CHANCELLOR OF THE EXCHEQUER

cc Financial Secretary
Sir Douglas Wass
Sir Kenneth Couzens
Mr Barratt
Mr Jordan-Moss
Mrs Hedley-Miller
Mr Hodges
Mr McMahon) B of E
Mr Dawkins)
Mr Ryrie - UKTSD

EXCHANGE CONTROL PACKAGE: MEETING WITH US AMBASSADOR

On the assumption that the US Ambassador is free to call on you tomorrow morning so that you can hand him your letter to Mr Blumenthal, I would suggest that you made the following points:-

(i) So far as direct investment is concerned, the package is entirely without discrimination: we are now permitting unlimited official exchange for direct investment world-wide.

(ii) Another major element in the package is permission to repay with official exchange foreign currency borrowing taken to finance outward portfolio investment up to one year ago. This again is quite without discrimination.

(iii) In the case of new outward portfolio investment, the Government decided that it would be unwise to relax controls entirely at this stage. Having settled on a gradual relaxation, they were faced with the problem of defining a class of securities which could be decontrolled. Denomination in a particular currency is an unambiguous way of identifying such a class of securities and is therefore a sound administrative basis for a partial relaxation of controls. In view of our Treaty obligations, it seemed right to make the relaxation in the first instance for securities denominated in EEC currencies.

(iv) But that partial relaxation is intended as a temporary measure consistent with our step-by-step approach. The Government's objective remains complete liberalisation of portfolio investment worldwide.

(v) The Government hopes that it will not be long before this objective can be achieved; but the actual timing must obviously depend on events in the foreign exchange markets which cannot be predicted with any confidence.

(vi) In the meantime UK residents will continue to be able to invest in dollar securities if they finance their purchases with investment currency or foreign currency loans. So far as the former is concerned, the premium is far lower than it used to be - under 10% recently compared with almost 50% as recently as February this year. There is thus much less of a deterrent now than there was before the Government took office.

(vii) We hope that the US authorities will welcome our decision to allow official exchange for investment in the quoted bonds of international organisations of which the United Kingdom is a member. The institutions affected include the World Bank, the Inter-American Development Bank and the Carribean Development Bank.

D.H.

D J S HANCOCK
17 July 1979

CONFIDENTIAL

Chancellor

3

PRINCIPAL PRIVATE SECRETARY

17/7

cc PS/Chief Secretary
PS/Financial Secretary
Sir Kenneth Couzens
Mr Hancock
Mr McIntyre
Mr Fitchew UKRep, Brussels
Mr Spreckley - FCO/EID(I)

EXCHANGE CONTROL: LETTER TO THE COMMISSION

Mr Fitchew (UKRep) has today suggested a drafting change in the final sentence of the draft letter to M. Ortoli submitted to the Chancellor by Mr McIntyre on 13 July. He thinks, and I agree, that it would be presentationally better for that sentence about confidentiality to be more direct and to read as follows:

> "I know that the Commission always shows great discretion in these sensitive matters and I should be grateful if on this occasion you would treat the information above as confidential until after the time of the announcement, as any advance leaks could be unsettling for the markets."

2. If it is confirmed that the announcement can be made by Written Answer tomorrow, we need to let Mr Fitchew know as soon as possible after lunch if the draft letter, as revised above, has been approved by the Chancellor so that a copy can be given by this evening to the cabinet of M. Ortoli, who is now himself in Strasbourg; and it would be helpful if the signed letter could go in tonight's bag to UKRep.

C H W HODGES
17 July 1979

CONFIDENTIAL

Exc/36/04

4

cc PS/Chief Secretary
PS/Financial Secretary
Sir Douglas Wass
Sir Kenneth Couzens
Mr. Barratt
Mr. Hancock
Mr. Ilett
Mr. McIntyre
Mr. Dyer
Mr. Dawkins - B of E

MR. HODGES 17/vii

EXCHANGE CONTROL: PQ AND WRITTEN ANSWER FOR 18 JULY

We discussed the draft Written Answer attached to your minute of 15 July. The Chancellor has agreed the draft PQ. In place of the first three sentences of the answer, he would like to say "In my Budget Statement, I announced my intention to take further steps, as circumstances allowed, in the progressive dismantling of exchange control." At the end, you and I agreed that the last sentence would be replaced by "Further details are available in the Vote Office".

2. For the record, this last sentence reflected on the one hand the Chancellor's wish not to imply that details were available to the Press before they were brought to the attentic of the House; and on the other, the Bank of England's reluctan to give the wealth of detail necessary in an exchange control notice to the House (and by implication the Press) before they were available to the banks, and not to place themselves in the position of having to notify the House before they issue exchang control notices to the banks.

MAH

M. A. HALL
17 July 1979

CONFIDENTIAL

PRINCIPAL PRIVATE SECRETARY

cc PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State -
PS/Minister of State -
Sir Douglas Wass
Sir Kenneth Couzens
Mr Barratt
Mr Bridgeman
Mr Dixon
Mr Middleton
Mr Unwin
Mr P G Davies
Mr Gill
Mr Hodges
Mrs Lomax
Mr Ilett
Mr McIntyre
Mr Ridley
Mr Cropper
Mr Cardona
Mr Dawkins) B of E
Mr Sangster)

REASONS WHY EXCHANGE CONTROL CANNOT BE ABOLISHED OVERNIGHT

As background briefing for the exchange control package announcement tomorrow I am circulating with this minute a brief note which explains why a good deal more technical work needs to be done before we could implement a further step in the relaxation of exchange controls going beyond tomorrow's package. As explained, this would apply even if Ministers decided that it was right to give up any protection for the balance of payments in the short term that the exchange control regime might afford.

D.H.

D J S HANCOCK
17 July 1979

REASONS WHY EXCHANGE CONTROL CANNOT BE ABOLISHED OVERNIGHT

1. The Government has decided to pursue its objectives of dismantling the exchange control regime by gradual means. There are both economic and administrative arguments for proceeding in this way.

2. The main economic argument is that the relaxation of controls provides an opportunity for a once-for-all stock shift as investors adjust their portfolios and financing schemes to accord with their commercial judgement previously restrained by the controls. The outflows caused by the stock shifts could, if confidence in sterling weakened significantly for some other reason, convert a welcome moderate depreciation in the nominal exchange rate into a dangerous sudden fall. This is not, of course, an argument against dismantling exchange controls. It is fully consistent with the view that, once the economy had adjusted to the process of dismantling the controls, there would be no loss to economic management, and significant gains to economic efficiency, from the absence of an exchange control regime.

3. The second main argument for gradualism is that it gives the private sector time to adjust. Exchange controls have been in existence for 40 years and are embodied in the way in which the financial institutions operate. A programme of gradual relaxation, well signalled in advance, gives all the institutions time to adapt their behaviour to the absence of controls in an orderly fashion. For this reason, the policy of gradualism has a good deal of support in the City. It is the journalists and the academic economists who tend to advocate overnight abolition - not those who actually make markets.

