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1-5-11



Macmillan
memorandum on
economic affairs,
8-10/1980

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PERSONNEL : ECONOMY

Harold MacMillan's memoirs 1980

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1/5/11

Haus der Revolution -
der ersten Republik
in Mail 1880.



10 DOWNING STREET

PRIME MINISTER

Here is a paper on the economy from Harold Macmillan. I understand that he promised you this when he visited Chequers earlier in the month.

Do you want this shown to anyone else?

MA

20 August 1980

Production of energy by demand growth

Pure investment caused by
Xmas wage increases
which correspond to increases
in identity on commerce
accompanied by equal or less
fixed investment in admin.

So far - attempt to
reduce money market has had
little more than that of
identity shift has to compete
with market - esp. in
P.C. - in its own name.

Price revenue in business.
- why tomorrow's investment
in real estate market

Trade monopoly ^{Price}
price up wages without need
to productivity.

MT notes on Macmillan memorandum

[transcribed by editor of www.margaretthatcher.org, December 2010]

Production of energy by atomic power.

Price increases caused by excessive *[excessive]* wage increases without corresponding increases in industry or commerce accompanied by equal or even greater increases in admin *[administration]*.

So far - attempts to reduce money [xxxxx] have fallen more on that part of industry which has to compete in the markets – esp. *[especially]* on p.e. *[private enterprise]* in its true sense.

Firms remain in business – cutting tomorrow's investment in [??ing] [assets?]

Trouble monopoly T.U.'s force up wages without regard to productivity.

MEMORANDUM

From: The Rt. Hon. Harold Macmillan, O.M.

1. The world economic situation is dominated by the gap between the sums paid by the oil purchasing countries (chiefly the West) and the oil producing countries (chiefly Arab). This is a classic example of the imbalance between the rate of saving and the rate of investment analysed by Keynes fifty years ago. The scale, however, is far beyond anything that could have been conceived by former economists. After making allowance for genuine investment by the oil producers there is estimated to be some 200 billion dollars, which is known in technical language as 'inrequisite'. In other words, this sum is not turned into goods and services by the oil countries but remains held mainly on short term in the international banking system.

So long as this gap remains there is inevitably world recession, and it is by far the greatest problem which besets the civilised world to-day in the economic field.

2. This gap has been to some extent, dealt with from 1974 by what is called the process of 'recycling'. This really means a desperate effort by the international banking system to find credit-worthy borrowers all over the world. This process cannot be pursued much longer. Already the banking system especially American is at risk

and any further attempt to force money upon unsound borrowers may lead to disaster. There is, therefore, this dilemma. Yet if the money is not re-lent in terms of goods and services (chiefly capital goods) the world recession will continue. If it is re-lent beyond what sound banking practice would allow, there is danger of a liquidity crisis overcoming the international banking system similar to, but on a much greater scale than, that of 1931. It only needs another Credit Anstaldt to start it off.

3. Short of occupying the oil producing countries by force, which seems both immoral and impractical, there is no method except by persuasion of compelling the Arab countries to allow this huge surplus to be invested fruitfully. What is really required is a massive investment in non oil producing countries, especially the so-called Third World, similar to the Marshall Aid for Europe in 1947. It is clear that this is a difficult task needing long and skilful negotiation. It cannot be solved by the sudden appearance of international officials for a few days in this or that Arab country. It needs a long and patient negotiation headed by trusted American and European figures. Meanwhile every effort should be made to increase the production of oil all over the world and the production of energy by atomic power as rapidly as possible. But since all this will take a long time the fact of the tendency towards constant recession must be taken into account.

4. All the circumstances, therefore, would demand at the present time not restriction and deflation, but powerful reflationary measures largely on capital account throughout all the countries of the West.

* * *

5. What is it that prevents the adoption of the natural remedy of reflation? It is the phenomenon which has developed in all the market economies certainly of the West and more particularly in Britain, of inflation caused by excessive wage increases without corresponding increases in production in industry and commerce, accompanied by equal or even greater increases in the administrative classes.

6. The situation in Great Britain has been worse than other Western countries because of the almost negligible rise in productivity. To the extent that the British disease has become more serious than the Continental, our competitive position had fallen in world markets even before 1974.

7. Faced with this situation most countries have taken restrictive action of various degrees of intensity. Only in Britain has this taken the severe form of the last year.

8. Here in Britain a combination of high Bank Rate (to a point which would have been regarded as sheer usury in any other age) and the consequent attraction of foreign money (mostly in the form of hot money) into Britain, by rates

higher than those prevailing in other countries and a corresponding increase in the value of the pound against the dollar, has seriously increased the competitive difficulties of British exporting industry without so far producing any marked effect upon the inflation of prices.

9. The so-called 'money supply' policy may be useful as a guide to what is happening just as a speedometer is in a car; but like the speedometer it cannot make the machine go faster or slower. In the first year of this Government the whole concentration of effort to squeeze wages down or to prevent excessive rises has fallen naturally upon that part of industry and commerce which, whether publicly or privately controlled, has to compete in the market. It has affected equally British Leyland, the Steel and the Coal Industries which are Government owned; but it has fallen more particularly upon private enterprise in its true sense, that is to say that part of the economy which is still operating independently of Government ownership or support. It must not, however, be forgotten that so-called private enterprise depends in many cases largely on the purchases by central or local government (for instance local authorities are the largest buyers of furniture in the country). Hence the squeeze upon public expenditure whether central or local both in capital and consumer goods coupled with the high rate of interest and the over-valuation of the pound (which is based partly upon British oil production and partly upon the attraction of high interest rates) have combined to put British production

industry, whether public or private, in an increasingly precarious position with little corresponding relief. It is, of course, true that in the private sector these processes are likely to result in smaller wage concessions this autumn (10% or less). This is partly due to the actual inability to pay any increase without bankruptcy and partly through the fear of trades unionists seeing the rapid growth of unemployment and their corresponding willingness to accept more reasonable terms.

10. Nevertheless, the picture is a serious one. For even if firms may be able to remain in business, either by drawing on existing liquid assets or by the sale of other assets, or by borrowing from the banks, many of them will be forced to reduce their output and to abandon their investment projects with a corresponding reduction in their competitive power in the future.

