnings; when redundancy terms are the envy of British industry; and when not one miner is threatened with compulsory redundancy?

Second, you may well ask why when the NUM leaders seem only too willing to fight their strike to the last steelman; to the last docker; indeed, for all they care, to the last butcher, baker and candlestick maker in their very own pit towns.

But, most important, you may ask why there is this deafening silence from the trade union and Labour movement in view of the real issues which confront this nation today:

And the real issues are quite simply whether we believe:

- in a democracy which accords the individual the right to express his views on matters which affect his future

- in the right of the individual in a free society to go to work, as well as to strike, if he so chooses

- the purpose of picketing is peacefully to persuade

- in law and order and the right of individuals to go about their lawful business

- in the duty of the police impartially to maintain that law and order.

I raise these issues simply to assert that this Government believes firmly in democracy, and the rights and duties it confers, and will resolutely uphold them.

No-one should be in any doubt about that.

We are, however, entitled to doubt whether others share our belief and our determination. We can be sure beyond reasonable doubt that some most certainly do not; instead that they have espoused the methods of fascism in all but name.

I have but one message for them: they will not - and cannot win. They are doomed to fail.

12 July 1984

From: THE PRIVATE SECRETARY

C
This arrived too late for official comments tonight but you may like to see
MDM
12/7

HOME OFFICE
QUEEN ANNE'S GATE
LONDON SWIH 9AT

12 July 1984

Dear David,

I attach the text of a speech which the Home Secretary intends to make in his constituency tomorrow ~~even~~ and which he wishes to release to the press. His intention is to reaffirm in the light of recent press criticism the Government's determination to press ahead with its policies, to stress the basic soundness of the economy and to reaffirm that violence will not be allowed to prevail in the miners' dispute.

I am afraid I must ask for any comments you may have on the text by 10 a.m. tomorrow, Friday. I apologise for the very short notice.

I am copying this letter to Andrew Turnbull (No 10) and Janet Lewis-Jones (Lord President's Office).

Yours sincerely
Hugh Taylor

H H TAYLOR

David Peretz, Esq.

CH/EXCHEQUER	
REC.	12/7 12 JUL 1984
ACTION	Mr Battishill
COPIES TO	CST, FST, MST, EST
	Mr Folger
	Mrs Lomax
	Mr Burgner
	Mr Portillo.

EXTRACTS FROM A SPEECH BY THE RT HON LEON BRITTAN., QC., MP., HOME SECRETARY, TO A MEETING OF LANGBAURGH CONSERVATIVE ASSOCIATION AT KILTON HALL, BROTTON, GUISBOROUGH, CLEVELAND, ON FRIDAY, 13 JULY 1984

<u>Release Time: 8 p.m., Friday, 13 July</u>

Political commentators, financial markets and even some Members of Parliament have recently contracted a severe bout of mid-summer jitters. The complaint is said to be catching. So let me make it clear that there are no jitters in Downing Street; no jitters at the Home Office; no jitters around the Cabinet table; and no jitters, either, among those whose responsibility it is to enforce the law of the land. This is so for three very good reasons.

First, the economy has been steadily recovering and nothing has occurred to change that or should be allowed to obscure it. Growth is up; inflation is down. ~~The~~ That crucial combination shows every sign of continuing. Of course there will be setbacks. The Government cannot control US fiscal policy. And it is not surprising that financial markets are affected by industrial disputes or the money supply figures. What the Government can and will do is to ensure that the firm consistent policies to bring down inflation and exert downward pressure on interest rates, which have provided the basis for sustainable economic recovery, will continue. How markets react over the weeks and months to come can never, of course, be predicted with certainty. But the underlying realities remain, and as it becomes clear beyond a doubt that the Government is not changing course, the temporary factors that have led to the

/present disturbances ..

present disturbances will be seen in a proper perspective.

Secondly, commentators who pontificate in very general terms about the state of the country should look a little more closely at the industrial disputes which appear to have made some of them run for cover. No-one would minimise the seriousness of the miners' dispute - above all, for the miners and their families and for the police who are the butt of inexcusable violence. A national docks strike is also, of course, no trivial matter. But let us not forget one supremely significant fact: militants at the head of the unions involved have not dared to ballot their members. The truth is that the vast majority of working people in Britain loathe the political posturing of the Marxist militants; and the militants know it. That is why, however infuriating and damaging the behaviour of a minority may be, freedom and democracy will ultimately be safe in this land.

What is equally clear, however, is that freedom and democracy are indeed under frontal attack from Mr Scargill and his storm troopers. So the third point which all at home and abroad should note is that the rule of law will be upheld and those who seek by violence and intimidation to overthrow it will be defeated.

Mr Scargill and some of his colleagues have set out deliberately to challenge the framework of freedom and democracy in this country. They seek to coerce through force all those who stand in their way. That challenge cannot be allowed to succeed if democracy itself is not to become a sham. Amongst those whom the militant miners are

/seeking to coerce ...

seeking to coerce by violence and intimidation are those who wish to go to work and have repeatedly expressed that wish in a clear, democratic vote. If coersion of that kind were to succeed, the criminal law of this country would become a dead letter; and personal freedom would have been trod under foot by mob rule. That cannot and will not be allowed to occur. The police know that they will continue to have my total support in the difficult tasks they are performing to ensure that the law of the land is upheld.

The militant NUM leaders make no secret of their brazen contempt for the law, for the courts, for the police and for their fellow workers. Those who follow and support them can have no doubt after their leaders' public statements that they are engaged in no less than an attack on liberal democracy in Britain. But they should have no doubt either that this Government will not allow lawless violence and intimidation to prevail.

We will continue to do what we know the country elected us to do. We will pursue sound money so as to achieve more real jobs. We will defend the national interest at home and abroad wherever it is threatened. We will uphold the rule of law. We will not be diverted from our essential tasks by a touch of mid-summer madness. And I strongly suspect that in 1987, or thereabouts, we will have no cause to regret it.

C ? Ask Michael P to look at again, with MOM's improvements? DLCP

CHANCELLOR OF THE EXCHEQUER

C.

You're to deliver this speech on Wednesday evening. It's pretty awful at the moment. I've played around with it a bit but it needs a lot more work.

Do you want any press release? I imagine you'll want to focus on the Green Paper stuff, if so.

You also have a (short) speech to deliver to the Conservative Industrial Fund on Tuesday (marking the last ball-to-ball arrangement) Michael would like to discuss with you at Prayers on Monday & will give you a draft in the

P10

course of the day.

Mo

13/7

10-12a

FROM: P MAKEHAM
DATE: 12 JULY 1984

CHANCELLOR OF THE EXCHEQUER

cc Mr Battishill
Mr Odling-Smee
Mr Scholar
Mr R I G Allen
Mr Folger
Mr P R C Gray
Mr Riley
Mr McDonald
Mr Portillo

SPEECH ON GREEN PAPER: SELSDON GROUP 18 JULY

You indicated that you would like to make a speech on the Green Paper. The Selsdon Group dinner next week would seem to provide a suitable opportunity. I attach a draft speech which has benefitted from comments by EB, GE, MP and Mr Portillo.

Peter Makeham

P MAKEHAM

[illegible]

[illegible] & the
[illegible] speech [illegible]
A logical speech [illegible] - with
a [illegible] on [illegible]
NB. Get Kinnock/Hattersley on
[illegible]

GREEN PAPER

1. One of the innovations of this Government has been to set policy in a medium term framework - and to stick to that policy. In the past, governments sanctified their policy switches by calling their approach "pragmatic". All too often this meant financial discipline was abandoned and governments staggered from one short term expedient to another. Inflationary pressures were accommodated.

2. The Medium Term Financial Strategy has changed all this. It has set ~~out~~ a framework which ensures consistency between monetary and fiscal policy. [It is a framework designed gradually to reduce the growth of nominal demand and to [improve the division of that growth between] real output and inflation.] — a framework within which inflation can fall and real output rise

3. But Setting the framework is only part of the story - [it has to be credible and built into people's expectations. People now know that the Government will stick to its strategy. That lesson was learned in the 1981 Budget.] People have to believe that framework will stick. They've learned that lesson from successive Budgets ~~People also~~ They now understand that the faster inflation comes down, the faster output and employment are likely to recover. The medium term approach has ~~been~~ played a vital part [of conditioning such] in changing expectations and, more important, in changing behaviour.

4. ~~It has also~~ The new approach has imposed a discipline on government ~~itself~~ too. The MTFS aims to maintain monetary conditions which are consistent with [steadily reducing] a steady fall in the rate of inflation. [This requires control over public borrowing which is consistent with the monetary objectives without placing] unacceptable strains on interest rates. [Consistent paths for borrowing, taxation and spending are now set over five years.] [Because of the need to restrain the]

For five years ahead, we set paths for borrowing, taxation and spending which are mutually consistent. But we must keep a firm grip on borrowing to avoid putting ~~an unacceptable strain~~ unacceptable strain on interest rates, The conclusion is obvious — any increases in

and an unacceptable burden on future generations.

borrowing requirement, any increases in public spending ~~inevitably~~ are bound to lead to ~~increases in~~ higher taxation.

5. ~~This is a link which~~ people have been encouraged to ~~forget~~ this link in the past. ~~Judgements have too often been made on~~ the benefits ~~derived from~~ of extra spending have been stressed. The other side of the equation — ~~while the price of that spending -ultimately~~ higher taxation ~~-was omitted from the equation~~ has been quietly ignored. We saw The result of these ~~attitudes has~~ those shortsighted ~~been~~ an inexorable increase in spending - and an equally inexorable ~~increase~~ rise in taxation. Although some people have tried to avoid the link between spending and taxation by assuming that the money for public spending can come from a bottomless pit called borrowing, this is not sustainable. Borrowing creates debt on which interest has to be paid in the future. So borrowing is just a tax on future generations, quite apart from its effects on monetary conditions and interest rates.