4. In addition to these general arguments for a policy of gradualism there is one severely practical point: we have not yet thought out the policy implications and administrative consequences of either:-

(i) complete relaxation of controls over outward portfolio investment (whatever that is taken to mean); or

(ii) what the ultimate state should be when the process of gradual relaxation of all our controls has been completed.

7

This note describes some of the problems that we face in designing the remaining steps in the relaxation programme. The problems that lie ahead are more difficult than those we encountered when designing the first two steps in June and July.

5. The problems arise essentially from the fact that control over outward portfolio investment is and has always been the centre of our exchange control regime. The July package is a significant first step in dismantling portfolio controls; but it is not so fundamental as to call in question the basic apparatus. Securities will continue to be placed in deposit and the authorised depository system will remain in business.

6. A decision to allow unlimited officiail exchange for all foreign currency securities (not just those denominated in EEC currencies) would oblige us to take a series of consequential decisions. The most obvious point is that it will be difficult to justify the continued operation of the authorised depository network unless it is needed to support some other restriction which is to be maintained. But a more important and difficult requirement is to define in a sensible way the scope and purpose of the remaining exchange controls once the basic control over outward portfolio investment has gone.

A limited further relaxation

7. A possible approach, consistent with the gradualist policy, would be based on the proposition that unlimited official exchange for outward portfolio should be regarded as the completion of the process of allowing residents to use sterling without penalty to acquire overseas assets for investment purposes, but that the relaxation of restrictions on other uses of foreign exchange by residents, and of sterling by non-residents, should be postponed. This would mean that, for a further period whose length would be decided in the light of progress with the economy, restrictions would continue to limit the freedom of both residents and non-residents to use sterling finance for international trade and of non-residents to borrow sterling in this country; and would also continue to prohibit the holding of foreign currency by residents on grounds of preference rather than need. The justification for the choice of portfolio would be that priority in the relaxation programme should be given to improving the nation's external balance sheet.

8. It is not certain that this argument for a partial relaxation would survive scrutiny. Many of those affected by controls would, no doubt, argue that, with portfolio controls gone, other restrictions were unjustifiable - and this might be felt particularly strongly if sterling remained strong.

9. Nevertheless, there are important considerations here that need to be more thoroughly examined. One argument is that it would not be in the national interest to encourage the international use of sterling finance. If sterling finance were freely available for non-residents for trading and other purposes, firms, and ultimately countries, would have an even greater incentive than now to maintain their working balances in sterling. The more they do that, the greater the exposure of sterling to fluctuations in the exchange rate caused by decisions to move working balances from one currency to another as confidence strengthens and weakens in particular currencies. The counter-argument is that restrictions on the use of sterling as a means of international finance limit the ability of the City of London to earn foreign exchange in return for financial services.

10. If the arguments against encouraging the international use of sterling finance prevailed, it would be possible to devise a scheme that limited the free transfer of sterling by residents to the traditional purposes - namely current transactions, outward direct investment, outward portfolio investment, gifts, emigration and private property. Even so, it would be necessary to remove restrictions whose only purpose has been to support portfolio controls (e.g. life insurance in foreign currency) The present restrictions coid be maintained on the purposes for which non-residents could borrow sterling. Some controls over the ability of residents to buy and sell sterling forward would also need to be continued although it would be necessary to modify the present rules affecting forward transactions.

11. An approach of the sort described above would pose a number of awkward borderline problems which would need to be thought out before the decontrol of portfolio could be implemented. One example is the position of savings accounts and deposit accounts. For exchange control purposes, foreign currency certificates of deposit count as foreign currency securities and free use of official exchange is to be allowed for them under the first stage of portfolio liberalisation. There is not a great deal of difference between a foreign currency certificate of deposit and a deposit in a foreign currency savings account. On the other

hand the distinction between a savings account and a chequeing account is tenuous and no exchange controls would be possible or sensible if residents were entirely free to hold foreign currency in chequeing accounts. More generally, borderline problems arise where controls, although not designed directly to support portfolio restrictions, lose much of their justification once portfolio is free (e.g. advance payment for imports). A good deal of detailed technical work is therefore required before the next stage in decontrol could be implemented even if the broad philosophy sketched out above in paragraph 7 were accepted.

A more radical approach

12. A different and more radical approach could be to say that, if you are prepared to accept the risks of decontrolling outward portfolio investment, you ought to do away with the whole apparatus of control. But even that robust view does not lead to a simple administrative answer. One special problem is the position of authorised banks and their present monopoly of foreign exchange dealing in London. Because exchange controls have existed throughout the whole period of the post-war development of the foreign exchange market in London, the organisation and control of that market has been implemented by the Bank of England largely, but not exclusively, under exchange control powers. If the powers are removed or cease to be used, the question immediately arises of whether the Bank's effective control is jeopardised. The answer may be that it is not, and that control is sufficiently assured by the Bank's traditional authority over financial institutions and its system of prudential supervision which necessarily takes foreign exchange exposure into account. The implications of this sort of situation would need to be studied before a decision could be taken.

Conclusion

13. Thus, quite apart from the general arguments in favour of a policy of gradualism summarised in paragraphs 2 and 3 above, a good deal of detailed technical work and analysis needs to be completed before Ministers can take informed decisions about the nature of the next stage in the process of dismantling our exchange control regime. This is true whether the next move is to be limited (as described in paragraphs 7 to 11) or radical (as described in paragraph 12).

cc Principal Private Secretary
PS/Chief Secretary
PS/Financial Secretary
Sir D Wass
Sir K Couzens
Mr Barratt
Mr Hancock
Mrs Hedley-Miller
Mr Middleton
Mr Hodges
Mrs Lomax
Mr Butt
Mr Riley
Mr Drane
Mr Allan
Mr Ilett
Mr Towers
Mr Ramell

Mr Dawkins) Bank
Mr Willetts)

Mr Fitchew UKREP Brussels

Mr Ryrie UKTSD, Washington

MR P G DAVIES

EXCHANGE CONTROL RELAXATIONS

I attach Q and A briefing, revised in the light of comments received yesterday, for today's announcement.

J P MCINTYRE

18 July 1979

GENERAL

Q. 1 Why are the relaxations being made?

A. 1 To simplify and reduce controls which limit freedom of choice and impose costs and distortions on the economy. Any additional overseas investment which results will yield an income that will benefit the current account later when the contribution from North Sea oil beings to decline.