11. What then can be said to have been gained? Certainly a shock has been given by the Government's policies to the nation as a whole, and even a sense of exhilaration amongst those who believe that steady continuance of these deflationary policies will achieve the desired result. (Incidentally, Mr. Biffin one of the protagonists of 'monetarism' has admitted that the effect of this policy on inflation may be negligible). The main visible pressure has fallen on private competitive enterprise. The high value of the pound, the excessive interest rates, and the postponement of capital investment by the central government, local governments and

industry, are together threatening not merely an alarming increase of unemployment (which so far as it is a result of reducing over-manning may be healthy economically, although dangerous socially). But in due course it threatens a serious blow to the balance of payments through the collapse of parts of certain important industries (e.g. textiles, paper making, etc.)

12. Meanwhile it is quite true that the Government have tried to bring similar pressures in the public sector whether in that of the producing side or the purely administrative side. Unhappily, they entered the campaign with apparently little knowledge of what powers they really have. They have little if any control of the wages paid either by central government or by local government. The powerful bureaucratic system which has taken away the central powers of the Treasury over state employment and much reduced the power of Ministers over their own departments, makes it almost impossible for the Government to fix the wages of its own employees, since they are now controlled by a whole series of committees and mechanisms which have become rooted in the system. (Even with the teachers, which is a solitary case where the Government has statutory control, subject to Parliament, it was found impossible to set aside an arbitration). On local authorities the only instrument which the Government can bring to bear is to reduce the grant. But the local authorities can retaliate in three ways. In spite of a reduced grant they can increase rates. Secondly, they can postpone capital projects, even the most essential and worth-

while. Thirdly they can cut their purchases of various commodities greatly to the injury of private enterprise and to that of the public as a whole. There is no way by which the Government can stop this nor is there any way in which the Government can force the local bureaucracy to reduce its own numbers or remuneration. Thus both locally and centrally the tendency is the other way, (just as it used to be said, perhaps jokingly, that the fewer ships the Navy had, the greater the number of Admirals).

13. It must be admitted that the troubles of the last fifteen years are largely due to the refusal of the trades unions to accept any curb upon their monopoly position, and their determination to force up the wages in terms of money rates without regard to productivity.

Conservative and Labour Governments in turn have made an attempt at a so-called 'wages policy', sometimes by voluntary method, sometimes by statutory control, and sometimes by a mixture of both. It was, of course, part of Conservative policy at the last General Election, that a Conservative Government would not attempt a wage policy but would only exercise control by 'monetary' means. That is to say, by squeezing productive enterprise, especially private enterprise, by putting cash limits upon public industries or services, and by restricting the cash available to local authorities. In fact, this amounts just as much to a wage policy as formerly, but by other means. Can it be said to have succeeded so far? Will it succeed if continued,

or will the cost be too high?

14. These are the questions which must now be faced. It is clear that a very considerable amount of success has been reached in the sense of giving a severe shock to the nation. Nor would it be wise to make a sudden change of policy, thus losing the confidence of the Party and of the people and creating a sense of confusion. There are, however, many adjustments that can be made, the most vital of which are

- (a) to reduce the rate of interest to a reasonable figure.
- (b) to try to repel rather than attract foreign hot money, again by reducing interest rates and thus reach a more realistic value of sterling.

15. It will be argued that the reduction of interest rates would force the Government from its policy of funding the public requirements rather than living on Treasury bills. I believe it will be found on examination that little of the foreign hot money goes into buying long term Government securities. These are the result of internal saving. My experience over a great number of years is that the mass of the public save out of habit or prudence. The only budget which I introduced as Chancellor of the Exchequer in 1955 was called 'the savings budget' and we raised enormous sums when money was 5% or less. The story of the Building Societies has

been the same. It may be argued that reduction in the rate of interest would not automatically reduce the excessive value of the pound. Nevertheless it can be tried and if it fails normal open market measures can be taken. If these remedies were applied they could be claimed as a success of the policy rather than a failure or change of direction. If they are not, the Government will be gradually forced either to further nationalisation of industries fallen into bankruptcy and/or to protective measures with all that this implies to world trade.

16. Wage policies as such have failed both Labour and Conservative Governments. Is there any way out other than a reversion to voluntary or statutory wage control? It would appear that the only course now is to try to divert attention from the excessive emphasis of wages to the problem which we all know to be basic - that of productivity.

17. British wages are not high compared to Continental or American, but British productivity is lamentably low. We all know the problem. We all know its roots. We all know its history and we all know what should be its solution. But in spite of some progress in various industries, we are lagging behind. The new industrial revolution is upon us, and we are not taking advantage of its opportunities.

18. It must be remembered that as civilisation proceeds the base on which it depends becomes, proportionately to the whole community, continually smaller. In a primitive society the whole population except perhaps the King or Chief, and a

few magicians or medicine men, are employed on production of wealth - ploughing the land, tending the cattle and so forth. Such a society is like a pyramid with a very small top and a very large base. As civilisation progresses the structure turns into something more like a pillar; we have now reached the point that a modern society is more like a pyramid upside down. The top is very large and the base upon which it depends is proportionately smaller. This has been made possible by the introduction of the machine in all its various forms, with great potential benefit. Yet all the benefits of civilised life, religion, the arts, education and the like depend ultimately upon the producers of wealth. I do not know what is the true proportion now: but let us say that one man at work supports three or four employed in defence or in the social services, or in the various evidences of civilised life including administrations. But this man can only sustain the burden if his productive capacity is steadily increased. You can, of course, try to reduce the burden by cutting down the burden on the producer. This, up to a point, is sound. But it soon becomes regressive. The right course is to increase the power of the one man through the proper use of the machine so that he can exercise the creation of wealth of say $1\frac{1}{2}$ men or $1\frac{1}{4}$ men.

19. If this be the true way out, as I am convinced it is, surely the full effort should be made now to organise a real campaign in favour of productivity. This must be combined of course with some relaxation upon the pressure of investment

but it should be accepted as the main task of Government to preach to industry.

20. We should organise nationally, locally and industrially, possibly through the existing NEDDY's, or possibly by some other organisation for the purpose. Churchill was always hankering after some kind of industrial parliament for he realised the extraordinary system whereby political matters are debated fully and openly while the decisions which effect a whole nation are taken by employers and trades unions without any clear picture being given to the public for the reasons actuating their decisions. If much of the restrictive practices were argued out fully in public the whole situation might well be changed and the pressure put upon the acceptance of modern methods of production and the best use of modern machinery.

21. It is by trying to switch the controversy on to productivity and the benefits in terms of wages, hours of work, holidays and the like that can follow the adoption of modern methods, that we may hope to obtain by a return to 'consensus' politics, sneered at by some, but the essence of Tory democracy. Devisive politics in a democratic system are not likely to be applied for sufficient length of time to become effective even if such methods were desirable. Nor can permanent deflation be a credible solution to the threat of national and international recession.

H.M.