Came into office: a long history

6. Over the last twenty years ~~real~~ public spending has risen by 90 per cent in real terms but ~~while~~ real national income has risen by only 50 per cent. As public spending ~~rose substantially as a proportion~~ took a bigger and bigger share of GDP, taxation rose too. In 1963-64 Taxes and rates, plus National Insurance contributions, ~~were some~~ accounted for just 29 per cent of GDP ~~in 1963-64~~ - By the end of the decade they accounted for ~~they rose to~~ over 37 per cent ~~by the end of the 1960s~~. The trend has been less clear ~~This proportion has fluctuated~~ since but ~~for~~ this financial year the ~~Non-North Sea~~ tax burden excluding the North Sea, will ~~is estimated to~~ be 38 per cent. We estimate that // What ~~this means~~ does this mean in practical terms? ~~is that~~ In 1963-64 a married man without children on average earnings ~~who was paying~~ paid less than one-seventh of his income in income tax. Today he would ~~in 1963-64 is now~~ paying over one-fifth ~~of his income in income tax~~. ~~It is~~ This is why we find ourselves in the ridiculous situation ~~this rise in the burden of taxation which has led to the indefensible situation~~ where~~by~~ growing numbers of people are both receiving ~~at the same time in receipt of~~ social security benefits of various kinds and paying income tax.

The State encroaches more & more on the responsibility

The whole process has meant a massive enlargement in the role of the

while the dead hand

state at the expense of the individual, ~~and~~ a corresponding increase in the

stifles initiative and enterprise and chokes

deadweight of taxation ~~holding back~~ our economic progress ~~as a nation.~~

Part of the solution lies in the reform of

7. Much can be done to reduce the damaging effects of taxation on our

We cannot abolish taxes entirely.

economy by reforming the tax system. Since we are bound to have

But we must do all we can to ensure that the taxes we do impose

taxation of some kind, we should try to ensure that our tax system is not in

don't distort

We took a major step down this

general distorting economic activity. The economy should operate as much

road in this year's Budget with our company tax reforms,

as possible as though taxation did not exist. That is the reason for moving

in the direction of greater neutrality. We have made substantial progress

this year with our business tax changes and the abolition of investment

the withdrawal of

We also need to alter

income surcharge and life assurance premium relief. Changes designed to

the

achieve a more appropriate balance of taxation - between different sectors

of the economy and different taxes - are also important. to secure a more

sensible outcome.

But we need to act on the level of taxation, as well as

8. But such reforms, although well worthwhile, cannot eliminate the

its structure.

damage caused by high levels of taxation and do not remove the need to

In practice, all forms

inevitably alter

reduce them. Any form of taxation must ~~affect~~ people's behaviour and

they

distort their choice~~s.~~ ~~This can~~ affect the incentive to work, the incentive

overall, they are bound to

to save, ~~or~~ the pattern of saving, ~~and~~ reduce ~~overall~~ national welfare.

Their effects are not confined to the wealthy. Some of the greatest damage is

These damaging effects are not confined to the well-off but affect many

inflicted at the lower end of the income scale. It is the

taxpayers. Interaction~~s~~ between the tax and social security systems, for

which

creates notorious

example, produce the ~~harmful effects of~~ ~~the~~ poverty and unemployment

so

us

the

is to thrive,

traps. ~~If we are to have a thriving~~ economy we must ~~get~~ the burden of

until it reaches

reduce

taxation ~~back towards~~ the more sensible levels of the early 1960s.

adopted the slogan

9. For too long, ~~the slogan of~~ governments ~~was~~ "Spend now, pay later".

But not this Government. The publication of the MTFS marked the first step

~~That has changed.~~ We need to consider the level of borrowing and the

in the process of halting the inexorable rise of public spending.

burden of taxation and then come to a view on the level of public spending

The publication of our Green Paper "The Next 10 Years" on Budget Day

which can be afforded. The MTFS provides the essential framework for

marked the decade.

such broad decisions of strategy over the next five years. We have now taken a further major initiative by producing, for [This is] the first time ~~by~~ a British Government, a document which considers these fundamental strategic issues rather further into the future. The Green Paper, published on Budget Day, is entitled "The Next Ten Years" and looks at taxation and spending into the 1990s.

It is the first time a British Government has been prepared to consider these strategical issues so far into the future

10. The purpose of the Green Paper ~~is~~ [was designed] to concentrate our minds on the sort of levels of spending and taxation we want in the years to come. ~~It~~ [The Green Paper] does not record decisions. It builds up reasonable assumptions about how the economy as a whole might develop [over the next decade] and ~~uses a framework - very much like the MTFS - to~~ [in this framework in much the same way as the MTFS] examines spending and taxation ~~over the next decade.~~ The Green Paper ~~throws light on such fundamental issues as~~ [looks at] future levels of taxation and borrowing and the effect ~~of~~ [which] public spending [will have] on them. These are [the critical issues on which] fundamental questions for the development of the economy [will turn] over the next ~~decade or so.~~ [10 years]

11. ~~It was hardly to be~~ [But I scarcely] expected ~~that this~~ [the] Green Paper - ~~as with any other Government publication~~ - would meet [would be met] with universal acclaim and unqualified praise. I am, however, encouraged to note the recognition by [I have been heartened by the way in which a] some [number of] commentators of [have appreciated] the significance and importance of the issues ~~the document addresses.~~ [the Green Paper covers.] But before elaborating on the key messages that emerge from the Green Paper analysis, I should like to comment briefly on some of the criticisms that have been made.

But I scarcely expected it would be met with universal acclaim and unqualified praise.

12. For the most part the ~~critical voices~~ [critics] have misunderstood the purpose of the Green Paper and what it is feasible to do when looking ten years ahead. Some have criticised the lack of specific assumptions for ~~the~~

particular economic variables, such as unemployment. But the Green Paper does not pretend to be include an economic forecast ~~looking that far ahead;~~ and it is foolish to imagine that it could. ~~such a task could credibly be attempted.~~

13. Others have criticised the lack of detailed projections for individual spending programmes, or jumped to alarmist conclusions as to what ~~about~~ the Green Paper implies ~~implications~~ for levels of service in particular areas ~~programmes~~. Comments of this sort are frankly misguided. The Green Paper was clearly set out ~~quite deliberately not intended~~ to provide detailed long term projections. Detailed programme figures, 10 years ahead, would not be worth the paper they were written on. ~~Moreover,~~ The precise balance between individual programmes has to be reviewed annually. ~~is a matter for regular annual reappraisal.~~ The Green Paper is designed to stimulate a debate about strategy and it is ~~strategic debate flowing from the Green Paper must focus~~ on the totals - national income, taxation and public expenditure - that we must focus. We have to ~~This is the central issue: in addressing it we must~~ ignore, for the time being, the insistent voices of the individual lobbies for particular interests.

14. One factor which will affect our plans towards the end of this decade is the likely reduction in North Sea output. Our opponents have pointed to criticised us for living in a fool's paradise temporarily warmed by North Sea oil. On the contrary, the calculations in the Green Paper explicitly take into account the effect on the economy our national circumstances of the profile of North Sea gradual reduction production in North Sea output. North Sea production is We expected to be close to its peak level in 1984-85 and that it may fall gradually after that, declining to ~~By 1993-94,~~ production may be little more than half its peak level by 1993-94. There may be some offset to this if real oil prices start to rise again as increasing ~~rising~~ world demand puts pressure on suppliers. But the effect may be partly offset. In net terms, we may see ~~However the net effect could well be~~ a steady decline in North Sea revenues - from about 3 per cent of GDP in 1983-84 to perhaps half that level ten years later ~~1½ per cent of GDP in 1993-94~~. If we are ~~Of course,~~ to maintain the

same level of public spending, ~~any~~ this fall in North Sea revenues will have to be covered by increased revenue from other taxes.

So much for the critics. But what about the fundamental question posed by

15. [We now come to] ~~the central issue in the~~ Green Paper - what are the prospects for achieving a lower burden of taxation by the mid 1990s? ~~That~~ The answer ~~depends on what happens~~ lies in the course of to public spending. The MTFS assumes that, if public spending is held constant, in five years the non-North Sea tax burden will ~~reduce~~ fall ~~by 1988-89~~ below ~~its~~ last year's level ~~in 1983-84~~ of 36 per cent. The Green Paper carries this analysis one step further. ~~It suggests that, on the~~ It states a number of assumptions, ~~stated~~ and then suggests that, if public spending can be held constant right up to 1993-94, the burden of non-North Sea taxation would ~~be reduced~~ fall to 31 per cent of ~~non North Sea~~ GDP ~~compared to 34 per cent in 1978-79. And this would be despite falling~~ also excluding the North Sea. This compares with a figure of 34 per cent in 1978-79. North Sea revenues will be falling over the ~~period~~ next 10 years. ~~This may~~ Does this sound like quite an achievement? Far from it. It would still leave the tax burden ~~some way~~ well above the level of the 1960s.

16. Not only that. Any growth in public spending would obliterate ~~s~~ even this limited progress ~~to lower taxation~~. Growth in spending of only 1 per cent a year ~~and don't forget this compares with an average rate of growth in spending of 3 per cent a year over the last two decades~~ -would leave the tax burden in 1993-94 only ~~very marginally~~ just below its level in 1978-79. And over the last two decades spending has grown on average three times as fast as that.

~~And, if growth in public spending were faster than 1 per cent a year, the tax burden in a decade from now would be higher than in 1978-79.~~

17. [We know that there are large] There are strong pressures - political, demographic, technological - for increases in spending. And, ~~of course~~ we must recognise that much public spending is directed to eminently desirable ends. ~~We shall,~~ As the recovery continues, [be beseiged by many] we shall hear many siren voices urging us to spend a little more here, or a little more there, on this or that good cause. And the amount of money ~~in~~ in many individual cases

at stake ~~each case~~ will often appear scarcely significant ~~in itself~~. Mostly, we shall have to say "no". we shall take no pleasure in saying ~~It will give us no pleasure to do so~~. And, when we do say "yes", it will ~~can~~ only be because we have been able to make ~~identify~~ an offsetting saving elsewhere~~, so that the overall spending total remains the same~~. So ~~I~~ no secrets if I admit ~~would urge~~ all those who lobby on behalf of ~~have a~~ favourite cause [to bring to government,] ~~to~~ I give warning that they will stand an infinitely greater chance of success if, when they make their pitch, they tell us where we can save the money they would like us to spend. [The fundamental lesson of the post war period is the inescapable connection between public spending and taxation. This is the central message of the Green Paper.]

