

**NATIONAL ARCHIVES**

**IRELAND**



<b>Reference Code:</b>	2011/127/1089
<b>Creation Date(s):</b>	24 October 1981
<b>Extent and medium:</b>	7 pages
<b>Creator(s):</b>	Department of the Taoiseach
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URGENT & CONFIDENTIAL

24th October 1981

Dear Assistant Secretary

In preparation for the forthcoming meeting of the Taoiseach with the Prime Minister in London, the Department may wish to have an analysis of the current political situation in Britain, with particular reference to the factors which influence British Northern Ireland policy. You would also, in this connection, wish us to try to assess the present

3. Analysis of current political situation in Britain  
by Ambassador Kennedy.  
of recent events.

2. In analysing the current political situation may I mention four recent, inter-related factors which, taken together, sum up what is happening. They are: (i) the Conservative Conference in Blackpool from 13 - 16 October, (ii) the current economic outlook which is the lodestar of the future political situation, (iii) this week's Croydon by-election and the challenge from the Centre, and (iv) the consequent pressures within the Tory party on Mrs Thatcher and her controversial policies. Together these inter-related factors will help us to anticipate the likely frame of mind of the Prime Minister when the two leaders meet.



IRISH EMBASSY, LONDON.

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3. (i) Superficially, the Conservative Conference seemed like a victory for Mrs Thatcher. She was rapturously received by the rank and file of her party activists and her emotional closing speech on the Friday was directed down on the floor towards them. They rose to the occasion with tumultuous applause. But the opportunity was lost by

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has not been arrested and the Government's Medium Term  
the Prime Minister to reach out to two far more important  
elements in her nationwide audience. One was the  
Conservative Government and MPs behind her on the stage,  
many of whom now have to face certain defeat if she refuses  
to modify her economic policies. And the other was the  
great British electorate beyond the Winter Gardens who  
were given no hope of change. She would not change, she  
said, "just to court popularity". "There Is No Alternative".  
(TINA, in code), was her watchword. Tragically, for Margaret  
it was the wrong speech.

4. (ii) For the hard truth of the matter is that an  
increasingly vocal number of influential Tory MPs are  
insisting that there is an alternative and are calling out  
for change. In a word, they want reflation. For what has  
happened to Mrs Thatcher is that her timetable has been  
proved disastrously wrong. She had hoped that half-way  
through her first Parliament the bitter economic medicine  
would begin to succeed and that in the run-up to the next  
election the tough measures of the first two years would be  
justified. How can she hope for this now? Unemployment  
has doubled since the Tories took over. It will pass 3  
million in the next few months when school leavers are  
included, and then rise to  $3\frac{1}{2}$  million next summer and to just  
under 4 million in 1983. It will stay there on present  
trends for two more years. Output will fall two percent  
next year before levelling out but it is now virtually certain  
that at no point before the next election will it be as high  
as it was during Jim Callaghan's harrowing winter of disconter  
in 1978-79. Meanwhile 20 per cent of British manufacturing  
industry has been sacrificed and more will be lost in the  
coming year. Public expenditure is higher than when the  
Government took power, as is the rate of increase in the money  
supply. Indeed, inflation is expected to increase to 14  
per cent next year as the effects of sterling's recent  
devaluation come through. Sadly, Mrs Thatcher's monetarist  
advisers got the timing wrong. Instead of unemployment  
leading to a reduction in demand and prices it has led to a  
tragic reduction in output. The upward thrust in prices

has not been arrested and the Government's Medium Term Financial Strategy is now seen to be wrecking the economy. Its economic policies have become the recruiting sergeant for the Liberal-SDP Alliance.

5. (iii) Certainly this week's by-election victory by the Alliance in Croydon has delivered a punishing blow to the Government. Coming as it does after Roy Jenkins' surprising showing in Warrington in July, when the Conservative was beaten into third place and ignominiously lost his deposit, the loss of Croydon by the Government is seen now as representing a dangerous trend across the country. The swing was, indeed, extraordinary. The Alliance gained 30% and the Conservatives and Labour lost 19% and 14% respectively. Bill Pitt, the victor, will bring Liberal strength up to 12 MPs and the SDPs now have 21 (of whom 20 were elected as Labour candidates and one as a Conservative). Suddenly it's the gang of 33. The Government's majority is still at a comfortable 34 but David Steel was probably right to say "We are now unstoppable". He pointed out that neither of the two main parties would be able to argue from now on that a vote for the Alliance would favour their opponents. "They have both suffered almost equally. We have taken votes from both sides". This is true. Although the actual defections in the House have almost all come from Labour, the Conservative party is suffering seriously at the polls from the rising tide of economic discontent. Indeed, it is beginning to look, if present trends continue, as if the Alliance could even win the next election outright. "Breaking the mould" is already a tired political cliché here but it is fully justified. With the polarisation of left and right, the centre ground is filling up with Alliance strength. The skilled worker, the backbone of Labour influence, is moving solidly into the Alliance.