Q. 2 Why are the relaxations being made now - to get the exchange rate down?

A. 2 This is not an attempt to get the exchange rate down. The exchange rate cannot be manipulated by relaxing exchange controls; but the strength of sterling has enabled the Government to press ahead with the general disman ing of controls foreshadowed in the Budget Speech. In time we would expec the relaxation to cause a capital outflow which would result in the exchan rate being lower than would otherwise have been the case. The Government' commitment to firm monetary policies should ensure that there will be no s drop of confidence in sterling.

Q. 3 Why not remove the controls completely?

A. 3 That would be unwise, as many closely affected by the controls would agree They have existed for 40 years, and we need a period of adjustment in whic people can adapt to their absence. We need to avoid any disruption to the markets which a sudden and complete removal of the controls might being.

Q. 4 How will these measures affect the balance of payments?

A. 4 This cannot be estimated at all precisely. Some outflow on capital accoun is likely which would not otherwise have occurred. Its size and timing wi depend on how far the new facilities are used, which in turn depends in part on general confidence in sterling. Any capital outflow should in due course bring about an improvement in the current account.

Q. 5 With a large PSBR to be financed and the prospect of public sector (eg. BP asset sales, will these changes result in a capital shortage for British industry and higher interest rates?

A. 5 For domestic investment, there appears to be no general shortage of funds a present, and no shortage is expected to arise as a result of the measures. No significant effect on interest rates is expected either.

ADMINISTRATION

Q. 12 <u>What does exchange control cost?</u>

A. 12 The estimate for 1979-80 is £14 million for the Bank of England's expenses and £300,000 for the Treasury, reflecting about 600 and 25 staff respectively. There are other and, in total, doubtless larger administrative costs to banks and others involved in the control and to the public generally, but these cannot be quantified.

Q. 13 <u>What savings for the taxpayer will the relaxations bring?</u>

A. 13 Taken together, the measures announced yesterday and in the Budget Speech will save about 50 or 60 jobs in the Bank of England.

Q. 14 <u>Why continue to burden investors with a complex system of control if the government has decided that it wants to abolish it sooner or later?</u>

A. 14 The government believes the controls <u>are</u> too elaborate and burdensome, and that is one reason why they wish to dismantle them. But there are strong arguments for liberalising in a gradual way (see A3 above), and this limits the degree to which the system can be run down or simplified very quickly. Nevertheless, some progress in simplifying the controls has been made already, both for companies and individuals. The rules affecting outward direct investment have almost been removed entirely. The Budget package greatly increased personal allowances (eg. the basic emigration allowance) and introduced a ration of official exchange for the purchase of property overseas - both these steps have significantly reduced the burden of the controls on individuals. And whatever the precise timing of the next major liberalisation measures, efforts will go on in the meantime to tidy up and simplify the system.

OUTWARD DIRECT INVESTMENT

Q. 15 <u>What are the benefits of the changes?</u>

A. 15 Companies will now have complete freedom to choose how to finance their overseas investment. This should be of particular help to smaller firms. (See also A1 above).

Q. 6 <u>Will the measures result in the export of jobs?</u>

A. 6 No. The evidence is that most direct investment abroad is additional to domestic investment, not in substitution for it. Indeed, in many cases, overseas investment can help to increase employment at home by assisting exports - eg. investment in marketing and distribution abroad.

Q. 7 <u>Will the relaxations make speculative attacks on sterling easier?</u>

A. 7 The government believes that if it sticks to the right economic policies, as it intends to do, there is no reason to expect that people will want to get out of sterling to an extent that causes any difficulty.

EEC ASPECTS

Q. 8 <u>Are we now meeting our EEC obligations?</u>

A. 8 We have not yet met our EEC obligations in full, but these measures are a large further step in that direction. To the extent necessary, our remaining restrictions are covered by the Commission's existing authorisation under Article 108 of the EEC Treaty.

Q. 9 <u>Have the Commission been informed?</u>

A. 9 Yes, and there have been discussion between officials.

Q. 10 <u>Does the EEC orientation of some of the changes mean that the government has decided to join the EMS?</u>

A. 10 The government will be making its first assessment of the position on the EMS exchange rate mechanism in September.

Q. 11 <u>Are the measures being offered in exchange for more progress on the EEC Budget and CAP issues?</u>

A. 11 These questions are not linked. But the government believes the measures will be well received in the Community.

14

16 Can firms now invest abroad without consulting the government?

A. 16 No. Applications must still be made to the Bank of England. For geninue direct investments, permission will normally be given. This procedure remains necessary for the time being as a guard against evasion of remaining controls on other kinds of transaction.

OUTWARD PORTFOLIO INVESTMENT

Q. 17 Why relax only for EEC currency securities and bonds of international organisations?

A. 17 The portfolio controls have to be relaxed gradually to avoid disrupting the markets (see A3 above). In practice, this has to mean giving priority for some kinds of investment. It makes sense to start with securities in Community currencies and bonds of institutions like the European Investment Bank and the World Bank of which we are members. But the government intend this to be only a temporary position and to take further steps as soon as possible.

Q. 18 Why are existing holdings of these securities no longer to be premiumworthy?

A. 18 Otherwise, owners might obtain windfall gains at the expense of the balance of payments by re-financing with official exchange. Moreover, the investment currency market is part of the restrictive regime, and the availability of official exchange to buy these categories of security is tantamount to derestriction. Existing holdings of property bought with investment currency were treated in the same way in the Budget measures.

Q. 19 Is the dollar premium being abolished?

A. 19 The new measures do not involve the abolition of the investment currency system. Proposals for further liberalisation measures are under consideration, but it is too early to say what steps will be taken and when.

Q. 20 What are the benefits of the changes?

A. 20 The controls have been extremely tough. The government wants to give individual investors and the institutions in which so many people have a stake more freedom to invest their money where they like. The liberalisation

measures will also help to remove economic distortions not least in our own capital markets, where the controls have had the effect of depressing the return on domestic investment. (See also A1 above).

Q. 21 <u>When will the next changes be made?</u>

A. 21 The government hopes to take further steps as soon as circumstances permit, but what those steps will be and precisely when they will be taken has not yet been decided. The Chancellor said in his Budget Speech: "As time goes by, I intend to take further steps in the progressive dismantling of exchange control. The pace of relaxation will obviously be influenced by sterling's strength, as well as by the speed with which we can solve the economic problems that face us".

Q. 22 <u>Why did owners of private property abroad lose the premium as a result of the measures announced on 12 June?</u>

A. 22 It would have been impossible to prevent the refinancing of existing overseas properties with official exchange if the premium was still available on sale or on emigration. The removal of the premium is an inevitable consequence of the relaxation of controls; and it does not involve a breach of faith, as no Government has given an undertaking that assets purchased with the premium could be sold for the premium.

