

PRIME MINISTER

cc Mr Ingham

Mr Powell

RESIGNATION OF MR LAWSON

Mr Gray

Although Mr Lawson's explanation for his resignation may appear to be a direct attack on you, I believe that it is possible to turn it to advantage. There are signs that a more favourable interpretation of events is emerging e.g. today's Daily Mail and the Leader in The Times. Also market reaction is increasingly seeing Mr Lawson's departure as a boon.

I believe the correct interpretation of events is that at the end of 1985 Mr Lawson and Sir Geoffrey Howe made a pitch for sterling to join the EMS. They failed to persuade you but Mr Lawson then sought to get into the EMS via the back door.

This failed for two reasons. First, his timing was poor. He genuinely believed that pegging to a low inflation currency would ensure, taking one year with another, that policy in this country was kept tight. But he happened to choose a moment when sterling was recovering after a long decline against the DM.

Secondly, and more fundamentally, he failed his own test for a successful policy framework. He argued that a country such as Britain could run an independent monetary policy with a flexible exchange rate; or it could fix its exchange rate to a low inflation country, with monetary policy directed to sustaining that link; but not hybrid. But he did precisely that.

Because he did not disclose his exchange rate regime he incurred all the costs of trying to link to another currency without any of the advantages of being in a structured system. For example, if we had been in the EMS in 1988 it is possible that there could have been a small revaluation, say from DM3.00 to DM3.10. That, in my view, would have ended speculation about a further move as the market would have regarded this as most unlikely in the foreseeable

future. In fact, pressures took sterling to DM3.28 and in seeking to resist it we reduced interest rates to levels which were quite inappropriate. (It was this rather than intervention which did the damage as most of the intervention was sterilised.) The Chancellor has also failed another of his own criteria. He endorses the principle that differences should be resolved either in private or collectively but his shadowing of the DM was neither.

The Times Leader attached says that:

"There has been no major dispute over policy but merely honourable disagreement about emphasis on one part of it."

Three points follow from this:

- it is nothing to do with your present style or the role of advisers but relates to a difference of view about the timing of our entry into the ERM
- it has proved that dismissing your adviser would not have achieved anything as the disagreement would have remained
- it was the Chancellor who withdrew support for the policy position agreed, not you. If he wants to join the "EMS as soon as possible" camp that is his privilege, and he had done the right thing by resigning, but it is he who is departing from the agreement reached at Madrid.

On the line to take, I suggest that you do not highlight the historic origins of this dispute as there is no advantage in publishing the policy errors that it produced. It is more important to stress that there is an agreed position between you and the new Chancellor and Foreign Secretary, and that the conditions set out are not attempts to raise the bar to a height

which cannot be jumped but a genuine concern that when we join we do so successfully. We need to remind people that sterling has entered a European exchange rate regime before and has had to leave. We need to get across that the removal of exchange controls will be a major challenge which France and Italy need to negotiate successfully if the expanded ERM is to be launched in favourable conditions. For example, Italians are large scale savers, most of which is channelled into Government debt. If they are given the choice of financial assets across the world the Italian Government's monopoly will be broken, which could cause a major rethink about their fiscal policy.

Mr Baker is anxious to put across the view that there has been no major difference between you and the Chancellor. I see no point in trying to disguise this - the effort should be to stress the consistency of your position and the validity of the conditions you have set.

AT

Andrew Turnbull

1 November 1989

c: Lawson (MJ)



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PANIC OVER

The Conservative Party has understandably been deeply disturbed by the crisis in the personal-political relationship between the Prime Minister and Mr Nigel Lawson, which led to the latter's resignation as Chancellor of the Exchequer. Though, as the recovery in financial markets has demonstrated, there is, and has been, no economic or financial crisis, and though no serious question has been raised about the broad lines of the Government's economic policy, the evidence of a significant disagreement between the Prime Minister and the former Chancellor over the British commitment to eventual membership of the ERM (exchange-rate mechanism) was serious enough to shake confidence in ministerial solidarity.

Mr Lawson was fully supportive of the Prime Minister and Cabinet in general terms yesterday, but he left no room for any doubt that the disagreement between himself and Mrs Thatcher had been a real one. Prime Ministers, he said, must appoint ministers they trust and differences between them should be resolved privately.