18. In the past we have suffered from ~~seen a~~ vicious circle of higher borrowing, higher taxation and reduced incentives. Success in controlling borrowing and lowering the burden of taxation turns vice into virtue. ~~achieves a virtuous circle~~. Lower taxation and improved incentives should encourage faster growth. lower ~~Reduced~~ borrowing, combined with falling inflation [and interest rates] will reduce debt payments and so help achieve lower taxation. ~~Also, holding~~ Public public spending must be held constant ~~does~~ but that does not mean inevitable cuts in services to the public. it inevitably Services ~~They~~ can still be improved by switches from lower priority programmes, to higher, by switches from public to private sector provision, and, above all, by increased efficiency. Indeed if we succeed ~~Success~~ in controlling borrowing and reducing ~~lowering~~ taxation we may actually be able to afford ~~could even mean greater~~ spending on public services in the future, lower taxation ~~as the higher rate of growth encouraged by lower taxation means a stronger economy.~~

the economy will grow stronger

19. The Green Paper forces us to concentrate our minds on the kind of economy we want in the years to come. Are we content to plan for a large public sector, high taxation economy in which a large ~~high~~ proportion of spending decisions are taken out of the hands of individuals and our resources are put to indifferent use by state monopolies? We know from the past that the result is sluggish growth and further loss of competitiveness. Or do we

want to see freedom and initiative thrive in an economy where success is rewarded.? For too long, these choices have not been squarely faced. Past governments have planned higher levels of spending on the basis of forecast growth. When that growth has not materialised, they have left it too late, or lacked the will, to undo their spending plans. So public expenditure ~~spending~~ has crept steadily upwards.

20. We are exposing plainly the three choices we face. ~~making the choice plain to see.~~ In ~~my view~~, Control of public spending is <u>central</u> to this government's objectives -<u>central</u> to our chances of getting taxes down to an acceptable leve; <u>central</u> to our drive to stimulate initiative, incentives and growth; and <u>central</u> to our determination to halt the steady encroachment of the public sector on the rest of the economy.

FROM: M D X PORTILLO
DATE: 19 JULY 1984

CHANCELLOR

cc Sir P Middleton
Mr Battishill
Mr Folger
Mr Culpin
Mr Ridley
Mr Lord

Actually, Monday 23rd July!

CHANCELLOR'S SPEECH TO CONSERVATIVE BOARD OF FINANCE
~~TUESDAY 22 JULY~~

I attach a draft press release. I can only guess at what may be appropriate by ~~Tuesday~~. Monday

C,
I suppose there is an argument for steering clear of the [illegible] this time but you may like a word with Millard as Progress.

MDT
19/7

M D X PORTILLO

Some rather hasty suggestions. You'll see the ~~dr~~ general drift.
NL

DRAFT PRESS RELEASE: BOARD OF FINANCE

TUESDAY 24 JULY

Both Mr Scargill and the dockers' leaders claim that their strikes are about protecting their members' jobs. In fact they are about destroying other people's.

The aim is to challenge democratically-elected governments by paralysing the economy. By the end of the strikes, a lot of people will have been thrown on the dole and will have Mr Scargill and Mr Connolly to thank for it.

None of them will take away anything like the redundancy money that is on offer to the miners. Some - the self-employed lorry drivers for example - will get nothing at all. But then Mr Scargill and Mr Connolly despise the self-employed, because they cannot be cowed by trade unions.

The steel men saw the trap all too clearly. They refused to allow their industry to be shut down and their livelihoods destroyed by miners' pickets. They know how many jobs were lost through their own strike. They remember that the NUM's so-called solidarity with that steel strike put not one miner's job at risk.

And they know too that Mr MacGregor was not to blame for the massive loss of jobs in steel. That was caused by loss of competitiveness, over-capacity and the recession. What Mr MacGregor is responsible for is making steel a highly-efficient industry and for the 70,000 jobs that have thus been saved.

Sadly, ~~throughout the recession~~ in the inevitable and too long delayed process of making British industry more competitive, many thousands of jobs have been lost, ~~as inevitably the~~ Older industries that were once some of our largest employers have had to adapt to the modern world. Many people have suffered in the process. But there has been a huge benefit to the economy. British firms are more competitive than for years, and we are beginning to see the benefits in growth and better living standards. But the mineworkers have so far been largely immune. The taxpayer has coughed up year after year to keep them in work. The registered dockers' jobs are protected by law. No question of sharing round the misery. Both groups are in any case highly paid and eligible for very large compensation for voluntary redundancy.

Yet these two groups - perhaps the most protected in the economy - are using their muscle to keep their industries inefficient and uncompetitive ~~to ensure that the jobs of the~~ In the process they are putting the jobs of other weaker groups ~~are put~~ at risk.

It throws new light on the far-left wing breed of trade unionists of our age. It explains a lot too about the Labour Party which those trade unionists keep in funds, and whose leader they helped to elect.

MO'M & MDXP!
1st 3ph Arrgt.
v.

CHANCELLOR OF THE EXCHEQUER

C/

On (2) you'll presumably want to suspend judgment ~~as~~ until you know what's on offer in the South West

On (3), Glasgow wanted you in the autumn. The only free weeks this side of Christmas are

19-25 November — Autumn Statement territory, though we should have gone public by then

3-9 December — when you were contemplating a regional tour.

We also need to try to rearrange Portcullis Club / the Parlour which both fall in the same week in November

That leaves you with no free weeks before Christmas (a nonsense

(PTO

Hereafter.

On (4), that will is free at present. But would you want this referred to Special Committee who haven't yet seen it?

MOM
19/7

FROM: M D X PORTILLO
DATE: 19 JULY 1984

CHANCELLOR

cc Miss Young

SPEAKING ENGAGEMENTS

1. **MCDOWELL GARDEN PARTY: SUNDAY 22 JULY**

When I spoke to Mr McDowell today about your press release, he asked that you should speak at the garden party on Sunday.The local press have come to know of it and will attend.

2. **TOUR: FRIDAY 7 DECEMBER**

The North East cannot arrange a programme. CCO are keen that you should do Yorkshire. I think that there is a good case for going there, but it is worth bearing in mind that the miners' strike may still be on. CCO are expoloring both Yorkshire* and the South West.

3. **GLASGOW CONSERVATIVES**

Scottish CCO do prize the function in question. Sir Geoffrey, they say, used to visit Glasgow and Edinburgh once a year. They would aim for 150-200, half businessmen, half party faithful. They are anxious too to balance east and west - the PM is going to Edinburgh in September. But then Norman Tebbit is doing a rally in Glasgow that month. I recommend acceptance.

but when!

5/6 September
4/5 October

4. **WELSH CONFERENCE FRIDAY-SATURDAY 21/22 JUNE 1985 IN LLANDUDNO**

OK

They wish to invite you. Will you wish to accept?

* Yorks can do. Fly to Leeds. Avoid S. Yorks. End in Huddersfield for CBF dinner. LP.

pp M D X PORTILLO

Chairman: Sir James Goold CA FCIOB
Deputy Chairman: Dr Alistair Smith CBE
Vice-Chairman: Ian Lang MP

Director: Sir Graham Macmillan
Deputy Directors: Robert M Balfour
Peter D Smith

Scottish Conservative Party

Headquarters: 3 Chester Street, Edinburgh EH3 7RF. Telephone: 031-226 4426

041-332-0001

cc Mr Battishill
Mr Makeham
Mr Portillo

Our Ref: JDG/BL/200

5th June, 1984

The Rt. Hon. Nigel Lawson, M.P.,
Chancellor of the Exchequer,
11 Downing Street,
London.
SW1.

Chancellor,

You will be expected to give an after-dinner speech if you accept this one. Shall I try and find a suitable date - or advice?/or - possible Scottish tour?
DB

Dear Mr. Lawson,

It is with great pleasure that I invite you to be the principal guest at a Dinner of the City of Glasgow Conservatives this autumn.

Your predecessor attended on two occasions and a large audience of businessmen and their wives together with Party workers greatly appreciated the event.

For the first time for many years businessmen were involved in working for the recent District Council elections and they raised a considerable amount of money for the Party. Unfortunately the election results were disappointing and I am most anxious that the business involvement should be maintained as only this way can we hope to improve for the Regional elections in 1986 and for the next general election.

A visit from you would be a tremendous boost and I do hope that you will accept. The function can be arranged on almost any date which would be suitable to you and I look forward to hearing from you when this would be possible.

I was pleased to meet you at the Conference in Perth and look forward to welcoming you again to Scotland.

Kindest regards.

Yours ever,

[signature]

Sir James Goold
Chairman

HM TREASURY — MCU
REC'D. - 6 JUN 1984
Mr. Baillie
82/2.7

FROM: M D X PORTILLO
DATE: 20 JULY 1984

Back to the drawing board, alas

CHANCELLOR

cc Sir P Middleton
Mr Battishill
Mr Folger
Mr Culpin
Mr Ridley
Mr Lord

CHANCELLOR'S SPEECH TO CONSERVATIVE BOARD OF FINANCE: ~~TUESDAY 24~~ MONDAY 23 JULY

I have revised the draft submitted yesterday to reflect the decision of the dockers' leaders to recommend a settlement to their members.

M D X PORTILLO

DRAFT PRESS RELEASE: BOARD OF FINANCE

TUESDAY 24 JULY

Mr Scargill claims that the coal strike is about protecting miners' jobs. In fact it is about destroying other people's.

His aim is to challenge democratically-elected governments by paralysing the economy. And he doesn't give a fig how many people he throws on to the dole in the process.

There was no disguising his enthusiasm for the dockers' strike despite the fact that it put many businesses and jobs at risk. Yet none of those put out of work would have taken away anything like the redundancy money that is on offer to the miners. Some - the self-employed lorry drivers for example - would have got nothing at all. But then Mr Scargill despises the self-employed, because they cannot be cowed by trade unions.

The steel ~~men~~ workers saw his trap all too clearly. They refused to allow their industry to be shut down and their livelihoods destroyed by miners' pickets. They know how many jobs were lost through their own strike. They remember that the NUM's so-called solidarity with that steel strike put not one miner's job at risk.