2)

EXC/34/04 (J

84/04

16

1 MR UNWIN

2. CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir Douglas Wass
Sir Lawrence Airey
Sir Fred Atkinson
Sir Anthony Rawlinson
Mr Byatt
Mr Littler
Mr F E R Butler
Mr Cassell
Mr Lovell
Mr Middleton
Mr P G Davies
Mr Ridley
Mr Cropper
Mr Cardona
Miss O'Mara
Mr. Hancock

OPENING ADDRESS TO FINANCIAL TIMES CONFERENCE ON BUDGET - 23 JULY 1979

I attach a draft speech, based on the outline which Mr Battisl circulated under cover of his minute of 11 July to Mr Unwin. You are due to address the conference for half an hour, but the organisers have requested that you be ready to take questi from the floor during this period, so your opening speech should last only 15-20 minutes.

The following points should be noted on the attached draft:-

i. You suggested that Michael Blumenthal's speech to the International Monetary Conference last month be quoted as a 'surprise text' during the course of the speech. A quotation appears on pp 2-3 of the attached draft.

ii. Your outline said "see Hoskyns list" for some further examples of possible deregulation. I understand that this has as yet been given only a very limited circulation, and I have not included any specific further examples in the draft (page 8)

iii. You suggested a 'trailer for tax reform'. The middle paragraph of p.9 of the draft raises this, but only specifically mentions ideas already trailed in the Budget speech.

Allen Ritchie

ALLEN RITCHIE
18 July 1979

203/7

17

DRAFT SPEECH FOR CHANCELLOR'S OPENING ADDRESS TO 'FINANCIAL TIMES' CONFERENCE, 23 JULY 1979

[Introductory Remarks]

The theme of your conference today is "Budget 1979 - new directions for the British economy". But before I talk about the new directions in which last month's Budget points us, I would like to say something about the old directions in whi our economy has been for too long heading. My object in doin so is not to blame all our troubles on our predecessors - our current problems go back a lot further than five years - but to secure some understanding of the nature and extent of the relative decline of the British economy and therefore why the changes we have embarked on are necessary. Our economic strategy needs to be seen in this perspective.

The present condition of the economy is an all too familiar one. Output growth slowing, after a consumer 'boom' which did more to boost output and employment in our competitors' economies than in our own. Inflation rising. The current account of the balance of payments in deficit. But what is depressing is not that we have been here before - but that, since we were last at this stage in the business cycle, nothing has changed. Over the five years 1973-78, France and West Germany achieved average growth rates of 2 per cent per annum and even Italy managed 1½ per cent. We managed less than 1 per cent and much of that was due to rapidly rising North Sea oil production. Our manufacturing output was over 4 per cent lower in 1978 than in 1973.

18

The previous Government had an 'industrial strategy' to regenerate British industry. But, on the yardstick of performance, British industry remains unregenerated. This is hardly surprising. Subsidising the inefficient firms and sectors in the economy at the expense of the efficient ones can never be a recipe for improved economic performance - even when it is done with the best of intention of preserving jobs. Such actions only tend to reinforce the rigidities built into our economic structure - in the labour market, in housing, in industrial relations - which characterise our economy, and which are reflected in our usually slow response to changes in economic circumstances - whether in seizing market opportunities abroad or even at home, or, as a nation, in responding to the fourfold increase in oil prices which followed the Yom Kippur war.

We need to recognise two things here. Firstly, that, if we are to reverse our relative economic decline, then we have look at the supply side of the economy - to improve the supply response of UK industry to changes in market conditio Secondly, that, to some extent, the rigidities and inefficie in the economy which condition the supply response have resul albeit often indirectly, from Government actions.

"To rectify this is a mammoth task. It requires that we chan our fundamental approach to macro-economic management. Since the Great Depression we have operated on a consensus about the goals and techniques of economic management, bred of the genius of John Maynard Keynes. Simply put, that consensus held that the Government's major policy concerns should be directed to the management of aggregate demand. The aim was

to smooth out peaks and valleys in the business cycle and to assure a steady, upward climb of employment and income. The supply side of the equation was largely neglected; it was assumed to take care of itself.

"To turn this situation around will require that we teach some old dogs some new tricks. We must emphasise once again the supply side of the economy. .... This is not to deny that we are of course concerned, and will continue to be concerned, about social problems - about the needs of the poor, the aged, the underprivileged. The point is that the needs of these people cannot be met unless we char our ways. We must look to the future."

Of course, this diagnosis is not unique to the United Kingd economy. Indeed, the last 200 or so words of my speech are not mine at all - they are those of Michael Blumenthal, Sec of the United States Treasury, addressing the International Monetary Conference in London less than six weeks ago. Mr Blumenthal was, of course, specifically talking about th American economy. But his remarks can be applied to some degree to all Western industrialised economies - indeed Mr Blumenthal referred in the same speech to "a growing consensus that the rigidities and inefficiencies which all Governments impose on their economies discourage the investment, productivity growth and dynamic change that is needed to break out of the situation we are collectively confronted with."

The problems we are confronted with in the United Kingdom are compounded by our poor economic performance as compared

with other countries. It is clear that the early seventies sa a major turning point in the development of the world economy with a dramatic fall in the ability of economies to grow at a satisfactory rate without excessive inflation. The heightenec risk of inflation and the problems of energy supply impose sev constraints on growth over the next few years for all countri Without a substantial improvement in our own economic perform there is a real danger that our relative economic decline may into an absolute decline. This is why we needed to act quick A world recession may not seem the best background against wh to put our house back in order. The cure may in the short-te make things more uncomfortable for us. But really we have no choice.

This is the background against which the Budget measures need to be seen. I regard the Budget as the first step in a long-term strategy to arrest and reverse our economic decline. I hope that this Conference will look at the Budget measures in that light.

What does this strategy consist of? How does the Government its role in reversing our economic decline? I see the Govern as having two main tasks. Firstly, effecting a long-term permanent reduction in the rate of inflation - the preconditi of a resumption of sound and sustained expansion in the mediun term. Secondly, reducing government intervention in the marke and government claims on resources, so as to promote a much freer working of the market economy.

Monetary policy is the key to reducing inflation. Experienc should have taught us by now that formal control of costs and prices does not work. Costs and prices need to be settled at the level of the firm, with minimum interference with the workings of the market. But, in order to prevent those with monopoly power from making inflationary increase in prices and wages, the Government needs to maintain firm control of the supply of money - so that, if increases in prices and wages go beyond a certain level, the money will simply not be there to meet them.

That is what we are doing. We have set a target for moneta growth slightly lower than that of the previous administrat Moreover, we are committed to a progressive reduction in suc targets over time.

Our action on Budget Day in raising MLR is an indication th we are ready to act as and when necessary to bring monetary growth under control. High interest rates, of course, are undesirable in many ways. As we bring public expenditure more into line with our monetary objectives, I hope that we can control the money supply without placing so much of the burden on the private sector, whether through taxes or interest rates. But I cannot stress too strongly the Govern commitment to controlling monetary growth in order to bring down inflation.