6. (iv) The importance of Croydon this week for Mrs Thatcher and her supporters in the Government is that it has greatly increased the pressures for change which one clearly sensed in Blackpool. In her winding-up speech at the Conference

she had a golden opportunity to appeal for reconciliation and unity to her party MPs and to the nation's electors beyond the fringe. But she lost it. Can she still hold out against needed change within the party - against Francis Pym, the Leader of the House of Commons, Peter Walker in Agriculture, Jim Prior in Northern Ireland, Michael Heseltine in Environment, not to mention Ian Gilmour the former Lord Privy Seal, St John-Stevas, Edward Heath and Geoffrey Rippon? Even Willy Whitelaw? As she comes back from Cancún this weekend she faces new public opinion polls which give Shirley Williams a real chance to win Conservative Crosby for the SDP (probably in the New Year), overturning a massive Conservative majority north of Liverpool, pushing Labour into third place and reinforcing the claim that the Alliance could now challenge the two main parties in almost any seat in the country. It was late in July that Mrs Thatcher decided to reshuffle her Cabinet because she wasn't getting support on deep expenditure cuts needed this autumn. Now she faces the same issue again, but she has been weakened in the meantime and may be unable to gain Cabinet support for the controversial five billion pounds in cuts she wants. Already we hear rumours that Geoffrey Rippon might even challenge her leadership early in November, not in the hope of succeeding but of mustering around 50 Tory MPs to show their strength in opposition to current deflationary policies.

7. Against this unsettling background we can try to assess the present state of mind of the Prime Minister, especially in relation to Northern Ireland. Perhaps we should begin by saying that she is now much more vulnerable than when she met the former Taoiseach in December last. We have to bear in mind that what she would regard as concessions to our point of view may only add to her problems within the party, and to violent reaction in Northern Ireland. The last thing she would want is a political burden in Northern Ireland added to her economic problems at home. Since she is under attack from her left in Westminster she will wish to keep her right intact. When I lunched this week with her

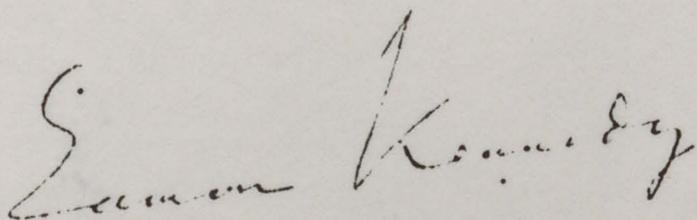
Parliamentary Private Secretary, Ian Gow MP, he spoke of a constructive, but low-profile meeting of the two leaders. Early November will be a sensitive time for her, especially if the threat from Geoffrey Rippon materialises.

8. And there are a number of positive factors to encourage a constructive meeting between the two leaders. The H-Block hunger strikes, which overshadowed Anglo-Irish relations since Christmas last, have come to an uneasy close and made it possible for the two Prime Ministers to meet in a friendly atmosphere. Secondly, the policies recently developed by our Government, especially those relating to the revision of the Constitution to make it more acceptable to the Northern majority, have met with a most encouraging reception here among the general public, in the press and in the Government. There is also great interest in the possibility of all-Ireland courts as a way around the damaging question of extradition. If it were possible, in addition, to find a solution to the problem of voting rights for British residents in Ireland and to developing a North-South, East-West approach on energy problems, the coming meeting could be most constructive. Thirdly, the succession of Jim Prior to Humphrey Atkins has brought a whole new team of ministers into the NI Office with fresh ideas, a sense of urgency, and solid political clout. Interestingly, they are in the main rather to the left of Humphrey Atkins' team in terms of conservative ideology.

9. The impression which he and his team give us over here is one of determination to encourage political movement again in N. Ireland and a realisation that violence is a direct result of political frustration. The debate at Blackpool on Northern Ireland was the first for five years. Prior may not call it power-sharing, but what he seems to be after is an agreed administration in which both communities can play a useful and constructive role and in which the minority would have built-in safeguards. When I spoke to the Anglo-Irish Parliamentary Group in the Commons earlier this week I was particularly interested in the ideas of Dr Brian

Mawhinney MP, who is quite close to Jim Prior. He advocated an elected assembly which would have powers transferred to it progressively in accordance with the decisions of an agreed majority in order to ensure that the Unionist community would need the support of the minority if devolved government were to be a reality. Mawhinney was making the point that you don't have to have a Sunningdale rerun in order to give the minority a role in Government. You don't even have to call it power-sharing. It's not beyond the wit of man to find a way in which the two communities can work together provided the will is there. I would say that this is Prior's view too.

10. It may well be that when the Prime Minister and the Taoiseach meet next month they will not wish to go into these details at the present stage of their prise de contact. But what we can say from here is that there is a growing feeling in every party that the days of the open-ended guarantee to the majority are coming to an end. Britain annually moves massive resources to Northern Ireland to keep that area on its feet, politically, economically and militarily. In return the British tax-payer wants the two communities to work in peace. There is a growing reluctance to subsidise the kind of intransigence which Humphrey Atkins has had to take from the Unionists since 1979 and which, because it has frustrated political movement, has only encouraged sectarian violence.



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