And they know too that Mr MacGregor was not to blame for the massive loss of jobs in steel. That was caused by loss over-capacity and the recession. What Mr MacGregor is responsible for is making steel a highly-efficient industry and for the 70,000 jobs that have thus been saved.

Sadly, throughout the recession many thousands of jobs have been lost, as inevitably the older industries that were once some of our largest employers adapt to the modern world. Many people have suffered in the process, but the mineworkers have so far been largely immune. The taxpayer has coughed up year after year to keep them in work. No question of sharing round the misery.

Yet the miners - perhaps the most protected group in the economy - are using their muscle to ensure that the jobs of the weaker groups are put at risk.

It throws new light on the far-left wing breed of trade unionists of our age. It explains a lot too about the Labour Party which those trade unionists keep in funds, and whose leader they helped to elect.

8.73

FROM: DAVID PERETZ

DATE: 24 July 1984

CHANCELLOR

I understand the Prime Minister's opening speech next Tuesday is likely to be mainly about the miners' strike, and an attack on Mr Kinnock - with only a fairly short section on economic policies.

2. For your speech, I guess it would be useful to have building blocks on:-

(a) state of the economy (perhaps with a bit about the US as well) - Sir T Burns to draft, or Mr Folger with Sir T Burns' help?

(b) interest rates and exchange rate (though hardly the occasion for a careful exposition) - Mrs Lomax to draft?

(c) (possibly) a section on the need for continued sense in working practices, pay, and generally making British enterprises more competitive - a message already learned by most of the manufacturing sector, and beginning to pay off in improved competitiveness, growth etc - but yet to be learned, apparently, by the miners - Folger or Portillo to draft?

(d) some political/knock-about stuff from Michael Portillo.

DLCP

D L C PERETZ

CONFIDENTIAL

FROM: P MAKEHAM
DATE: 8 October 1984

1. **MR BATTISHILL**

2. **CHANCELLOR OF THE EXCHEQUER**

cc Sir P Middleton
Sir T Burns
Mr Littler
Mr Cassell
Mr Evans
Mr Lavelle
Mr Odling-Smee
Mr Scholar
Mr Hall
Mr Portillo

MANSION HOUSE SPEECH

I attach a preliminary draft, which includes contributions from HF, EF and Sir T Burns. It is very much a rough first draft and we will be submitting a second draft towards the end of this week.

Peter Makeham

P MAKEHAM

I am afraid the joins still show in this very first draft; but it would be helpful to have any general comments on coverage, content and length before you leave for the Party Conference.

8/10.

CONFIDENTIAL

CONFIDENTIAL

MANSION HOUSE: DRAFT SPEECH

[Reply to the toast "Prosperity to the public purse and the health of the Chancellor of the Exchequer." Opening passage to be added.]

When I spoke here last year, I was able to review more favourable economic prospects at home and abroad. I also refered to some of the challenges we faced, particularly international debt and change in our own economy, especially changes in the City. Those economic prospects have been realised. We have made progress in tackling the challenges. The bedrock of such progress has been a consistent strategy which provides the framework within which change and changing attitudes can be encouraged.

2. Of course, tackling uncertainties and helping to manage change is the lifeblood of the City. In this month it is particularly appropriate to recall Mark Twain's advice "October. This is one of the peculiarly dangerous months to speculate in stocks in. The others are July, January, September, April, November, May, March, June, December, August and February". Uncertainties and change are not avoidable.

3. I have spoken on other occasions about the exciting changes that are taking place within the square mile that makes up the City of London. The Government welcomes those changes and has helped to encourage and create the conditions in which they can take place smoothly and with success.

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4. To bring about an environment conducive to change we have swept away unnecessary and outdated controls which have served in the past only to stifle initiative and suppress enterprise and experiment. In the area of fiscal reform we have taken a number of steps to improve incentives, remove distortions which have been harmful to economic activity and generally to reinforce and strengthen the forces for competition already at work among our financial institutions.

5. In this same vein, My Lord Mayor, the Government withdrew the reference on the Stock Exchange to the Restrictive Practices Court, and we are bent on spurring competition in the financial services industry.

6. In all this, we have a clear objective in view: to restore the City of London securely to its rightful place among the world's leading financial centres. But, as we meet here tonight in these splendid surroundings, let there be no misunderstanding of what that involves. The City's position as a leading financial centre does not belong to us as of right. It is a privilege which must be earned by maintaining worldwide respect for the quality and range of services which the City has to offer and by jealously guarding its cherished reputation for excellence. The future will not be easy. Others are already laying claim to the leading role which once we took for granted. But I believe that, working with you, my Lord Mayor, the bankers and merchants of the City of London, we can together ensure that success.

7. The Government stands ready to play its part, and I should like to say a word briefly about some of our other intentions.

8. Next month, we shall be publishing in a White Paper our proposals for establishing the kind of regulatory framework needed to preserve continuing confidence in the securities and investment industries.

9. Our belief in the need to rely heavily on the active involvement of the City itself is no secret, and I am confident that the proposals in the White Paper will provide the welcome reassurance that investors need in an increasingly sophisticated world, whilst steering well clear of unnecessary and stifling bureaucracy and red tape.

10. In this company, my Lord Mayor, I need hardly say that no-one underestimates the difficulties confronting supervisors faced with the task of trying to monitor organisations whose activities cover a wide spectrum of financial business. Chinese walls are not a new sight to the City - but there are going to be many more of them. And their effective policing will be crucial if London's cherished reputation for probity is to continue to be safeguarded, as clearly it must.

11. Nowhere is this more so than in the gilts market, where great changes have been set in train. Here a crucial safeguard will be separate capitalisation of market-making firms.

12. The equities market too is changing. The two markets may choose different ways of achieving transparency. Indeed, different degrees of transparency may be appropriate to their different circumstances.

13. I welcome the proposal for a last trade tape in heavily traded equities. And I hope that perhaps some equally reassuring arrangement may be devised for the gilts market.

14. It may be appropriate for me this evening to refer briefly to two other pieces of proposed legislation.

15. First, the Trustee Savings Banks. We intend to pave the way soon to enable the TSBs to complete their transition to full corporate status, so that they may take their proper place in the market. Whilst I cannot anticipate what may take place in the forthcoming Parliamentary session, I can say that I am hopeful that this transition may not be long delayed.

16. Second, the building societies. The period for commenting on the Government's Green Paper on the future role of the societies ran its course three days ago.

17. We have received, as we expected we would, a large number of representations on this subject. These are being carefully studied. Again, it would be wrong for me to anticipate what may come of those studies. What I can say is that we shall be proposing a comprehensive new framework for the societies,

aimed at preserving their traditional features whilst increasing competition by enabling them to provide a wider range of financial services. We hope to prepare firm proposals for legislation in the new year.

18. I turn now to the international scene. There were to my mind three issues above all, running through the meetings of the international financial community last month in Toronto and Washington: the pattern of the global recovery, the uncertainties of US prospects, and the international debt issue. All three are closely interconnected, but I would like to concentrate tonight on international debt.

19. In my remarks last year I described this as "perhaps the greatest immediate problem" facing the international economic scene. That the debt problem has not, in the past year, led to even more serious concern is a tribute to the painstaking efforts devoted to it by the international financial community and some debtor countries. If we analyse the origins of the debt problem I think there is no doubt that the strategy adopted so far to meet it has been broadly right. But there are also elements in that response which we need to explore and develop further.

20. Those who analyse the debt problem mostly agree that its origins lay in a combination of three factors. First, it lay in too much borrowing, with an over-reliance on bank finance. Overshooting is not a phenomenon confined only to the exchange markets. Second, it lay in the emergence

of a worldwide economic recession, with rising real interest rates, on a scale not experienced for decades. Third, it lay in a loss of confidence in borrowers' creditworthiness, manifested initially by a shortening of maturities.

21. The response has in many ways been totally apt. A cut back in borrowing, typically on the basis of adjustment programmes devised by the IMF. A resumption of growth - the industrialised world has been growing a good deal more strongly than most commentators were forecasting a year ago. And the beginnings of a return in confidence - and with it a willingness to give adjusting countries a real breathing space - an approach exemplified by the recent Mexican multi-year rescheduling agreement.

22. This response remains appropriate. But the process cannot be rushed. The debt strategy we have adopted recognises the need for time. Time for adjustment to work. Time for banks to get their balance sheets in order. Time to develop new forms of financing.

23. More adjustment is still needed if debtor countries are fully to regain the confidence not only of the outside world but also of their own people. A huge volume of potential investment has been lost to the debtor countries by the flight of capital from their own residents.

24. As adjustment proceeds over a longer time scale than traditional IMF programmes, so will the Fund require to develop

- as it is already developing - new techniques of surveillance. In the United Kingdom we too are developing policies in appropriate areas: for example in relation to the resumption of export cover to countries which have rescheduled debt.

25. Over-reliance on bank finance in the past brought problems for borrowers and lenders. One of the legacies has been the need for banks to respond to doubts about the value and proportion of some of their assets by a higher level of provisioning and by additions to capital resources.

26. But there is another moral to be drawn. The need in the future must be to supplement or substitute for bank finance. Banking flows will of course remain important; they cannot realistically be replaced altogether, but non-bank private flows should gradually become more prominent. This judgement was widely shared by the participants in the London Economic Summit earlier this year.

27. In the decade after 1973, bank lending to debtor countries doubled as a proportion of total borrowing, while the rate of increase of direct investment grew at a much slower rate. It seems not unreasonable for debtor countries to ask themselves whether past inhibitions on such investment are really justified. They might also consider the political implications of other options to achieving economic equilibrium. And they might ponder the variety of regimes - in developing and developed countries alike - which seem compatible with national self respect. It seems not unreasonable for the Fund to put the same point and ask the same questions, as indeed we have encouraged them to do.

28. A resumption of direct investment, as traditionally understood, is not the only form of private financial flow which we need to encourage. At the opposite end of the spectrum, some debtors are beginning to contemplate returning to the bond market. We need to leaven the debt lump in a variety of ways: to devise new instruments to bring stable capital to countries whose underlying resources are so abundant. This is a challenge to which the ingenuity of the City has proved more than equal in the past.