22

There is an important message here for both sides of industry. Inflationary wage increases will simply not be accommodated. Rather the result of an inflationary level of wage costs increases will be to make markets more difficult for British sales, and, at the margin, to drive firms into bankruptcy and inflict needless unemployment on their employees. But whilst a substantial rise in unemployment over the next year two is possible, it is not inevitable. The level of unemployment is not simply determined by the Government. Management and unions have a choice and a responsibility, too. If those involved in pay bargaining adhere to a simple principle of 'no increase in pay without increased production' then we can make the adjustme to a lower inflation rate and more growth and jobs in the longe term far more painlessly than if we continue to insist on tryin to pay ourselves more than we earn.

Let me now leave inflation and turn to our other main task - th of reducing government involvement in the economy. There are a number of aspects to this. Firstly, we need to cut back on the government's direct claims on our limited resources by reducing the public sector's too large borrowing requirement. This means cutting back on existing public expenditure plans. The Budget made a start on both of these tasks and we shall continue along the same path.

Cutting public expenditure inevitably involves some difficult choices. But there is no escape from such choices. We have to relate our expenditure on public services to our capacity to fin them - and our recent economic performance has simply not been adequate to finance ever-increasing expenditure on public servic The current cut-backs are necessary if future improvements in the quality and standards of our public services - which we stro

desire - are to be possible. We need both to accept this and to direct our energies towards a discussion of where the real priorities for public expenditure should lie. For instance, wh is more important? - subsidising school meals or maintaining standards as regards the provision of classes? Low prescriptio charges for everybody or hospital services for those who need t Rent subsidies for all council tenants or housing people adequa In all three cases I have mentioned - school meals, prescriptio charges, rent subsidies - the poorer members of our society ar already rightly protected, and will continue to be. But is it really a sensible use of resources to subsidise everybody else indiscriminately as well?

Another aspect to reducing government involvement in the econon is reforming the many government regulations which inhibit the efficient use of resources - and which have undoubtably contributed to the supply side inertia which has typified British industry. Our aim in reviewing such regulations is to make the economy more flexible, by encouraging the development of new and profitable activities, and, at the same time, hastening the smooth run down of old and unprofitable ones. We have already made a start on de-regulation by ending all controls on prices and dividends. And we do not intend to incur ourselves the heavy price that the rigidity of the last four years of pay guidelines has involved. For example, despite the high level of unemployment, shortages of skilled engineering manpower are currently the cause of some engineering companies turning away orders - and also the cause of much managerial time being expended on rescheduling production and in recruitment

efforts. Pay rigidity has hindered the market solution of this kind of problem - higher relative wages for the kind of skills in short supply.

Another example of unnecessary Government regulation - at least in our current circumstances - is exchange control. We took ~~some steps~~ an important 1st step towards dismantling these controls in the Budget. ~~and further relaxations were~~ A second major step was announced last week. We are also currently reviewing the extent of existing Government regulation in a number of other areas.

Tax reform has a crucial role to play in our economic strategy. As it has grown up, our tax system has come to represent a major impediment to initiative, innovation and risk-taking. The first step in correcting this was the switch from direct to indirect taxation made in the Budget - from taxing earnings to taxing spending. The very high marginal tax rates on high incomes were an obvious absurdity, and needed to be reduced promptly. But the 3 pence reduction in the standard rate - the marginal rate for the vast majority of taxpayers - will improve incentives all the way down the line.

I said in my Budget Speech that this was an 'opportunity Budget', not a 'giveaway Budget'. There has been a good deal of talk about whether or not the tax changes make most households better off.

25

[I hope that the index of real take-home pay which the government proposes to introduce will help settle these kind of disputes.] But, in the end, the point of the Budget tax changes was not to make everybody better off in the short term - we are not trying to engineer a 'consumer boom' in the name of demand management. Rather our aim is to make everybody better off in the long-term, through the successful pursuit of a long-term economic strategy, in which tax reform plays a central part.

Like other aspects of the Budget, the tax changes announced there represent only the first - but very important - steps of a long-term programme. I have already announced - in my Budget speech - our intention to press ahead with a thorough study of our present system of capital taxation. We would also like to further reduce the burden of income taxation - our long term aim is a standard rate of no more than 25 per cent. [We will also consider whether tax reforms in other areas are appropriate to our long-term strategy.]

I have tried this morning to draw your attention to the nature and extent of our economic problems, and sketch out our strategy for reversing our long-term decline. My purpose in doing so has been to put the Budget in what I consider to be its proper perspective. I am confident that the new directions we are now taking are the right ones.

But, in the end, the capacity of government - any government - to influence the course of events is limited. What the government can influence, and to some extent control, is the economic environment in which the myriads of decisions which in the end determine the course of the economy are taken. This we are trying to do - through tax reforms, a reduction in the extent of government regulation, cuts in public expenditure and a firm monetary policy to bring down inflation

Whether or not the 1979 Budget marks the end of our economic decline depends on the response of the British people to these changes in the economic environment. There is a need for a positive response from everybody. From management, by seizing market opportunities when they present themselves. From unions, by accepting again the responsibilities associated with free collective bargaining. It is my belief that the British people will respond to the new environment and that the 1979 Budget will mark a turning point in this country's economic fortunes.

for, in the main, the capacity of government to influence the economy and the economy of producers is limited. What the government can influence, and to some extent is effective, is the economic environment in which the economy [illegible] is being [illegible] and [illegible] the [illegible] of the economy and labour work to the British state – through its reforms, a moderation of the extent of government regulation, cuts in public expenditure and a firm monetary policy in the same [illegible].

Whether or not the 1923 budget marks the end of the excessively [illegible] approach to the management of the British people by their leaders in governments of both parties, there is a need for a political climate that encourages [illegible] management, [illegible] individuals that they [illegible] influence. They should, in principle, be aware of the responsibilities [illegible] with that [illegible] [illegible] the British people will [illegible] the [illegible] and [illegible] the 1923 budget calls [illegible] a climate of [illegible] economic freedom.

27

18/7/79 Reference

WA 719-720

84/10 J

NATIONAL FINANCE

Exchange Controls

Mr. Wilkinson asked the Chancellor of the Exchequer whether he has any plans

Sir Geoffrey Howe: In my Budget Statement I announced my intention to take further steps, as circumstances allowed, in the progressive dismantling of exchange control. I have decided to allow complete freedom of choice in the financing of outward direct investment, and to take three significant steps towards liberalising outward portfolio investment.

With effect from tomorrow, 19 July, official exchange will be available without limit for all outward direct investments, and foreign currency borrowing taken at any time to finance such investments will be eligible for repayment with official exchange. As regards portfolio investment, also with effect from tomorrow official exchange will be available for investment by United Kingdom residents in most securities denominated and payable solely in the currencies of other EEC countries.