20th August 1980

cc Mr Holtzman



*Prime Minister
Treasury
A Commentary on
Harold Macmillan's*

Treasury Chambers, Parliament Street, SW1P 3AG *Memorandum.*

01-233 3000

3 October 1980

*R
7/10*

Tim Lankester Esq
Private Secretary
Prime Minister's Office
No.10 Downing Street
LONDON SW1

Dear Tim,

We promised to let you have a commentary on Harold Macmillan's memorandum about the world economic situation, a copy of which Mike Pattison sent to John Wiggins. I now attach such a commentary.

Mr Macmillan makes a number of points with which the Government could, of course, agree, indeed strongly endorse. Other points need more careful handling.

Whilst recognising the sensitivity of the memorandum, the Chancellor wonders whether the Prime Minister might like to send a copy of the commentary to the Paymaster General.

*Yours ever,
Richard,*

R I TOLKIEN
Private Secretary

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MEMORANDUM FROM MR HAROLD MacMILLAN: SUMMARY AND COMMENTS

Summary of Mr MacMillan's views

Although the oil price increases and strain on international balances stemming from unspent surpluses of the oil producers affect all the industrial countries, the UK is particularly hard hit because of high costs attributable to increasing wages without commensurate productivity improvements. This is being compounded by the Government's measures to curb inflation, namely the high interest rates which are handicapping the trading sector of the economy while helping to keep up the exchange rate and so making UK exporters even less competitive.

His recommendations are:-

- (a) an approach to the OPEC countries to encourage them to invest in development in the Third World, in parallel with expansion of oil production outside OPEC and of nuclear and other power programmes (para 3);
- (b) a campaign to educate the public in the key importance of increasing productivity and adapting to technological change (para 20) - this might help to remove restrictive practices and excess pay claims, the causes of poor competitiveness (para 13);
- (c) reduction in interest rates to bring down the exchange rate and so help the competitiveness of UK exporters (para 14).

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Summary of pointsParagraphs 1-2

World economic situation dominated by unspent surpluses of the oil producers

Paragraphs 2-3

Burden of OPEC surplus only partially coped with by recycling - strain on international banking system - danger of possible collapse

Commentary

The main recessionary force in the world economy is correctly identified as an imbalance between the rate of saving (OPEC oil revenues) and the rate of investment (OPEC spending on goods and services). This is conceptually similar to the notion of deficient aggregate demand analysed by Keynes. But, as is pointed out, it is on a much larger scale than conceived by Keynes. And it is accompanied by historically high rates of inflation throughout the OECD area which preclude the adoption of Keynesian remedies to stimulate demand.

(Mr MacMillan's reference to an "inrequitable" OPEC surplus of \$200 billion is puzzling. If the reference is to the OPEC current surplus, the figure is generally expected to be around \$120 billion in 1980 and to fall in 1981.)

It is not clear whether the concern is about insufficient or excessive lending by the international banking system. In either case, it is unduly alarmist. It will not be easy for the banks to maintain the momentum of lending, given the strains on their balance sheets and high exposure to a limited number of countries. However, since 1973 the markets have expanded both in size and depth and this will enable them to continue to play a major intermediate role in recycling. But this does not mean that prudent banking standards will or should be relaxed. Greater attention is now being paid to sound prudential surveillance of the international banking system; this was reflected in the communique of the Group of Ten central bank Governors in April.

It is widely recognised that it will only be possible to deal substantially with the recycling problem if the markets are soundly based. The memorandum's fears about the possibility of an international financial crisis, and specifically about the health of the US banking system, are therefore exaggerated.

It will, nevertheless, clearly be necessary to strengthen the role of the international financing institutions. HMG's view is that this should mean building on the existing institutions and adapting them to meet changing circumstances.

Paragraph 3

Need for an initiative like the Marshall plan involving investment by oil producers in non-oil producing countries, especially the Third World - "Trusted American and European figures" should work on Arab leaders to persuade them to do this

Marshall Plan was an initiative of the United States who responded to need by lending large sums at low interest rates. Current problem and its solution moral responsibility not of US or Europe but OPEC who (as Venice summit communique put it) 'have undermined and in some cases virtually destroyed the prospects for growth in developing countries'.

Certainly OPEC must be urged to take greater responsibility for the problem of recycling. But no such willingness as US showed post-war is evident in OPEC countries. We see them concentrating on short-term lending for high returns. Behaviour does not encourage hopes of their responding to moral suasion from West.

Paragraph 4

"Every effort should be made to increase the production of oil all over the world, and the production of energy by atomic power as rapidly as possible".

This is indeed policy of UK and other industrialised countries - as shown in Venice summit communique stressing importance of conserving oil and use of alternative energy sources. UK fortunate in having own oil and gas resources - expect to be self-sufficient in oil in the 1980s. £ millions are being invested in the coal industry each year.

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The Government also announced last year a substantial programme of new atomic power station construction and planning is going ahead for a £1 billion plus project to gather gas in the North Sea.

[Venice summit communique: "To break the link between economic growth and oil consumption requires conserving oil and increasing production and use of alternative energy sources"].

Paragraphs 4-5

Meanwhile, recession could be countered by reflation - except that Governments inhibited by problem of inflation.

Inflation is rightly identified as the main reason why the "natural" (ie Keynesian) remedy of reflation cannot be adopted. It is precisely because governments worldwide are quite properly inhibited by the problem of inflation that recession cannot be countered by old-style reflation. The experience of the last round of oil price increases has taught us that bringing inflation under control must be the first priority. Without this, consumer and investor confidence will be undermined and sustainable growth is simply not possible. Inflation is a social and economic evil, and a bar to growth.

[Venice summit communique: "Determined fiscal and monetary restraint is needed to break inflationary expectations. We must guard against the threat of growing unemployment and worldwide recession".]

Paragraph 6

UK the most vulnerable because of falling competitiveness - which began earlier than the first oil price crisis

To be welcomed as a general assertion of importance of this issue. But advisable not to be drawn into historical comparisons. It is difficult to assess our competitive position at any time. According to the conventional indices - relative export prices, relative wholesale prices and relative normal unit labour costs - our competitiveness

improved between 1966 and 1974. Yet our share of world manufacturing exports fell over the decade prior to 1974. This would suggest that it was non-price factors which led to the fall in our share of world markets rather than our poor productivity performance.