29. What is indisputable is that success in tackling international debt must be closely linked with the pace of world economic recovery and with success in bringing down the level of interest rates.

30. I said in Washington, and I repeat tonight. The biggest single contribution to easing the debt problem which could be made over the next year or so would be developments of US policies which could lead to lower dollar and world interest rates.

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MANSION HOUSE - DOMESTIC DEVELOPMENTS

1. I now turn to our own economy. Developments over the past year have been much as we expected. Output in the first half of 1984 was 3 1/4 per cent higher than a year earlier - without the effects of the miners strike it might have been 4 per cent. The balance of demand growth has changed even more than expected towards investment and exports. In 1983 the main sources of demand growth were consumer spending, as the savings ratio fell, and less de-stocking. More recently the growth of consumer spending has slowed as the savings ratio has steadied but exports have been helped by the rapid growth of the world economy and fixed investment is up by 15 per cent on a year earlier.

2. I have mentioned the impact of the miners' strike on GDP. It of course also has an impact on public expenditure this year. It is one of a number of exceptional factors that have put pressure on expenditure. Local Authorities will also again substantially overspend their provision, justifying the stricter penalty regime for next year and the powers we have taken to cap rate increases. Although for these reasons public expenditure pressures this year are very strong, the overall level of borrowing [is broadly in line with that which I envisaged at the time of the Budget]/[is expected, as in the Budget forecast, to be significantly lower than in 1983-84]. The Government continues to attach the highest importance to maintaining control of public expenditure.

3. Inflation has continued at a lower rate than expected by most commentators. Against the background of widespread expectations of rising inflation. I suggested in my speech last year that the prospects for inflation remained encouraging and that indicators at the time pointed, if anything, to a downward path in 1984. The latest inflation figure at [4.8] per cent is a little below the same month in 1983 but this understates the

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progress made because of erratically high price increases for seasonal foods and mortgage interest payments. The GDP deflator, a useful measure of the domestic component of inflation, was rising at a rate of less than 3 1/2 per cent in the first half of this year. [Possible passsage of monetary policy/exchange rate: to be drafted later in the light of market reaction to September money numbers.] * in here later

4. The increased unemployment level over the past year has been disappointing. Employment has risen and so has the level of vacancies but the bulk of the new jobs have gone to ~~females~~ women, many on a part time basis. It is important to draw the correct lesson from this experience and I shall say more in a moment. partly figs

5. There have been some signs of a slowing in the recovery in the industrialised countries this summer and the forward indicators in a number of countries, including the UK have weakened. Many commentators have concluded that we may be about to enter the downswing of the business cycle. This judgement may prove to be premature; industrial disruption in West Germany and the UK has affected the reported figures. Although the recent US growth rate has clearly been unsustainable; there is clear scope for faster growth in Europe and while rising nominal and real interest rates in the first half of half of this year have been disappointing these may well be reversed. [illegible] too compressed

6. In my recent speech to the IMF in Washington I conceded that we made no claim to having abolished the business cycle. All experience suggests that growth rates in the industrial countries do fluctuate from one year to another Over the past 25 years or so there is evidence of some regularity in those oscillations. But this is far from being a mechanical or inevitable process. It is important to examine the underlying pressures and not simply extrapolate past behaviour. There are a few signs of the factors that we would expect to be associated with a violent or sustained cyclical downturn and the message from the leading indicators may not be sustained. It is

important to recognise that the policy framework in recent years has been very different to the pattern in earlier years. Monetary policy has generally been directed towards reduced inflation and nominal GDP growth over the medium term rather than directed to output targets. Interest rates have been volatile and are subject to different pressures. As a result - the leading indicators particularly interest rates, may not bear the same relation to output fluctuation as in the past, and they may be reversed rather earlier.

7. The prospect for 1985 is that we will see a further year of recovery. Maybe the various demand components will make a more equal contribution to demand growth. The clearest threats to sustained recovery remain the growth of world demand and the level of interest rates. Both are closely tied up with developments in the US and the progress of policy. Given the stance of US fiscal policy we must accept the risk of fluctuating US interest rates - and that the movement of US output is potentially volatile. Recently we have heard a good deal about the benefit that high US import growth has brought to the European countries' external demand. But the high level of real interest rates which also derive substantially from US policy has to be put on the other side of the balance sheet. We must continue to press the US Administration to correct the unbalanced nature of policy. Many underestimate the progress that has been made this year; but more needs to be done, urgently.

8. The prospects for inflation remain favourable. Again it has to be recognised that inflation will not fall in every year. But it is quite wrong to imagine that recovery of output inevitably means a sharply higher inflation rate. Our expectation is that we will continue to see downward pressure on inflation; some of the volatile factors that have been damaging inflation in recent months may well have reversed themselves by this time next year.

Will be interpreted very badly

9. However what is much more important than the short term movements of demand components is the underlying supply performance of the economy. That is what determines the medium term growth rate and prospects for employment. And much more important than attempts to take the pulse of inflation year by year is the medium term profile. That as we have seen will be determined by monetary policy. This was the theme of my Mais lecture: output and unemployment determined by supply performance and inflation by monetary policy. Of course in the short term there are many more influences but they tend to even out if we take a number of years together.

10. This government has made a considerable number of changes in the direction of improving supply performance. A large number of controls have been abolished; increased competition and tax changes have all been pointed in the same direction. But we recognise that more needs to be done. Improved micro-policies involves difficult choices - just as with improved macro-policy. This means reducing subsidies whether for spending, saving or even capital investment; a return to a tax system which is more neutral in the way it affects choices; closing low productivity, loss-making activities; maintaining free trade and reducing protection where it exists; reducing government expenditure and taxation, in tandem.

11. And lower wage growth is a crucial aspect of this improved supply performance There is considerable misunderstanding about the role of lower wages in generating more jobs. We are not advocating a return to stone-age technology. But we must recognise that the bundle of goods that consumer's buy will be determined by relative prices. If labour costs were lower we would see some shift in relative prices and an increased share of labour intensive products in consumer spending.

12. We must also recognise that average figures for earnings and productivity are just that; they reflect the mix of people who are in the averages. [Some people have difficulties with the concept of averages like the man who drowned

in a river that was on average 3 feet deep.] If a significant number of those who are unemployed were to find work in below-average productivity activities and at below-average earnings it would strike me as an unambiguous improvement. But average earnings and productivity statistics would be lower than they otherwise might have been. There is much to be said for a high [illegible]

wage, high productivity economy. That is certainly the case as applied to individuals. But the average statistics will move in that direction if a sufficient number of below average productivity became unemployed - and that is not a welcome development.

13. There is no doubting the level of overmanning in UK industry in 1979. Much of the increase in unemployment in recent years represents a correction of that overmanning. The unemployment tragedy has been the failure to generate sufficient opportunities for those displaced to find work elsewhere. In large measure this is due to continuing obstacles to employment at real earnings levels that can be afforded by producers. This is the way in which the US has adapted and I make no apology for continuing to represent it as a standard we should aim to achieve.

14. In my Mais lecture I argued that US labour market, not budget deficits had been the prime determinant of the US jobs success. Several people have questioned this and point to the recent combination of larger budget deficits and falling unemployment. A number of points need to be noted. The first is that the contrast between European and US performance has been a factor over the past ten years, not only the last four. Indeed US employment rose 13 million between 1975 and 1979, a period over which US fiscal yes, but... deficits were declining but has only increased 2 million between 1979 and 1983 when fiscal deficits have been rising.

15. Clearly the recent rapid growth of output has reduced unemployment. But to put this down exclusively to fiscal policy is to ignore some other important developments in the US. In particular inflation has fallen rapidly,

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partly because of deregulation and other pressures for increased competition. It is also striking that the US recovery has not been characterised by an unusual growth of consumer and government spending where might be expected if tax change were the dominant force; instead it has been led by domestic investment. And many are prone to forget that the potential timing and scale of US recovery was clearly spotted by those who monitored monetary policy, identifying a clear change in the Autumn of 1982.

16. Many see the recent US developments as the last stand of Keynesianism. After being wrong so often about the profile of recovery and inflation they sieze upon this example to make their point about the virtues of budget deficits. But in doing so they are missing some important lessons we need to absorb if we are to improve employment prospects substantially.

The economic progress we have witnessed over the past year has been substantial - both at home and abroad. The way the economy is taking change in its stride is notable too. Many uncertainties remain. The essential element in facing them is the pursuit of a consistent strategy - that we have.

The emphasis on competition within a clearly defined framework is as much a hallmark of our policies tackling the structure of the economy as it is of our financial policies. The Medium Term Financial Strategy and the encouragement of the enterprise culture remain the foundations of our strategy. If I may use an analogy today - on the Feast of St. Luke - we have laid the foundations on rock.

The need to safeguard the prosperity of the public purse is indeed part of that strategy - a toast to which we can pledge ourselves again tonight.

10-6a

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FROM: P MAKEHAM
DATE: 12 OCTOBER 1984

1. MR BATTISHILL

2. CHANCELLOR OF THE EXCHEQUER

cc Sir Peter Middleton
Sir Terence Burns
Mr Bailey
Mr Littler
Mr Cassell
Mr Evans
Mr Lankester
Mr Odling-Smee
Mr Scholar
Mr Hall (or)
Mr Robson
Mr Portillo

MANSION HOUSE SPEECH

I attach a redraft of the speech.

2. The section on the City may need to be redrafted in the light of further developments; it is expected that the announcement will be made on Wednesday. The section on the costs of the miners' strike has omitted precise figures which are in the process of being agreed with the Department of Energy.

Peter Makeham

P MAKEHAM

Total = 3123 words
= 25 mins
approx.

Max 15 minutes
∴ needs approx 1,200
words cut

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MANSION HOUSE

[Reply to the toast "Prosperity to the public purse and the health of the Chancellor of the Exchequer".]

[1. I welcome the privilege of replying to your toast again at this great annual Banquet. The past year has seen great changes in the City of London, although much less change than last year in the main dramatis personae. I note with great regret that we shall be returning to an all male cast.

2. When I spoke here last year, I was able to review more favourable economic prospects at home and abroad. I also referred to some of the challenges we faced and the changes in our own economy, especially in the City.