Secondly, official exchange will also be available for investment in foreign currency securities issued by international organisations of which the United Kingdom is a member, including those issued by European Community institutions and the World Bank. One of the consequences will be that the sale proceeds of existing new holdings ~~of~~ such securities, however acquired, will no longer be eligible for sale in the investment currency market.

Thirdly, foreign currency borrowing taken by United Kingdom residents to finance outward portfolio investment and which has been outstanding at least one year as of tomorrow will be repayable with official exchange. As in the case of last month's measure, I have discussed these changes with the Commission of the European Communities.

Further details are available in the Vote Office.

CODE
18-78
SS 10/76

CONFIDENTIAL

Exc/54/04 (3)

NB
Listen to type.
D.H.
18/7.

MR HODGES

(1) Mr Hancock
(2) Chancellor of the Exchequer

copies for:

Chief Secretary
Financial Secretary
Minister of State (Commons)
Minister of State (Lords)
Sir Douglas Wass
Sir Lawrence Airey
Sir Fred Atkinson
Sir Kenneth Couzens
Sir Anthony Rawlinson
Mr Barratt
Mr Jordan-Moss
Mr Littler
Mr Dixon
~~Mr Hancock~~
Mrs Hedley-Miller
Mr Ridley
Mr Ilett
Mr McIntyre

EXCHANGE CONTROL RELAXATIONS

The Secretary of State for Trade's letter of 13 July comments on the exchange control package which is to be announced on the afternoon of 18 July. As before, Mr Nott would have liked the Chancellor to go further; this time, he makes a particular plea for the complete relaxation of the control on the use of sterling for the finance of third-country trade.

Mr Nott acknowledges that there would not be time for the Chancellor to act on his recommendation without delaying the next stage of the relaxations, and asks that work be put in hand on third-country trade with a view to relaxation in the Autumn package. The attached draft letter points out that this work has already started, without committing the Chancellor to make this particular change in his third exchange control package.

N J Ilett

N J ILETT
18 July 1979

EXC)84/04 (3)

29

DRAFT REPLY FROM: CHANCELLOR OF THE EXCHEQUER

TO: The Rt Hon John Nott MP
Secretary of State for Trade
1 Victoria Street
LONDON SW1

Copies to: PRIME MINISTER
FOREIGN AND COMMONWEALTH SECRETARY
INDUSTRY SECRETARY
GOVERNOR OF THE BANK OF ENGLAND
SECRETARY TO THE CABINET

Thank you for your letter of 13 July about the relaxation of exchange controls.

As you recognise, the business involved in putting together a larger package would have delayed implementation of measures announced on 18 July. I have already set work in hand on preparing a third step in the dismantling of the controls which, if sterling remains strong, I would hope to take in the Autumn; and this work will include studying further the question of extending sterling facilities for third-country trade to the banks, on which I have noted the views recently expressed to you by your British Overseas Trade Advisory Council. ~~It is of course too early to judge how the third package should be composed or when it should be introduced.~~

I am sending copies of this letter to the Prime Minister, the Foreign and Commonwealth Secretary, the Secretary of State for Industry, the Governor of the Bank of England and Sir John Hunt.

EXC/34/04 (J)

30

REPLY FROM CHANCELLOR OF THE EXCHEQUER

DRAFT ~~LETTER TO:~~

COPIES TO: PRIME MINISTER
FOREIGN AND COMMONWEALTH SECY
INDUSTRY SECRETARY
GOVERNOR OF THE BANK OF ENGL.
SECRETARY TO THE CABINET

To: The Rt Hon John Nott MP
Secretary of State for Trade
1 Victoria Street
LONDON
SW1

Thank you for your letter of ~~You wrote to me on~~ 13 July about the relaxation of exchange controls.

~~I am pleased that you are happy with the relaxations which [I am announc on] [today] 18 July, which cover outward direct investment and securities denominated in EEC currencies.~~

As you recognise, ~~acknowledge in your letter~~, the business ~~work~~ involved in putting together a larger package would have delayed ~~the~~ implementation of t~~hat packag~~e ~~as a whole, and I have not therefore added to~~ the measures announced on 18 July. ~~measures. But~~ I have already set work in hand on preparing a ~~the~~ third step in the dismantling of the cont which, if sterling remains strong, I would hope to take ~~early~~ in the Autum and this work will include studying further the question of extending ~~cover, the extension of~~ sterling facilities for third-country trade to the banks. It is of course too early ~~to say exactly~~ for me to judge how the third package should ~~will~~ be composed, or when it should be introduced.

I am sending copies of this letter to the Prime Minister, the Foreign and Commonwealth Secretary, the Secretary of State for Industry, the ~~and~~ Governor of the Bank of England and Sir John Hunt.

~~GEOFFREY HOWE~~

CONFIDENTIAL

EXC/54/04 (I)

CONFIDENTIAL

CHANCELLOR OF THE EXCHEQUER

Chief Secretary
Financial Secretary
Minister of State - Commons
Minister of State - Lords
Sir Douglas Wass
Sir Lawrence Airey
Sir Fred Atkinson
Sir Kenneth Couzens
Sir Anthony Rawlinson
Mr Barratt
Mr Jordan-Moss
Mr Littler
Mr Dixon
Mrs Hedley-Miller
Mr Gill
Mr Hodges
Mr Ilett
Mr McIntyre
Mr Ridley

EXCHANGE CONTROL RELAXATIONS

The Secretary of State for Trade's letter of 13 July commented on the new exchange control package. As before, Mr Nott would have liked you to go further and he made a particular plea for the complete relaxation of the control on the use of sterling for the finance of third country trade.

2. He acknowledged that there would not be time for you to act on his recommendation without delaying the July package; but he asked that work be put in hand on third country trade with a view to relaxation in the autumn "assuming of course that sterling remained strong".

3. I attach a draft reply which assures Mr Nott that the work is already in hand. If you agree, I would suggest that the letter should authorise us to consult officials of the FCO and Departments of Trade and Industry at the appropriate stage.

D.H.

D J S HANCOCK
19 July 1979

Confidential

32/23

DRAFT REPLY FROM THE CHANCELLOR OF THE EXCHEQUER

TO: The Rt Hon John Nott MP
Secretary of State for Trade
1 Victoria Street
LONDON SW1

COPIES TO: Prime Minister
Foreign and Commonwealth Secretary
Industry Secretary
Governor of the Bank of England
Secretary to the Cabinet

Thank you for your letter of 13 July about the relaxation of exchange controls.