Paragraphs 7-8

UK Squeeze tougher than in other countries - yet high interest rates - and exchange rate - have not so far produced any marked effect on price inflation

There has already been considerable progress in reducing the inflation rate. The year on year RPI increase fell from 21.9 per cent in May to 16.3% in August. There was a sharp break in the trend of monthly increases in retail prices after April. After rising at a rate of around 1 $\frac{3}{4}$ % per month in the first quarter of the year, the RPI increased at a monthly rate of less than 1% between May and August. (Smaller price increases were particularly evident in the case of manufactured goods and services provided by the private sector.)

The strong pound is one of the major factors moderating price increases. It is helping to keep down the cost of imported raw materials and of imported final goods (which have hardly risen since the beginning of the year). This in turn has helped to moderate price increases in the shops by putting pressure on domestic firms not to raise prices. Recent CBI surveys have cited such competitive pressures as an important factor restraining firms' ability to raise prices.

Paragraph 9

Burden being borne by the trading sector - directly and also indirectly through public sector's lower demand for goods (capital and consumer) as part of drive to cut public spending: only benefit is the willingness - at present - of workforces to settle for smaller pay rises

This is indeed one of the ways in which lower wage settlements are being brought about; as Mr MacMillan recognises, monetary policy brings down wage inflation in the private sector via pressure on producers to keep down the growth in their costs, and on labour not to price themselves out of a job.

There are other mechanisms too. In particular, with inflation now coming down and the Government firmly committed to reducing monetary growth over the medium term and hence future inflation, wage earners and settlers can be expected to take account of the better price prospects in settling wage claims. This will itself have an important downward influence on wage settlements - both in the private and public sectors.

There is encouraging evidence of lower settlements in hard-pressed parts of the private sector eg car industry. And the Government are determined to exercise strict control over increases in the public sector over the next year.

Paragraphs 10-11

Are gains by way of giving shock to the nation sufficient to compensate for costs in terms of low output, high unemployment and industrial collapse?

A false antithesis. Whilst there is bound to be a transitional loss of output and jobs, the extent of this will depend on how quickly people adjust their behaviour to the policies necessary on monetary growth and public finances. And it is unrealistic to suppose that any other policies would have avoided a painful period of readjustment sooner or later. Reflationary measures might save a few jobs now; but they would cause higher inflation and unemployment later, and postpone the time when sustainable and soundly based growth could be resumed.

Paragraph 12

Public sector pay is less responsive than private (comparability awards, no central control of local government which can put up rates and/or postpone construction schemes and cut purchase of goods from private sector). Government cannot force local bureaucracy to cut itself.

It is right to draw attention to these difficult problems. But although the public services are less directly responsive to economic pressures, Governments can successfully impose financial pressures, and this happened in the last pay round. Mr MacMillan may have been confused by the "catching up" hangover: once this once-for-all phenomenon is discounted, a different picture emerges. (If one looks

at pay settlements over the last year (using either DE or CBI data), average public trading sector settlements have moved almost exactly in line with average private sector settlements, and average public service settlements have been some 3% below this figure, and indeed below the level for average manufacturing industry as well).

There is some force in the point about theoretical independence of local government over pay and staff levels. Much depends upon the attitude of the local authority employer. They are now signs of a new-found toughness.

Manpower figures for this Government's first full year in office (ie the year ending June 1980) show a 1.4% reduction in local authority employment in England and Wales - a record reduction and a very considerable achievement. The recent call for revised budgets and subsequent cut in this year's rate support grant is proof of the Government's determination to curb current spending (which covers staff remuneration) as well as capital expenditure by local authorities.

Paragraph 13

Trade unions criticised for refusing - over last 15 years - to accept curbs on their monopoly position and bargaining without regard to raising productivity; current monetary policy represents latest form of wages policy.

We can agree with the remarks about trade unions' responsibility. Government have already taken a number of steps - in the Employment Act [parts already operative; fully operative from 1 October] to redress the balance of power in industry. They intend in addition to publish a Green Paper later in the year [Note: this could be in November] on the whole subject of trade union immunities.

The thesis that current monetary policy represents the latest form of wages policy can be criticised on both macro and micro grounds. On macro, control of inflation is effected by monetary policy; earnings increases are not a direct cause of inflation, but affect the speed at which inflation responds to monetary policies. In other words, the Government is not seeking to control earnings throughout the economy generally, but to control inflation. But this will impact on earnings increases because, in the aggregate, increases in excess of monetary growth will lead to higher unemployment.

At the micro level, monetary policy does not constitute a "wages policy". A wages policy smacks of norms, etc. The Government's monetary policies leave employers free to pay what they can afford, but greatly increase the pressure on them to look carefully at what they can afford, and to stand up against settlements which they cannot afford. In other words, monetary policy seeks to make the labour market operate more effectively, rather than to try to supersede it as a wages policy would. The Government are confident that negotiators will increasingly reach more responsible settlements against the background of the overall discipline on monetary growth and public borrowing.

Paragraphs 14-15

Government should reduce interest rates to "a reasonable figure" thereby repelling foreign 'hot' money (as well as helping businesses).

Interest rates were increased last year to help bring money supply under control. In the short-term the relative level of UK interest rates influences inflows from abroad, but this is not the only reason for these inflows and hence the strength of

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sterling. Other important factors are overseas confidence in the Government's firm fiscal and monetary policies and possession of North Sea oil amid uncertainties about future oil prices and supplies. It is by no means clear, therefore, whether a reduction in interest rates would have the impact Mr Macmillan believes.

High interest rates are undoubtedly causing difficulties for many companies. But the first priority must be to reduce inflation. To reduce interest rates too rapidly would risk a continuing high rate of inflation which in the long term would be far more damaging to industry and the economy. The Government firmly intend, however, to reduce interest rates further, and their medium term financial strategy will ensure this. But the timing must depend on monetary developments and prospects.

A flexible exchange rate is an essential counterpart to a firm monetary policy. The Government therefore have no target level for sterling but allow the exchange rate to be determined primarily by market forces intervening simply to smooth excessive fluctuations and to preserve orderly conditions. Intervention on a larger scale could well prove ineffective and by increasing the money supply would risk undermining the tight monetary policy fundamental to beating inflation. It would thus endanger rather than improve competitiveness in the longer-term.

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Paragraph 15

Sufficient savings would flow in, without high interest rates, to fund Government debt.

There may be occasions when lower interest rates would not damage gilts sales. But in general this will not be the case. Moreover, there are other channels through which interest rates have their impact on money supply growth; there is no doubt that over time lower interest rates would tend to be associated with higher than otherwise money supply growth.

Paragraph 15

Alternative options are worse - further nationalisation of bankrupt firms and/or protectionism.