Those economic prospects have been realised. We have made progress in tackling the challenges. Tonight, I shall review the advances we have made in the economy and in the City. I start of course with the Square Mile.

3. Issues of self-regulation and statutory powers are not new to the City. You will, of course, recall my Lord Mayor, that this is the centenary of the passing of the London Brokers Relief Act of 1884. The detailed regulations governing brokers in London had been swept away by Parliament in 1870. The 1884 Act completed the process of restoring market freedoms by abolishing the annual tax which had been levied on brokers.

The wisdom of freeing markets is beyond dispute - as of course is the wisdom of providing relief to brokers.

4. The freedom for market forces to stimulate competition and innovation is the hallmark of our micro-economic policy. It is also therefore our fundamental objective in approaching changes taking place in the City.

5. Financial services however need to be subject to an appropriate regulatory framework. It is this which maintains the confidence of investors and potential investors in the integrity of the market, and hence ensures its long term health.

6. Regulation does not have to mean the dead hand of bureaucracy. For the City, it is a matter of taking the standards of the majority and seeing that they are maintained throughout. The principle is that those who set the standards - operators themselves - are best placed to regulate their peers. Where it works self-regulation is highly effective. It also has an immense advantage in the speed with which changes in rules can be made to meet changing circumstances.

7. There has to be a statutory framework. But such a framework will strengthen self-regulation, for it enables real powers to be delegated to the self-regulators. As the Secretary of State for Trade and Industry has announced this week, therefore, we have opted for self-regulation within a statutory framework.

8. We propose two bodies. One for the securities and investment industry and one for the marketing of investment products. Both will have statutory backing provided certain basic principles are adhered to. When our proposals are published in full in December, I am sure they will be seen to strike the right balance between the necessary protection of investors and the required free play of market forces.

9. In this company, My Lord Mayor, I need hardly say that no-one underestimates the difficulties confronting supervisors faced with the task of trying to monitor organisations whose activities cover a wide spectrum of financial business. Chinese

walls are not a new sight to the City - but there are going to be many more of them. And their effective policing will be crucial if London's cherished reputation for probity is to continue to be safeguarded, as clearly it must.

10. Nowhere is this more so that in the gilts markets where important changes have been set in train. Here a crucial safeguard will be separate capitalisation of market making firms.

11. The equities market too is changing. The two markets may choose different ways of achieving transparency. Indeed, different degrees of transparency may be appropriate to their different circumstances.

12. I now turn to the economy. Developments over the past year have been much as we expected. Output in the first half of 1984 was 3½ per cent higher than a year earlier - without the effects of the miners' strike it might have been 4 per cent.

13. Last year the main sources of growth in demand were consumer spending, as the savings ratio fell, and less de-stocking. More recently the growth of consumer spending has slowed as the savings ratio has steadied. The balance of demand has switched towards investment and exports even more than expected. Exports have been helped by the rapid growth of the world economy. Manufacturing investment is up by 15 per cent on a year earlier.

14. I have mentioned the impact of the miners' strike on GDP. It has also of course had an impact on public expenditure this year. Up to the end of September the cost of the coal strike in public expenditure terms was about [£ million] and in PSBR terms about [£ million]. To set these costs in context, subsidies to the NCB before the strike were running at over £1 billion a year - or £130 a week for every miner. These subsidies would grow even larger if uneconomic pits were kept open. The country

cannot afford to subsidise loss making pits any more than it can afford to subsidise loss making activity elsewhere on the economy. The NUM alone amongst unions seems to believe that it is possible and desirable for the country to prosper by consciously and systematically backing losers.

15. The strike is one of a number of exceptional factors that have put pressure on spending. Local Authorities will again substantially overspend their provision, justifying the stricter penalty regime for next year and the powers we have taken to cap rate increases.

16. Although for these reasons public expenditure pressures this year are very strong, the overall level of borrowing will benefit from higher North Sea oil revenues. [Latest PSBR figures] As envisaged in the Budget forecast, borrowing this year should be lower than in 1983-84. The Government continues to attach the highest importance to maintaining control of public expenditure.

17. Inflation has continued at a lower rate than expected by most commentators. Against the background of widespread predictions of rising inflation. I suggested in my speech last year that the prospects for inflation remained encouraging and that indicators at the time pointed, if anything, to a downward path in 1984.

18. The latest inflation figure at 4.7 per cent is a little below the same month in 1983. Even so, this comparison understates the underlying progress made as the RPI has been raised by the recent mortgage rate increase. A useful measure of the domestic component of inflation, the GDP deflator, was rising at a rate of under 4 per cent in the first half of this year.

19. It may be helpful here if I say something about the Government's policy on short-term interest rates, in case there are still misconceptions about this. The

arrangements introduced in 1981 were designed to give markets a greater influence on rates. This is consistent with a policy that is directed at controlling monetary aggregates and over time should bring about a quicker and smoother adjustment of rates than would be achieved if the Government were administering them as under the earlier regime for Minimum Lending Rate. But for this to work effectively it is important that markets concentrate on the right things.

20. The sharp rise in interest rates last July occurred at a time when the exchange rate, and in particular the sterling dollar rate, was falling and when there were widespread anxieties about whether our fiscal and monetary policies were on track. These domestic anxieties, as I think is now recognised, were unfounded. But they coincided with worries over industrial disputes and a mistaken view of our exchange rate policy. The combined effect was to impose massive upward market pressure on interest rates. In the circumstances it was impossible to resist this pressure without creating dangerous doubts about the government's central anti-inflationary strategy.

21. I said at the time that it is characteristic of financial markets that they tend to overshoot, and that is what occurred. When the market's worries about domestic financial policies were shown to be exaggerated, interest rates quickly fell back, [though they remain above their pre-July levels]. They have remained steady during a further period in which sterling has intermittently been under pressure. This is in marked contrast with the behaviour in July.

22. It suggests that markets are taking a more balanced view of financial developments. In particular, they are recognising that it is monetary conditions, and not the exchange rate, that are of central relevance to interest rates. That has always been our policy, and it remains so.

23. And - possibly another lesson from July - the markets are also focussing not on one month's money figures but on a run of months. Given the way in which the money figures can swing about from month to month that is the only sensible way to look at them. The fact is that on a three, six or twelve-month comparison, monetary growth, on both the broad and narrow measures, is within the target ranges. This has undoubtedly, and rightly, underpinned market confidence recently.

24. The increased unemployment level over the past year has been particularly disappointing. Employment has risen and so has the level of vacancies. Many of the new jobs have gone to women working on a part time basis. Over the year to last June, the estimated number of people in work rose by some quarter of a million. The number of part-time women employed rose by about 165,000. It is important to draw the correct lesson from this experience and I shall say more in a moment.

25. There have been some signs of a slowing in the recovery in the industrialised countries this summer. The forward indicators in a number of countries, including the UK, have weakened. Many commentators have concluded that we may be about to enter the downswing of the business cycle.

26. This judgement may prove to be premature. In this month it is particularly appropriate to recall Mark Twain's advice about October. "October" he said

> "This is one of the peculiarly dangerous months to speculate in stocks in. The others are July, January, September, April, November, May, March, June, December, August and February.

27. The evidence that we are reaching the downswing is weak. Industrial disruption in West Germany and the UK has affected the reported figures. There is clear scope for faster growth in Europe. The very high rates of US growth were obviously unsustainable and this growth is now moderating. The rise in nominal and real interest rates in the first half of this year was disappointing. But it may well be reversed.

28. In my recent speech to the IMF in Washington I conceded that we made no claim to having abolished the business cycle. All experience suggests that growth rates in the industrial countries do fluctuate from one year to another. Over the past 25 years or so there is evidence of some regularity in those oscillations. But this is far from being a mechanical or inevitable process.

29. It is important to examine the underlying pressures and not simply extrapolate past behaviour.

There are few signs of the factors that we would expect to be associated with a violent or sustained cyclical downturn and the message from the leading indicators may not be sustained.

It is important to recognise that the policy framework in recent years has been very different to the pattern in earlier years. Monetary policy has generally been directed towards reduced inflation and nominal GDP growth over the medium term rather than to output targets. Interest rates have been volatile and are subject to different pressures. As a result - the leading indicators, particularly interest rates, may not bear the same relation to output fluctuations as in the past.

30. The prospect for 1985 is that we shall see a further year of recovery. The various sources of demand may well make a more balanced contribution to growth. The clearest threats to sustained recovery remain the growth of world demand and the level of interest rates. Both are closely tied up with developments in the US and the progress of policy. Given the stance of US fiscal policy we must accept the risk of fluctuating US interest rates - and that the movement of US output is potentially volatile.

31. Recently we have heard a good deal about the benefit that high US import growth has brought to the European countries' external demand. But the high level of real interest rates which also derives substantially from US policy has to be put on the

other side of the balance sheet. We must continue to press the US Administration to correct the unbalanced nature of policy. More needs to be done, urgently.

32. The prospects for inflation remain favourable. Our expectation is that we shall continue to see downward pressure on inflation; some of the volatile factors that have been damaging inflation in recent months may well have reversed themselves by this time next year.

33. So the immediate prospects are good - sustainable growth combined with low inflation.

34. More important still are the long term prospects and the underlying performance of the economy. Concentration on short term movements can be misleading. Constant attempts to take the pulse of inflation or the pattern of demand risk exaggerating erratic movements, which tend to even out over a number of years. Such attempts also risk identifying proximate causes rather than the real underlying changes.

35. It is the profile of inflation over a number of years which is important. That is determined by monetary policy.

It is the underlying efficiency of the economy which is important. And that will determine growth and employment in the medium term.

36. This government has made a considerable number of changes in the direction of improving the efficiency of the economy. A large number of controls have been abolished. We have encouraged increased competition and and reduced distortions in the tax system.

37. But we recognise that more needs to be done. Improved micro-policies involve difficult choices - just as with improved macro-policy. It means reducing subsidies whether for spending, saving or even capital investment; returning to a tax system which is more neutral in the way it affects choices; closing low productivity, loss-making activities; maintaining free trade and reducing protection where it exists; controlling government spending and reducing taxation.