2. As you recognise, the business involved in putting together a larger package would have delayed implementation of measures announced on 18 July. I have already set work in hand on preparing a third step in the dismantling of the controls which, if sterling remains strong, I would hope to take in the autumn; and this work will include studying further the question of extending sterling facilities for third-country tr to the banks, on which I have noted the views recently expressed to you by your British Overseas Trade Advisory Council.

3. As you say, this proposal raises rather fundamental questions about the role of sterling as an international currency. This is one of the points that my officials are now examining. I have asked them to keep the FCO and the Departments of Trade and Industry in touch with their work.

4. I am sending copies of this letter to the Prime Minister, the Foreign and Commonwealth Secretary, the Secretary of State for Industry, the Governor of the Bank of England and Sir John Hunt.

33

APS

Mr. Hodges

MR. HANCOCK

84/04

cc: Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir Douglas Wass
Sir Kenneth Couzens
Mr. Barratt
Mr. Bridgeman
Mr. Dixon
Mr. Middleton
Mr. Unwin
Mr. P.G. Davies
Mr. Gill
Mr. Hodges
Mrs. Lomax
Mr. Ilett
Mr. McIntyre
Mr. Ridley
Mr. Cropper
Mr. Cardona

Mr. Dawkins) Bank of
Mr. Sangster) England

REASONS WHY EXCHANGE CONTROL CANNOT BE ABOLISHED OVERNIGH

The Chancellor was most grateful for the notes attache to your minute of 17th July. He has commented that your paragraph 9 gives the crucial balance.

2. He has made the further point that we must not overloo the staff savings in the Bank of England, etc. potentially involved.

MAH

(M.A. HALL)
19th July 1979

24/7

34

PRINCIPAL PRIVATE SECRETARY

cc PS/Financial Secretary
Mr Unwin
Mr P G Davies
Mr Hodges
Mr Ritchie
Mr Ridley
Mr Cropper
Mr Cardona

FINANCIAL TIMES CONFERENCE

I should like to suggest a small amendment to Mr Ritchie's draft - his minute to the Chancellor dated 18 July refers.

2. The references to exchange control on page 8 seem to me to understate the importance of the steps that have been taken. I therefore suggest that the second sentence of the second paragraph on page 8 be amended to read:-

> "We took an important first step towards dismantling these controls in the Budget. A second major step was announced last week."

D. H.

D J S HANCOCK
19 July 1979

20/7

35

PS/CHIEF SECRETARY

cc Principal Private Secretary
PS/Financial Secretary
Sir K Couzens
[illegible]att
Mr Gill
Mr Hodges
Mr McIntyre

EXCHANGE CONTROLS

You asked for a brief form of words for the Chief Secretary to use in his winding up speech tonight to refer to the exchange control relaxations. I suggest the following:-

"The Chancellor has announced today further measures to relax exchange controls. With effect from tomorrow 19 July official exchange will be available without limit for the following purposes:-

(i) All outward direct investment - this replaces the £5 million ration announced in the Budget Speech.

(ii) Investment by UK residents in most securities denominated and payable solely in the currencies of other EEC countries.

(iii) Investment by UK residents in foreign currency securities issued by international organisations of which the United Kingdom is a member.

(iv) The repayment of foreign currency borrowing taken by UK residents to finance outward portfolio investment which has been outstanding at least one year as of tomorrow.

Further details are available in the Vote Office."

2. Someone may ask why this announcement has been made by way of a Written Answer. The Leader of the House said on Monday that it was not Government policy to have a major policy statement made by means of a Written Question. The

Chief Secretary might say in reply:-

"The new announcement is a continuation of the policy which the Chancellor announced in his Budget Speech. /The Chancellor's words were: "As time goes by, I intend to take further steps in the progressive dismantling of exchange control." Hansard 12 June Col 245./ The Chancellor will be answering Oral Questions tomorrow and Members will be able to put supplementaries to him with the benefit of having been able to study today's announcement."

3. An extensive Q and A brief on the exchange control relaxations was circulated today under cover of Mr McIntyre's minute to Mr P G Davies - you have a copy. Mr Gill will be letting you have copies of a similar Q and A brief on sterling.

D.H.

D J S HANCOCK
18 July 1979

ECCS P9

Chancellor
Accept content to reply as suggested to Mr. Higgins supplementaries (flagged).

37

1. MR HANCOCK DH 1/8.

2. CHANCELLOR OF THE EXCHEQUER

cc for: Financial Secretary
Sir Douglas Wass
Sir Kenneth Couzens
Mr Barratt

1/8

cc to: Mr G K Willetts (B/E)

EXCHANGE CONTROL: SUPPLEMENTARY PQs ON 19 JULY

1. Mr Hall's minute to me of 24 July recorded the Chancellor's scepticism about the arguments suggested for replying to Mr Terence Higgins' Supplementary about passport marking, and also his requests for information about staff savings in the Bank of England and about the arrangements for promulgating the most recent package of exchange control relaxations.

Passport Marking

2. The Financial Secretary has commented (Mrs Diggle's note of 26 July) that the practice of marking passports when foreign currency facilities for travel are issued should end with the dismantling of the remaining controls of outward portfo investment. This accords with the recommendation in my minute of 20 July, which reflects the belief that, so long as particular restrictions have to be kept, we need some credible enough system of monitoring and enforcement.

3. It is true that a lot of banks etc. still fail to mark passports as they should and that, if a UK resident misuses (eg. invests) abroad currency allowed only for genuine travel purposes, it may never be detected (although, if it were, this could lead to his having to repatriate the funds). Credit cards may indeed be used by UK residents to obtain foreign currency while they are abroad, in addition to what they could get from a bank in the UK. But issuing companies onl get permission from the Bank of England to offer such facilities if they show that they can efficiently monitor the use of their cards overseas; and, in practice, they report apparent abuse to the Bank of England. Thus, though not covered by passport marking, credit cards are within the ambit of the control and so should not in general undermine our remaining outward portfolio rules.

Bank of England Staff Savings

4. As a result of the relaxations announced on 12 June and 18 July, the Bank have already saved 16 posts in the Exchange Control Department (contract staff in Birmingham). They estimate that, compared with their 1979/80 budget, a further 53½ posts will be saved by the end of next February. They consider that the full extent of savings will be determined more by the public's response to the relaxatio

/which...

which may for some time include many enquiries, than by the Bank; but the Treasury's cash costs will be reduced in step with the reduction of the work-load.

Issue of Exchange Control Notices

5. The Bank of England issue a series of Notices, in two loose-leaf volumes, designed to draw attention in a convenient form to the detailed arrangements and instructions for administering the Exchange Control Act 1947. The Notices give certain exemptions, delegations, permissions, consents, authorities and directions under the Act and its related Statutory Instruments, and are the accepted means of informing the banks, various markets and other persons dealing with transactions involving Exchange Control of changes in policy and their detailed implications for existing arrangements, including permissions and delegated authorities.