Government will stick to its policies, so question of alternatives does not arise. But (if pressed):-

(a) Government agree protectionism not a useful option (international agreements; open trade is in UK interests; protectionism removes incentives to domestic producers to improve efficiency) though ready to take action against dumping and negotiate selective restraints; it is no answer to problems of a high exchange rate for it would only tend to drive the rate still higher and transfer the burden further on to those firms which were not protected.

(b) Government are opposed to indiscriminate subsidies and to propping up failing industries indefinitely, so frustrating necessary change and adaptation.

Paragraphs 16-20

Better substitute for either overt wages policies or indirect pressure on wages through monetary policy would be campaign in favour of productivity - accept contraction of industrial base but exploit technological progress. Such a campaign conducted 'nationally, locally and industrially, possibly through existing "Neddy's" or some other organisation for the purpose' would put pressure on unions to co-operate in raising productivity.

We strongly applaud Mr Macmillan's emphasis on the need to exploit technological progress and improve our levels of productivity which are very low by comparison with those of our main international competitors.

To achieve these aims requires an entirely new climate, where efficiency and success are rewarded, innovation encouraged, and failure properly penalised. Government policies are designed to establish this climate - by encouraging the entrepreneur; by developing a tax system which increases incentives and allows employees to retain a larger part of any extra earnings; by controlling the growth of the money supply and thereby paving the way for lower rates of inflation; and by reducing the size and demands on industry of Government bureaucracy.

Ministers have used every opportunity to stress the need for improved levels of productivity both in speeches and in fora such as the NEDC - an institution first set up under Mr Macmillan's own Premiership. The NEDC, EDCs and SWPs already devote a great deal of their time to examining ways of improving the competitiveness of British industry. There are a number of other organisations in this field, such as the British Productivity Council. It is doubtful whether any new organisation could contribute very much.

So far as a new campaign on productivity is concerned, the trouble is that it is no good talking in generalities. You

have to get down to nuts and bolts. Neither Governmental productivity campaigns nor bold 'declarations of intent' can by themselves achieve the kind of change in attitudes at plant and workshop level which are required to achieve improvements in productivity; in the last resort only individual managers and workers can do this.

Paragraph 21

Mr Macmillan claims his proposals would offer hope of consensus - better than 'divisive' policies (sic) or 'permanent deflation' (sic).

There is no question of "divisive" policies. Indeed, there is an increasing consensus about the need to face realities and not to try to dodge them by excessive government borrowing and "printing of money". Hopeful signs in the pay field confirm this. Nor is there any question of "permanent deflation". Soundly-based economic growth will emerge as inflation comes down and the demands of the public sector on national resources are reduced. New jobs must be real jobs - not based on limitless subsidy from the taxpayer - if they are to be secure. To talk in pejorative terms of "permanent deflation" implies that there is some feasible alternative. This is a dangerous illusion. The so-called alternatives will only lead to higher inflation and more damage to jobs and output in the longer term.

HAROLD MACMILLAN - INTERVIEWED BY ROBERT MACKENZIE
Transcript from BBC 1, The Way Ahead, 14 October 1980

2
PRIME MINISTER
Have you already got
a copy of this?

INTERVIEWER: Mr MacMillan we last talked on television 18 months ago on your 85th birthday, and then you were deeply concerned about the dangers of Soviet expansionism. I remember you explicitly predicted the invasion of Afghanistan, which did occur of course since. I want a little later to come to that world situation, which again is even more disturbing perhaps than it was then, but first the situation here in Britain - which probably in most people's minds is the most immediate problem of all - a disturbing situation, unemployment headed back to pre-war levels and so on. And throughout the west the economic situation is deteriorating in the 18 months since we talked. Do you think we're drifting towards a permanent recession, even a depression?

MACMILLAN: Well I think it has come on us rather more suddenly than people expected. It began of course, the world recession, in 1974 when the oil prices were suddenly raised. Now people were saying well that's a long way from us, but it isn't. Because what has happened as the result of the rise of the amount of money paid by the oil purchasing states to the oil producing states, most ly Arab, is that there is an enormous sum of money which cannot really be used. The Arab states receive this enormous sum, they put it on deposit at the banks, they have it on short term money - sometimes day to day money, hot money, they buy a few investments of course. But they cannot, in their own countries, they haven't the populations to take it in terms of goods for services, and they have not been able to spend the money. Therefore there's a gap. And this is the classic case, happened before in our history. If the rate of savings,

that is to say the rate at which money is taken out of the market, isn't equalled by the amount of investment, in capital goods, in consumer goods of all kinds, then there's a gap, there's a recession. It is the underlying position, and it's no good talking as people do I see in the papers and in speeches, about the recession as if it was a thunderstorm "oh it'll go away. We'll have fine weather soon". You've got to look to the causes of things, and it's exactly the same as the one in my youth. There's a cause, and the cause in this case is that the rate at which money is taken out of the market doesn't enter back into it in terms of goods. And therefore all through the world, every country, in Britain, France, Germany, all of them, are short of orders. That's what it comes to. Now in addition to the world situation we've got the particular so called British disease.

INTERVIEWER : Now what is the British disease, and how much does it resemble ~~xx~~ the economic problems that you saw first when you entered Parliament in 1924 - and that led to the problems of the 20's and the great depression of the 30's?

MACMILLAN: I think the position of it is that its new form is something rather ~~the~~ post war. Perhaps the result of our too great prosperity at some time. It's really the apparent determination of everybody to take more out of the pot than they're putting in. In other words wages and salaries are at a higher level than has been earned by productivity. Everybody knows it, every Party agrees with it. The last Government for instance preach it, the present Government preach it, but nothing very much is done about it. It isn't really a wage problem it's rather lower compared to Germany and Continental wages. It's because of

the lack of productivity, modern plants and modern methods and modern useage. Now this is the British disease and this has gone on all through.

INTERVIEWER : Overmanning in a sense, that is; insisting upon keeping more people on the assembly line or in a particular job than is justified and then demanding they all get higher wages?

MACMILLAN: Or using old fashioned methods and refusing to adopt new methods because of the quite natural fear of unemployment. We'll come to that later what the answer to it is, but this is the disease as we've all known it. And 3 Governments in turn have tried to appeal to the people, either for a voluntary wage freeze, or for a statutory wage freeze, two Labour Governments, one Conservative Government, all have tried. But this is the real fundamental problem.

INTERVIEWER : You therefore are referring back to Heath, Wilson and Callaghan; Mrs Thatcher came in since our last conversation, a month or two after our last conversation, with a fresh new argument; that monetarism was the answer. That if you controlled the money supply, gradually reduced it year by year till it equalled only the growth in productivity or production, that this would be the answer. Now it came as a shock, what was your reaction to it when she first announced the policies?