38. And lower wage growth is a crucial aspect of this improved supply performance. There is considerable misunderstanding about the role of slower wage growth in generating more jobs. We are not advocating a return to stone-age technology. But we must recognise that consumers' choices are determined by relative prices. If labour costs grew more slowly we would see some shift in relative prices and an increased share of labour intensive products in spending.

39. Nor are we saying that anyone in work need be worse off. Slower growth in the real wages of employed people is surely not onerous. And it can mean all the difference to whether those unemployed can find work.

40. There is much to be said for a high wage, high productivity economy. Certainly high pay for high productivity is to be welcomed. But average figures for earnings and productivity are different. They reflect the mix of people who are in the averages. [Some people have difficulties with the concept of averages like the man who drowned in a river that was on average 3 feet deep.] If there were a significant increase in jobs in which the levels of productivity and earnings were below average, average figures for earnings and productivity would grow more slowly. But there would be no reduction in productivity - no downgrading - in any individual job. And the gain in employment would surely be a welcome development.

41. There is no doubting the level of overmanning that existed in UK industry in 1979. Much of the increase in unemployment in recent years represents a correction of that overmanning. The unemployment tragedy has been a failure to generate sufficient opportunities for those displaced to find work elsewhere. In large measure this is due to continuing obstacles to employment at real earnings levels that can be afforded by producers. This is the way in which the US has adapted and I make no apology for continuing to represent it as a standard we should aim to achieve.

42. In my Mais lecture I argued that the flexible operation of US labour market, not budget deficits had been the prime determinant of the US jobs success. Several people have questioned this and pointed to the recent combination of larger budget deficits and falling unemployment. A number of points need to be noted.

The first is that the contrast between European and US performance has been a factor over the past ten years, not only the last four. Indeed US employment rose 13 million between 1975 and 1979, a period over which employment in the European Community [with a similar sized labour force] rose by only 2 million.

43. Clearly the recent rapid growth of output in the US has reduced unemployment. But to ascribe the rapid growth in output exclusively to fiscal policy is to ignore some other important developments in the US.

In particular inflation has fallen rapidly, partly because of deregulation and other pressures for increased competition.

It is also striking that the US recovery has not been characterised by an unusual growth of consumer and government spending which might have been expected if fiscal policy had been were the dominant force. Instead it is business investment that has been unusually high by the standards of earlier recoveries.

44. Many self-styled Keynesians see the recent US developments as the last indication of their beliefs. After being wrong so often about the profile of recovery

and inflation in the UK they have siezed upon this example to make their point about the virtues of budget deficits. But in doing so they are missing some important lessons we need to absorb if we are to improve employment prospects substantially. They particularly miss the point that it is the flexibility of the US labour market which has meant that gains in output have been substantially reflected in gains in employment.

45. The economic progress we have witnessed over the past year has been substantial - both at home and abroad. The way the economy is taking change in its stride is notable too. Many uncertainties remain. The essential element in facing them is the pursuit of a consistent strategy - that we have.

46. The emphasis on competition within a clearly defined framework is as much a hallmark of our policies tackling the structure of the economy as it is of our financial policies. The Medium Term Financial Strategy and the encouragement of the enterprise culture remain the foundations of our strategy. If I may use an analogy today - on the Feast of St. Luke - we have laid those foundations on rock.

47. The need to safeguard the prosperity of the public purse is indeed part of that strategy - a toast to which we can pledge ourselves again tonight.

FROM: M D X PORTILLO
DATE: 15 OCTOBER 1984

CHANCELLOR

MANSION HOUSE SPEECH

I attach a re-draft of sections of the speech covering the City, international debt, Johnson Mathey, the recovery, inflation, public expenditure (including the costs of the strike) and exchange and interest rates. It is not, therefore, a whole speech, but will I hope provide a useful second string to the new draft being prepared by Sir Peter Middleton.

M D X PORTILLO

DRAFT (MP1) MANSION HOUSE SPEECH

REPLY TO THE TOAST "PROSPERITY TO THE PUBLIC PURSE AND THE HEALTH OF THE CHANCELLOR OF THE EXCHEQUER"

My Lord Mayor, Lords, Ladies and Gentlemen. I hope you will not take it amiss, my Lord Mayor, if I begin by drawing attention to the fact that this is the first occasion in history on which the Mansion House Banquet has been presided over by a lady. You will realise that in pointing this out there are no sexist connotations to my remark. I have had the benefit, along with my colleagues in the Government, of the determined and courageous leadership of a woman for nearly the last decade, both as Leader of the Opposition and for the last five-and-a-half years as Prime Minister.

But your presence here tonight, Madam, is highly symbolic. The occasion, the Mansion House Banquet, is a symbol of the traditions of the City of London, traditions that have made and maintained its position as a key financial market in the world. But the fact that you are presiding, Madam, symbolises the City's willingness to adapt and to enter the modern world. It is the combination of the City's reputation ~~one~~ won over very many years and its flexibility in meeting the challenges of the modern world, that will sustain its position in the years to come.

May I congratulate you, Madam, on a most distinguished eleven months in office. In a month's time we shall welcome with open arms your successor, but nonetheless, I hope I shall not be misunderstood if I say that at next year's dinner we shall all feel a tinge of regret at returning to an all-male cast.

The City

It is with the changes in the City that I wish to deal first.

Issues of self-regulation and statutory powers are not new to the City. You will, of course, recall my Lord Mayor, that this is the centenary of the passing of the London Brokers Relief Act of 1884. The detailed regulations toverning brokers in London had been swept away by Parliament in 1870. The 1884 Act completed the process of restoring market freedoms by abolishing the annual tax which had been levied on brokers.

If today I were to introduce a Brokers Relief Bill, I believe it might arouse certain controversy: even hostility on the Left. But I commend the wisdom of those who framed the 1884 Bill so as to produce freer markets.

A year ago when I addressed this dinner, we were still in the immediate aftermath of the decision of the then Secretary of State for Trade and Industry to exempt the Stock Exchange from the Restrictive Trade Practices Act. At that stage there were still those who believed that the effect of that decision would be no change. Those who were hostile to the City, claimed that the Stock Exchange had been let off. Some of those who were the City's friends, feared that an opportunity to bring about change had been missed.

A year later, such fears seem laughable. The year has produced frenetic activity: mergers, takeovers, engagements and marriages. In just 12 months, the scenery has been thoroughly re-arranged. In the rush, a number of familiar milestones and landmarks have disappeared. Many new ones have been erected in their place. The difference, I believe, is that the new institutions that have come into being are stronger - broader and built on more solid foundations.

That development has two important consequences. First, our institutions are likely to be better placed to compete in world markets. Second, their strength and breadth bring into sharper focus questions of possible conflicts of interest, investor protection and the need for an effective system of regulation.

There is a delicate balance to be struck here. It is certainly not any part of the Government's wishes to hamper the City unduly with restrictions or controls. It is in the nation's best interest that the financial markets of the City should work efficiently and freely. The country relies on such markets as an economical way of providing medium and long-term finance for British companies. That role is at the heart of maintaining a successful capitalist economy. The Government also wishes to see the London market internationally competitive with British financial institutions operating in foreign markets successfully to the benefit of balance of payments and the economy generally.

But we have a responsibility for ensuring adequate investor protection too, and not just for the sake of the investor. It is as important for the City's reputation, a valuable commodity in this game, that the regulatory system should be adequate, should operate successfully, and should be beyond reproach.

We established investor protection as an important principle from the outset. It was prominent in our decision on the Stock Exchange and the Restrictive Practices Court. But we have been flexible. For example, we stated that in our view single capacity - the separation of jobbers and brokers - should remain, unless and until an alternative means of providing adequate investor protection could be found. From the outset, our minds were open to any alternative that could adequately safeguard the investor's interest.

The Government has a strong commitment, as you all know, to spreading the ownership of shares widely. Over the years, our privatisation programme has played an important part in increasing markedly the number of workers who own shares in their companies. Some of the reforms in my last Budget, for example the abolition of the investment income surcharge and the halving of the rate of stamp duty, removed important distortions which stood in the way of individual investors. The privatisation of British Telecom next month should take our policy of wider share ownership an important stage further.

Since it is our objective to introduce new investors to the markets, the question of investor protection looms all the larger in our minds. But equally it will be in the best interests of those new investors that the City continues to operate as freely and smoothly as possible.

The Gover Report dealt comprehensively with these important questions. Norman Tebbit will be responding shortly to the Gower recommendations. His response will provide the essential background and framework against which and within which the City can continue to evolve and adapt.

<u>**International scene**</u>

Speaking to this dinner a year ago, I referred to the subject of international debt as being "perhaps the greatest immediate problem". In the 12 months since, we have on a number of occasions had cause to fear the worst. At times the problems seemed intractable, and the dangers very imminent.

Today, I believe we are a little better placed. We are not entirely out of the woods, but there has been clear progress. Some debtor countries have achieved conspicuous success in some aspects of adjustment. Both Mexico and Brazil, for example, have produced a remarkable turnaround in their balances of trade.

There are still dangers. First, a number of other countries have not yet faced up fully to the need to make adjustments. Second, those countries who have embarked must find the necessary political will to sustain their programmes over a period of years.

They will not be helped to do so if American interest rates and the value of the dollar remain as high as they are today.

Johnson Matthey

But the immediate dangers to the survival of a number of banks in the lender countries have eased somewhat. In the event, one banking failure which we in Britain faced was that of Johnson Matthey, and that had nothing to do with international debt. The Bank of England moved swiftly and efficiently to deal with that situation, in the process saving Johnson Matthey's gold bullion subsidiary and averting any danger to London's position as a key gold market.

The Economy

I now turn to the economy. Developments over the past year have been much as we expected. Output in the first half of 1984 was 3¼ per cent higher than a year earlier - without the effects of the Scargill strike it might have been 4 per cent.

Last year the main sources of growth in demand were consumer spending as the savings ratio fell and less de-stocking. This led critics to claim that the recovery was based entirely on a consumer boom. However, we were confident that the recovery would broaden as it progressed. This has of course occurred. The growth of consumer spending has slowed as the savings ratio has steadied. The balance of demand has switched towards investment and exports even more than expected. Exports have been helped by the rapid growth of the world economy. Manufacturing investment is up by 15 per cent on a year earlier.