By implication he made it clear that he did not consider that these conditions had been fulfilled in his recent relationship with Mrs Thatcher. He also described the recent article by Sir Alan Walters which denigrated the ERM as only "the tip of a singularly ill-concealed iceberg," which left the Commons to make up their own minds about how far Mr Lawson considered the base of that iceberg to be largely Sir Alan's broader influence and how far it comprised Mrs Thatcher's own wish to put a brake on British membership of the ERM.

But it is now clear that a synthesis has been reached between the apparently different positions held by the Prime Minister on the one hand and other Cabinet ministers who are nearer to the position Mr Lawson has held. The clear commitment to that synthesis was

perhaps the main point of Mr John Major's first speech to the Commons yesterday as Chancellor.

Over the weekend, Sir Geoffrey Howe had made a speech declaring that the Government must be seen to be acting in good faith in implementing the Madrid agreement and the commitment to enter the ERM. Mrs Thatcher, on the other hand, had so heavily stressed the conditions and the difficulties other member states might have in fulfilling them as to leave doubt about how far she was hoping they would not be fulfilled.

Mr Major, however, united these positions by both endorsing the conditions which Mrs Thatcher had enumerated and at the same time declaring unambiguously that Britain will join: "The question is not whether but when." That is henceforth the Government's position.

Whether Mr Major's enumeration of the conditions will satisfy Mr Lawson's criterion that we should seek membership at the earliest date remains to be seen. But it is a synthesis on which government policy can unite and on this assumption, the Conservative Party should now put behind them the temptation to panic to which some backbenchers have yielded, particularly in respect of the leadership, in recent days.

It is worth repeating again; there has been no major dispute over policy but merely an honourable disagreement about emphasis on one part of it. The party's backbenchers have no cause for timorous pessimism. Mr Major has made it clear that the Government's policies will continue and Mr Lawson has declared his confidence that they will lead to a fourth election victory under Mrs Thatcher. Tory backbenchers should respond accordingly and accept that now the drama is over, they should put the agitation of the last few days well behind them.

SUMMITRY AFLOAT

Yesterday's unexpected announcement that President Bush and President Gorbachov are to meet in the Mediterranean at the beginning of December was presented by spokesmen for both countries as little more than a familiarization exercise from which no agreements could be expected. The decision, reportedly initiated by Mr Bush, to bring the first superpower summit of his presidency forward by half a year will none the less raise hopes about what might be achieved.

leadership to stay in power, and at what cost? The Soviet leader would like an answer as he prepares for the next Communist Party Congress which is set to address such fundamental principles as private ownership and the role of the party.

President Bush and his advisers should be alert not only to the possibilities, but also to the pitfalls, of so hastily arranged a meeting. They might cast their minds back to the last summit called at short notice in 1987.

Getting to grips with 'hacking'

From the Chief Executive
Sir, Your leading article (26) states that the Gov may be reconsidering the of implementing the La mission's recommendati computer-misuse legislati

In my opinion delay issue would be most serio UK IT (information tech industry and its custom investing heavily in cc security and it would be mistake if hackers and writers were permitted to c to attack our systems at w in ways which cost industr

Society is increasingly dent on complex comput tems and networks. The U not fall further behind countries in making del misuse of them illegal. T Commission's report deal vincingly with all the arg and recommended specific tion. Judging by what ou tomers are telling us, UK in attaches a high priority to on this issue.

Yours sincerely,
A. B. CLEAVER, Chief Exe
IBM United Kingdom Ltd.
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October 26.

From Mr Eddy Peers
Sir, Your report (October the strident concern by le industrialists at the possibi the Government dropping the hacking-legislation highlight shareholders now need to directors questions about their companies are run. questions should address th tent of the hacking problem whether the industrialists' ca concern is a direct result of experience. Furthermore, ho these companies intend to pr their systems in the future?

Whilst anti-hacking legis might raise public awarene the problem, industrialists' cerns demonstrate that the already sufficient business v ness. Parliament should be u to pass legislation which w force companies to disclose losses they had suffered thr computer abuse and make corporate responsibility to computer-held information se from unauthorised use, modi