MACMILLAN: Well it's now called monetarism, because we had other names before. I suppose you might say David Hume in 1730 or so was the first man to say if the amount of money increases more than the amount of goods the price of goods will rise and vice versa. We've all known it. This is now being elevated into rather a new doctrine as if it were something, almost a dogma. But there's a great deal to be said for it. I think it can help, but it's going to help in the same sort of way that the speedometer helps one to

one to drive a car at the right pace. It doesn't make the car go. It's men and women who make the car go, the car industry go, men and women. And anything like monetarism is just a guide. We've had it of course before. Because when I was - I'm now talking nearly 50 years ago - the great crisis of 1931 - Ramsey Macdonald's Government fell, the National Government was formed. We did all the same things. We said we're spending too much, we had the Geddes' axe just as they're having the cuts on local governments, on education, on social services now. We even put up the bank rate. Do you know what we put it up from - to 6%, those were the days. And it's all the same argument. But the underlying position remained, there was a world deflation. And the right answer to it is not more deflation, it's reflation. Not to make more people out of work, hanging about doing nothing, but to use the sharpened machinery to make more wealth. That's the answer.

INTERVIEWER: Are you then saying that monetarism, whatever its virtues, doesn't begin to get at the root economic problems of the British economy?

MACMILLAN: Today it's even more difficult than in the past because - let me give you the background to the kind of picture that I have in my mind as to what a modern state is; a very primitive state on its first legs is like a pyramid, ~~xx~~ very broad based and a tiny top. Everybody is employed in agriculture or hunting and they only have to support the King or chief or a few medicine men or something, and everybody is working to produce wealth. Then as society develops, and as civilisation develops, it turns into a kind of pillar. On the top there are now kings and courts, there are churches, there are religions, there are arts, there are sciences, they're all that modern civilisation needs. And then now [we've reached

we've reached a point in which it's almost an inverted pyramid. Because the actual producers of wealth, goods that are sold in the market, are now perhaps are now perhaps, at the bottom of the pyramid one man in three or four. And on the top is supported all the great paraphernalia of civilisation, universities, the churches, the schools, arts, literature, everything in which we're proud ...

INTERVIEWER : The service industry is top too?

MACMILLAN: Everything, services industries, everything. But it all depends on the creation of wealth. And this could only have been done because of the invention of the machine. You take the last century; from 1840 to 1900 the prices remained absolutely stable. The price level was the same. Wages and salaries doubled, in other words the standard of living doubled in 60 years of Queen Victoria's reign. Why? Because they invented the machine and used the machine. And now that's the only answer, to create more wealth. And what ~~fix~~ frightens me about this is that the only pressure seems to be not upon the great spending parts of the structure, the local authorities or the national civil service, but upon private enterprise who are at the bottom of the pyramid and support the whole.

INTERVIEWER : Would you indeed say that the only people who've really suffered under the monetary policies of the last 18 months have been the business community and the wealth producers?

MACMILLAN: Yes because they've been keeping the level of interest rates so high, far higher than - one third higher than New York, twice as high as Bonn, twice as high as Paris. It attracts a lot of money here of course, but it makes it extremely difficult for business. It makes you have to borrow a great deal of money and then add the profit to it before you can make a successful business. It's gone very hard. In fact, as I saw the Chancellor say - and he

said truly, that business people ought to refuse to pay more wages and so not have to borrow from the banks. But that'd be all right if he did the same. But in all this year that the Government's been in they've not refused to pay more wages. They found of course when they got there that there were all these machineries for wage fixing, there was Clegg on the one side and there were all kinds of arrangements. And in fact the wages of the Government, and local government, ~~xx~~ have in the public sector risen much more than the private sector. So that the whole pressure is coming up on one part, and unhappily upon the part that sustains the whole.

INTERVIEWER : What do you think accounts for that curious error? Really you're saying that the Government has allowed public spending on salaries in the public sector to more or less keep up with inflation and put all the pressure on private industry which has had to release people in such large numbers into unemployment. What accounts for that?

MACMILLAN: Well because they've got to face very strong forces. If you want to have a row in this country, if you're determined to make everything unworkable, of course you can do it. You can only work it if people want to work it. When the Chancellor says to me, as a businessman, all right I'm not to pay so much wages or I can't borrow from the banks, what will he do when the miners go on strike, what will he do when the trains don't run, what 'll we do when the tractors, when the motor car drivers don't run, when the electric light goes out We've all got forces that will all ruin each other if we want to. So in the end he hasn't really got the power. He has no more power than I had, or any of us have, which is to try and to

persuade people to behave reasonably.

INTERVIEWER : But do you think there's a sense in ~~xx~~ which the Government has been slow to come around to persuasion, in other words, and I've followed the economic theories lying behind monetarism closely - there was an early argument that you just let everything else take care of itself. If you got the money supply right then you needn't argue with the unions or anybody else because the logic of control of the money supply would carry the day?

MACMILLAN : That's perfectly good logic. That was the logic on which poor Sir Charles Villiers was treated with some scorn because he asked for £400 million to keep Britain's steel industry going. But his successor, who is a man of rather immense knowledge and experience, has asked for exactly the the same amount of money. And the Government must either shut up the steel industry or give it. So it's in the position of a banker. Of course it could refuse the client, just as the bank can refuse a small private business. But can it dare shut up the railways? does it dare shut up the steel industry? of course not.

INTERVIEWER : Now in a way it could be argued that this Government, which is a direct successor to your own Government of the late 50's, early 60's, Conservative Government, is being forced to recognise truths that you took as self evident? As you know, some say that the present Government is determined to repudiate Macmillan/Butler Conservatism, arguing that that was too paternalistic, too willing to pay out public money, and all that kind of thing. Do you think they are being, in a sense, forced to re-examine their assumptions and come back to something not unlike your own version of Conservative policy?

the whole world's in this position. The war going on now in the Gulf will make it worse because almost certainly the price of oil will go up making the gap bigger. Oil won't be needed because of the terrible state of business all over the world. I saw a little chart from monetary policy that there was a slight fall in the last month in the money supply, but how much more has there been in the employment supply. How much more in the production of wealth? You could get a fall on both sides. I remember the old word they used in the 30's used to be 'equilibrium'. The theory was that if the forces of production and the forces of demand were equal everything would be all right, there would be equilibrium. And I remember at the end of some argument Maynard Keynes saying this, yes but of course the best equilibrium is to be dead, then the forces of demand and the forces of supply are exactly equal. And you can get equilibrium at a very low level, this is the danger. We've got to go through this stage, but we've got to aim at getting out of the desert. Were like the poor children of Israel wandering ~~about~~ about in the desert, 40 years they wandered under Moses - who must have been rather a dilatory man I think. I ~~am in no doubt about the fair division of manna~~ arguing no doubt about the fair division of manna. And there was the promised land over the hill. It's there for us, and perhaps that's why I might try and tell ~~what~~ what I feel about it.