Inflation

Inflation has continued at a lower rate than expected by most commentators. At the time of my speechlast year, most predictions were for inflation to rise. I suggested then ~~in my speech last year~~ that the prospects for inflation remained encouraging and that indicators at the time pointed, if anything, to a downward path in 1984. But both that statement and the prediction at the time of the budget that it would fall to about 4½% at the end of the year were regarded as optimistic by most commentators. Since then, outside forecasts have tended to come into line with the Treasury.

The latest inflation figure at 4.7 per cent is a little below the same month in 1983. Even so, this comparison understates the underlying progress made. The RPI is strongly affected by movements in mortgage interest rates. This dist~~ribution~~ortion has operated in both directions, producing an RPI of less than 4% just over a year ago, and of over 5% in recent months. This tends to mask the underlying rate of the index. A useful measure of the domestic component of inflation, the GDP deflator, was rising at a rate of under 4 per cent in the first half of this year.

This is good, but not good enough. It is not a rate of inflation that we believe we should continue to live with. That is why our objective remains to achieve stable prices.

The Government has not forgotten for a moment the evil~~s~~ of inflation, even if some critics and commentators appear to have done so. Not least amongst those evils, is the fact that rising inflation is the precursor of higher unemployment.

There are those who argue either that we have switched, or that we should now switch, from the fight against inflation to the fight against unemployment. Such statements are nonsense.

We have always given a high priority to the fight against unemployment. One of the reasons that we have pursued so vigorously policies to combat inflation is that lower inflation is necessary for lower unemployment. We have also long recognised that the battle against unemployment would hinge not so much on macro-economic policy - for example, high levels of public spending which have been tried and which have failed before - but on the vigorous pursuit of a wide range of micro-economic policies. By that, we mean removing restrictions, distortions and controls that operate on the markets, particularly the labour market, so as to make it more difficult, expensive or otherwise unattractive for employers to take on or keep on workers.

Between pursuing such micro-economic policies and maintaining the fiscal discipline necessary to reduce inflation further, there can be no conflict. That is why it makes no sense to say that the Government has switched or should switch its priorities.

So the Government will remain faithful to its fiscal policies that have succeeded in bringing inflation down to its present low levels, will continue to pursue the medium-term financial strategy and its monetary targets; and to attach the highest importance to maintaining firm control of public expenditure.

Public expenditure

This last task has been as difficult this year as ever before. To begin with, we have had to absorb the public expenditure costs of the Scargill strike. The impact has been a large one, but not nearly so great as a number of commentators and politicians would have us believe.

Up to the end of September the cost of the coal strike in public expenditure terms was about [£ million] and in PSBR terms about [£ million]. To set these costs in context, subsidies to the NCB before the strike were running at over £1 billion a year - or £130 a week for every miner. These subsidies would grow even larger if uneconomic pits were kept open. The country cannot afford to subsidise loss making pits any more than it can afford to subsidise loss making activity elsewhere on the economy. The NUM alone amongst unions seems to believe that it is possible and desirable for the country to prosper by consciously and systematically backing losers.

I can make the point no better than the way it was put in last week's Spectator by Jimmy Reid, ex-communist, ex-Leader of strike action at Upper Clyde Shipbuilders. He wrote:

> Arthur Scargill...is absolutely insistent that economics should play no part whatsoever when reviewing the operation of a pit. This is mind-boggling. If coal

in a particular seam costs £10,000 a ton to extract so be it: that is his logic. But wouldn't it then be rather expensive to burn? You would have to burnish it, put it in pendents and sell it in jewellers' shops."

The strike is one of a number of factors that have put pressure on spending. Local Authorities will again substantially overspend their provision, justifying the stricter penalty regime for next year and the powers we have taken to cap rate increases.

For these reasons public expenditure pressures this year are very strong. The pressure on spending Departments to find offsetting savings is correspondingly strong. What is more, the overall level of borrowing will benefit from higher North Sea oil revenues. [Latest PSBR figures]. So even if for exceptional reasons - for example the extra costs as a result of the strike which because borne this year should enable us to make savings in future years - even if this year public expenditure turns out a little higher than planned, borrowing should be lower than in 1983-84 as envisaged in the Budget forecast.

interest and exchange rates

Forecasting public expenditure and the PSBR is not made any easier by fluctuations in interest rates and the rate of exchange.

It may be helpful here if I say something about the Government's policy on short-term interest rates, in case there are still misconceptions about this. The arrangements introduced in 1981 were designed to give markets a greater influence on rates. This is consistent with a policy that is directed at controlling monetary aggregates and over time should bring about a quicker and smoother adjustment of rates than would be achieved if the Government were administering them as under the earlier regime for Minimum Lending Rate. But for this to work effectively it is important that markets concentrate on the right things. We have been accustomed to our interest rates following US rates or standing above them. In the late 1970s our rates were sometimes all of 4 points above US rates.

Over a period of years while this Government has been in office, UK interest rates have reflected market confidence in our policies and the success of those policies. That enabled us to enjoy interest rates that were increasingly detached from US rates. Last summer our rates stood at fully 3 percentage points below US rates.

The sharp rise in interest rates last July occurred at a time when the exchange rates of the pound and most other currencies were falling against the dollar. That coincided with anxieties about whether our fiscal and monetary policies were on track.

These domstic anxieties, as I think is now recognised, were unfounded. But taken together with strikes not only in the mines but also in the docks, markets temporarily lost ~~the~~ confidence in maintaining lower rates of interest in the UK to those available in America. The effect was to impose massive upward market pressure on interest rates. In the circumstances it was impossible to resist this pressure without creating dangerous doubts about the government's central anti-inflationary strategy.

But it was quite wrong to imply either that there was a sterling crisis or that the Government had after all discovered a target for the exchange rate. In fact, the pound remained quite strong against other currencies such as the Deutschmark.

I said at the time that it is a characteristic of financial markets that they tend to overshoot, and that is what occurred. When the market's worries about domestic financial policies were shown to be exaggerated, interest rates quickly fell back, [though they remain above their pre-July levels]. They have remained steady during a further period in which sterling has intermittently been under pressure. This is in marked contrast with the behaviour in July. Although the dollar is stronger still now against other currencies - [by 10 cents against the pound ~~dollar~~] - this time there are no suggestions of either a sterling crisis or a Government exchange rate target.

It suggests that markets are taking a more balanced view of financial developments. In particular, they are recognising that it is monetary conditions, and not the exchange rate, that are of central relevance to interest rates. That has always been our policy, and it remains so.

And - possibly another lesson from July - the markets are also focussing not on one month's money figures but on a run of months. Given the way in which the money figures can swing about from month to month that is the only sensible way to look at them. The fact is that on a three, six or twelve-month comparison, monetary growth on both the broad and narrow measures, is within the target ranges. This has undoubtedly, and rightly, underpinned market confidence recently.

FROM: M T FOLGER

DATE: 17 October 1984

c/ Philip will get figures on the revised basis tomorrow am. ?

cc Sir T Burns
Mr Battishill
Mr Evans
Dr Rowlatt EA1
Mr Makeham
Dr Vernon

CHANCELLOR OF THE EXCHEQUER

MANSION HOUSE SPEECH: RPI PERFORMANCE

You asked earlier this evening for some information on RPI movements.

2. The figures for the full RPI are:

calendar 83 on calendar 82	+ 4.6 per cent
1st 9 months 84 on 1st 9 months 83	+ 5.0 per cent

3. For the "RPI excluding the mortgage interest rate" we would need to consult EA1 tomorrow to see what could be calculated and released. (And Department of Employment might also need to be consulted.) However EB estimates for movements in the RPI excluding housing are as follows:

calendar 83 on calendar 82	+ 5.0 per cent
1st 9 months 84 on 1st 9 months 83	+ 4.4 per cent.

By stripping out housing we remove the distorting effect of mortgage rate changes and also the RPI impact of the Housing Benefit cuts this spring (which are probably something it is less legitimate to leave out).

pp. M T FOLGER

PMP

Miss O'Mara

cc. Mr Evans
Mr Wynne-Owen
Mr Vernon

Mansion House Speech: RPI performance

The figures I have been asked for this morning are attached.

I have consulted DE about the use of the RPI less mortgage interest payments and they are considering the matter. If they have any objection they will discuss it with Huw Evans later this morning.

Penelope A Rowlatt
18 October.

Percentage changes on a year earlier

	1st 9 months average 1983/1982	1st 9 months average 1984/1983	Annual average 1983/1982
RPI	4.5	5.0	4.6
RPI less housing	5.0	4.4	5.0
RPI less mortgage interest payments.	5.3	4.6	5.2

David
I assume is acceptable
M.

.ph

CONFIDENTIAL

FROM: HUW EVANS
18 October 1984

MR PERETZ

cc Sir T Burns
Mr Battishill
Mr Folger
Dr Rowlatt

MANSION HOUSE SPEECH

I understand that the latest draft of the speech says on the RPI "Inflation is below 5 per cent and can confidently be expected to decline further as monetary growth continues to decelerate, as indeed the underlying rate of inflation has been decelerating. If we exclude the somewhat distorting effect of fluctuations in the mortgage rate from the index, the RPI for the 9 months to date is 4.6 per cent up on a year earlier, compared with an inflation rate (on the same basis) of 5.3 per cent for the first 9 months of 1983".

2. I think the word "confidently" in the first sentence is a little unwise if it is taken, as it probably will be, to apply to 1985. Perhaps of more substance, the Department of Employment feel strongly (and I agree) that we should not give so much prominence to a new version of the RPI: they are constantly resisting pressures for special indices eg for the low paid or for London weighting, and the Chancellor's apparent use of a new index might add to the pressures already being felt in the Retail Prices Index Advisory Committee and elsewhere.

3. An alternative formulation which I think gets over the same point would be as follows:

> "... underlying rate of inflation has been slowing down. The path has been influenced by erratic movements in mortgage rates. Excluding these in order to give a better indication of the underlying position, other prices in the index for the first 9 months of 1984 were 4.6 per cent up on a year earlier. This compares with an increase on the same basis for the first 9 months of 1983 of 5.3 per cent."

4. A final drafting point: "slowing down" is better than "decelerate" for inflation rates.

VH

PP H P EVANS

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