INTERVIEWER : Well now it does raise a fair question because you came through the great depression, and indeed played a major part in the stimulation of new ideas by your support of Keynes and so on. And there's a great cloud passed over Keynes in these days, he has got to be totally out of date. On reflection; how do you see us moving out of the present economic disasters?

MACMILLAN: Well I don't know, and it would be impertinent for me to say. But I myself feel that you must never be tied to a dogma. If it's a piece of mechanism, if it's a principle, that's different. But if it's mechanism, what's bank rate, what are all these things, they're just mechanisms to use. I remember once a fellow got up in the House of Commons and said to me the Prime Minister (that was me) seems to think you ought to drive the economy sometimes on the brake and sometimes on the accelerator. To which I replied: well I don't see how else you do drive a car in a crowded street. You've got to be pragmatic and see how it goes. But you've got to realise that the underlying situation in Europe, and in Britain - apart from this temporary problem of the wage inflation - the underlying one is of recession. And the only future, as it was in '31, is a form of reflation, pouring more wealth - not keeping factories idle, not keeping more and more men idle - but using the wealth that we have, using it in modern methods of course, but using it.

INTERVIEWER : Now some people say reflation, which is the word you used, is the great danger, that it would stimulate this degree of inflation we have - which is one of the highest in the western world if not the highest - and this is the line of great danger if we reflate, that is encourage expansion and so on. Can we do it without restimulating inflation?

MACMILLAN: I think it would be fatal for us suddenly, I agreed with the Prime Minister, for us suddenly to make a turn. You can't do that, you've got to have a plan. And perhaps we could come in a moment or two to where I see the world and Britain might have a plan - in which we could get the advantages of expansion without its dangers, that's what we want to get. But meanwhile we've got to face it, the

MACMILLAN: Well only two ways. We talked about 1931 - a long time ago for most of the people who're wanting to hear what you and I have to say - but it led fairly quickly to 1935/39. And what worries me almost more than the parallel of 1931, but I think we shall get out of it - we'll do something here, is the other - as you said, since we spoke last the power of the West has fallen, the power of the United States has fallen. The actual forward movement of the - I don't call it the Communists, it's the Russians, esp[er]sion. It has been going on ever since Peter the Great, Alexander, Catharine, all through history it has gone on. As I told you then Afghanistan would be taken. I remember on that day a fellow rang me up from one of the newspapers and said why do you think the Russians have gone into Afghanistan? So I said well I suppose they've gone for the winter sports. which he seemd to think was a good answer. But I said have you ever been to Clapham Junction. He said no. I said well nobody wants to really sit on that station. You went there in the old days because you could go either south to the sea at Brighton, London-Brighton, or London-south-east, it was a junction. If you've got Afghanistan you command India, which is now indefensible as partitioned, and you command Iran, you can go south east or south west. You can get to the Indian Sea. You have got Clapham Junction. You may have some difficulty, and they are having difficulty I can see in getting hold of it and getting it under control. But that is its purpose. It's not just to sit there
And then there started the war in the Gulf, of which we can not be the beneficiaries, the West,, but who else can be. Two colonies in Africa held by Cubans. This is what I pointed out last time, the Horn of Africa, there's Aden we've lost. All these pieces I read about the Gulf, I remeber these islands, Bahran and Shaja.

INTERVIEWER : As Prime Minister, you kept them ?

MACMILLAN : We had troops there, I sent them up to help the Kuwaitis. So ~~xx~~ it's growing all the time and nobody ~~xx~~ notices, we've got accustomed to it. People talked to Churchill, but remember about Churchill that nobody listened to him. It was only when the war came and we very nearly got into a hopeless position that he was sent for. Nobody seems to listen to it, the American powers No I don't want a war with the Soviets, of course not, but it will happen if we weaken. With Khrushchev I remember discussing all this. And he invented I think the very phrase, it was called co-existence, we could exist side by side. But only exist if we're both equally powerful. If one weakens then the temptation's too great. We can exist but ~~xx~~ we have weakened. And Europe, which always seems to me to look too much to America. America's a great nation but in western Europe, in our unity in western Europe, in the Community, we have a greater population, more people more wealth, more pluck, more resources than the whole of the United States. Oughtn't we to be doing a little more, why should we depend on them entirely? We ought to be playing our part and there ought now to be - there are many weak armaments - there ought to be a big rearmament programme, which incidentally would do quite a lot of good for some empty shipyards and some empty steelworks.

INTERVIEWER : So on that point you would endorse the Government's policy of increasing British military contribution to the West?

MACMILLAN : Yes, and it ought to be much more, and we ought to take the lead with the West. Instead of going to the United States. And not saying we're hanging behind your skirts but we're partners with you, we're equal with you in strength and power, let us sit down together and see how we can make ourselves so powerful and so strong that then co-existence follows equally an economic crisis in communism as there is in ~~xx~~ capitalism

Co-existence might even turn into co-operation: *With* two people of equal strength and equal determination and equal will.

INTERVIEWER : Turning back to the specific economic problems of Britain, and I strongly sense that you don't feel the Government has got it right yet with its obsessive concern with monetarism, what ought to be the approach to try and get us out of what could ~~xxx~~ turn into a fairly ugly economic situation headed perhaps for 2½ - 3 million unemployment?

MACMILLAN : Well I'm not criticising the Government, I think they didn't realise that they've got it the wrong way round. If you are going to first do it by saving, by what I call the Geddes' axe again, you ought to start it on the local authorities on the Government's side of of functions and not on the poor private enterprise. And I don't think they realised that they have so few powers. So that in a way they've spent the year hitting the wrong head. On this plan this is the only thing to do.

INTERVIEWER : To deflate?

MACMILLAN : Of course it is. But it isn't the way out, it's just to try and hold the position for the moment.

INTERVIEWER : What's the way out?

MACMILLAN : Well these are dreams, they're old men's dreams ~~xxxxxx~~ and old men dream dreams of course, but they're the dreams that I have dreamt from the time the first war ended and the 40 years I sat in the House of Commons and the long years I was a Minister. They're a bit out of fashion on both sides. Both sides now seem to want confrontation at home, not abroad. Do you notice how the people who are so terribly pacifist overseas are all militants at home, have you noticed that. They want to have a row, they want a fight. Well I don't think you can do that in this country. You've got to get

people, different parties, different Governments, to have a reasonable degree of agreement of where we're going. And look where we could go. I talked about the desert. The new industrial revolution, it's all around us. We all know it, the technological, the technical, a completely new world within 10 years will be created. And look what it does to people. Of course the Luddites resisted the first industrial revolution when they brought in the power looms and put all the private looms out of business. What did they go on?

INTERVIEWER : Smashed them?

MACMILLAN: Yes but what did the poor people go on, they only went onto the poor laws. We can't do it that way. We can't bring about this revolution in the old way of hardship. We've got to do it by consent. Now supposing people, let's say the national bodies of industries and leaders of trade unions, why can't industry and the unions sit down and say boys it's there, it's waiting for us. If we'll get together, industry by industry, plant by plant, take the new technology, it will end up I think much nearer not 3, 8 hour shifts but much nearer 4, 6 hour shifts; and perhaps eventually 6-4hr shifts, when these things really begin to work. Sit down and work out what we can do, what we can make of it. Not be right behind the Germans but right ahead of them, not right behind the Japanese but ahead of them. We can do it.

INTERVIEWER : But surely the trouble is that the relationships between industry; and management on the one hand and unions on the other are less good than they were and Government is more at arms length with the unions, and indeed with industry in many cases, than in a very long time. I mean you present the possibility but surely the reality is deeply disturbing?

MACMILLAN: Well it's because they don't get together. They have got to get together. They got all to admit that they've made some mistakes themselves. In fact, they're not as far apart when you get down to be particular works as they are at the top. They fight at the top in their conferences and all that, they're much nearer together when you come to the shop floor. But they've got to make an offer. I would have thought you could do it. Jim Callaghan called this himself, a sort of new social contract. If they would stay put for a couple of years, with wages and salaries more or less as they are, and make this great effort. But with the clear understanding who is going to benefit. The benefits should be squared, high wages, short hours. And more than that, I think we've got to move into some new concept. Why can't we set up an industrial parliament, as Churchill always wanted to do and used to talk to me about. Do you think an industrial parliament would ever stand the nonsense we've been having about how to finish a great factory like the Isle of Grain's for two years? Of course not, it would be blown out of the air. Let them do the work themselves, everybody take part. Let us create a new concept of the co-operation of industry and trade unions, and workmen and masters as they used to call them, I call them employers employees, but they're all the same. They're in the same regiment. They would be welcome, a new deal, call it what you like, in which everybody got a fair share of the profits when they came and benefits when they're realised and knowing quite well that that's part of their history. I am of course an old man, and I have many memories: it's 66 ~~so~~ years ago since the first war began, it's 40 years since Churchill after all his ~~xx~~ warnings was elected by both Parties was called to a position almost hopeless. And what did we do then? We got together, we formed the National Government. It was Ernie Bevin and Churchill and all of us, Herbert Morrison, all of them,

We don't care if they were Labour, Socialist, Liberal, Conservative and we saved the nation and we saved the world. It's not quite as as that but it's getting towards it. Now what are we going to have? First, unnecessary suffering, heavy unemployment - of course better looked after than in the bad days I'll say that, but there's still a very heavy charge on everyone on working - a gradual decay, a slide down. That's at best. At the worst Britain for the first time in its long and splendid story taking no part in the defence of freedom of the world. I can't believe it. It can't happen that way. Now you may say I've talked only of these material things, wages and money, in life - unless you of course go entirely out of life altogether - one has to live both. There's the practical side of life and the spiritual side. The material and the idealistic. Doesn't this appeal to both. Isn't unity and common sense and friendship good in itself. And isn't the defence of the freedom of the world something to work for that is spiritual too. Just before these last papers filled with the war in the Gulf, and our conferences here, there was the whole country deeply moved I thought, I felt, by the Polish story. Here were these ancient people, 3 times partitioned, and again seized by a hostile power, hardly able to make a bit of a struggle for freedom, but determined to do what they could. I don't know whether you saw it sir, but there was a picture which was in all the papers which struck me deeply. They were setting out on a very difficult task, if they went too far one way the Russian tanks would be on them, if they didn't go far enough they wouldn't get any of the freedom they wanted for their trade unions and their rights to free speech and all the rest. They were on a pretty difficult job. And there was a picture of them, not hundreds, thousands, tens of thousands of people on their knees. Perhaps in their spirit they might try and face what we've got to face in the next few years.

From

THE CHAIRMAN OF THE PARTY

The Rt. Hon. The Lord Thorneycroft C.H.

PT/SOB

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12th September 1980

To/...

THE PRIME MINISTER

I have prepared the attached note
on Harold Macmillan's memo. I have sent it, naturally,
to no-one but yourself.

A handwritten signature consisting of a large, stylized capital letter 'T' with a horizontal top bar that curves slightly to the right. A small period follows the vertical stem of the 'T'.

I have read Harold's memo. While there is much in it that is true and valuable, the total effect of the argument put in the way in which it is, and coming from the quarter which it does, will in my judgement do damage to the Prime Minister's position.

This would be the greater pity since I do not believe that Harold Macmillan's views do indeed vary sharply from those being presented by the Prime Minister. Both recognise the imbalance caused by OPEC; both want to find a way out of the dilemma of how to expand without sending inflation through the roof; both recognise the desirability of getting interest rates down; both realise the rigidities of the administrative strictures which have been created and imposed upon the productive or market sector; both acknowledge, and the Prime Minister has taken a leading part in arguing, the vital need to stress the 'productivity' factor in finding a solution. With so much in common it seems unwise to launch an argument which, as presented here, will be represented by the media as a theme barely distinguishable from Mr. Callaghan in its pressure for reflation and increased expenditure which sounds as though the money supply were an irrelevance, that no steps taken by the Government are likely to temper inflation, and that industry is unlikely to survive the medicine at present being administered.

I don't think Harold Macmillan means this but he will most certainly be represented as saying it. The doubts and cautionary notes that he quite properly inserts will be ignored; the similarity with the arguments of the Left will be stressed; the term consensus will be twisted from the Tory democracy theme of one nation to a compromise of principal and abandonment of purpose.

My conclusion is that he should, if possible, be stopped from saying it. We should consider how best to secure this. Could we ask him to lunch to discuss the memo? In the meantime the Prime Minister might find some opportunity of forestalling some aspects of his initiative e.g. by opening up again the argument on 'productivity' and its relation to solving the dilemma of how to expand activity without maximising inflation.