6. The main recipients of the Notices are Authorised Banks and Authorised Depositaries, (i.e., stockbrokers, solicitors, some accountants and others authori[sed] to hold foreign currency securities) but anyone may purchase them from the Bank at a cost of £23 for a complete set, with an updating service costing a further £9 pe[r] year. Changes in Notices are frequently promulgated by means of Supplements, rather than by complete reissue.

7. With regard to the recent relaxations, the Bank issued various Supplements al[l] of which were dated 19 July, i.e., the day following the Press announcement. They were as follows:-

		Subject
i.	Supplement to Notice EC 18 (a single sheet of paper). -	Outward direct investment.
ii.	Supplement to Notice EC 67 (a single sheet of paper not strictly related to the above measure but aimed at tidying up an anomaly left over from the Budget measures).	Guarantees given by United Kingdom residents in respect of borrowing taken by overseas subsidiaries and branches of UK companies.
iii.	Three separate Supplements to the Notice EC 7 (respectively 3, 8 and 10 sides).	Portfolio investment; covering respectively the relaxation on repayment of foreign currency loans to finance portfolio investment, switching of restricted securities and relaxations on investment in EEC and certain other securities ("liberalised securities").

All the above Supplements were issued to Authorised Banks and those at i and iii above were also issued to Authorised Depositaries (who receive only those Notices in which they have a direct involvement unless they elect to pay for the complete

/Volumes...

39

Volumes and updating service).

8. The total print order for items i and iii was 74,000 of each and for item ii, 30,000. Most of these Supplements were required, and were issued, within a few days. The exact cost of printing has not yet been established but is estimated to be in the region of £16,000 - a figure which would have been lower had it not been that because of the urgent timetable printers were required to work on a Saturday.

9. The Supplements were issued to show exactly what changes were needed to existing Notices. The quite lengthy Supplements to EC 7, dealing with the rather complicated portfolio rules, had to set out the new rules in detail for Authorised Depositaries, particularly for the necessary new category of "liberalised securities", explaining just what new permissions were being given and on what conditions. Such essential detail would have made a Parliamentary reply or Treasury Press Notice intolerably long.

Simplification of Exchange Control Rules

10. When there are no longer restrictions on outward portfolio investment, there will be scope for other quite significant consequential relaxations, specially in the rules for personal transactions. Meanwhile, we are pursuing a variety of relatively minor simplifications with the Bank, who are however concerned to avoid a series of changes involving new adjustments for those affected and amendments to EC Notices on a piecemeal basis over the next 2 or 3 months, before it is clear whether a really radical change in the whole regime can soon be made.

11. At the same time, the Bank are already striving for more simplified administration, for which it is important, but not all that easy, to change the established attitudes of the more junior staff in the Control. An example is the much smoother and swifter methods now being adopted for dealing with outward direct investment applications (which continue to need checking while portfolio controls continue).

12. I attach a draft reply to Mr Higgins about the two points he raised in his Supplementary.

C H W HODGES

1 August 1979

C80

Pl type for Chancellor

OB

DRAFT LETTER FROM: CHANCELLOR OF THE EXCHEQUER

TO: THE RT HON TERENCE HIGGINS MP
House of Commons SW1A OAA

Copy to: G K Willetts Esq
Bank of England
New Change, London EC4M 9AA

I have looked into the two detailed points which you raised in the House about exchange control in your Supplementary Question on 19 July.

On the first point, I have satisfied myself that we do need for the time being to continue passport marking by authorised issuers of foreign currency facilities for travel abroad. This is a key element in the arrangements for monitoring and control of the limits that we still have, albeit much increased in my Budget, on the amounts allowed for each journey without special reference to the Bank of England. We cannot sensibly abolish the limits so long as important restrictions remain on outward portfolio investment, since otherwise their evasion would be too easy. But I might add that I aim to get rid of those restrictions, and passport marking with them, as soon as I judge that circumstances allow.

~~In reply~~ As to the second point ~~on~~ in your Question, the newly liberalised foreign currency securities are required to be in the custody of an Authorised Depositary, who takes responsibility for observance of the current exchange control rules. This is a well-tried system for ensuring that purchases and sales are made in accordance with the rules: in particular, so long as some foreign currency securities are not liberalised we need to see that they do not get procured outside the rules with the sale proceeds of securities which have been liberalised.

I hope this fully answers the particular points you had in mind.

(GEOFFREY HOWE)

EXC 150/04 (5) Confidential. 84/04 41

MR HANCOCK) Copy to each
MR MIDDLETON)
MRS GILMORE)

cc Mr Barratt
Mr Littler
Mrs Lomax
Mr Riley

DOMESTIC MONETARY POLICY AND EXCHANGE CONTROL

As it appears that the next steps on this, including the Bank sending the Treasury a copy of their paper on the Future of the Reserve Asset System, is likely to fall during the leave season, I think that it wo be useful to let Treasury Ministers have quickly our first reactions to the Bank's proposals for further work by them on monetary controls as revealed at the Monetary Seminar, and in discussions which led up to it. I attach a draft minute which I would welcome your reactions.

2. The first part deals with the reserve assets ratio and special deposits, and so with the interaction with the Banking Act. The secc deals, amongst other things, with the interaction between monetary cc and exchange control, necessarily at this stage in a very tentative w this follows the oral discussions of this point with Sir Douglas Wass and Mr Middleton.

3. If it would help to have a quick word on this, I will ask my secretary to arrange a short meeting: I would like it to go forward before the weekend.

J.M.B

J M BRIDGEMAN
19 July 1979

received 4.20pm
on 20th

DRAFT

CONFIDENTIAL

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Sir Douglas Wass
Sir Lawrence Airey
Sir Ken Couzens
Mr Barratt
Mr Littler
Mr Hancock
Mr Middleton
Mr Unwin
Mrs Gilmore
Mr Riley
Mrs Lomax
Mr Waller
Mr Williams
Mr Ridley
Mr Cardona
Mr Cropper

DOMESTIC MONETARY POLICY AND EXCHANGE CONTROL

You, and the other Treasury Ministers, might like to have an initial reaction to the Bank's package, as revealed by the Governor at the Prime Minister's seminar, before you have your next informal meeting with the Governor. I have some misgivings about the timing of the Bank's proposals on the ending of Reserve Assets/Special Deposits. But more seriously, there seems to be a risk that if the Bank were allowed to keep to their timetable for the discussions on monetary base, some of the options could well be pre-empted before then by decisions on Exchange Control.

Reserve Assets and Special Deposits

2. I think that most of us in the Treasury have some sympathy with the Bank's proposal to end the Reserve Assets requirement, and with it the Special Deposits scheme. As the Treasury economists' paper for the seminar brought out, the Reserve Assets/Special Deposits mechanism has ceased to be an effective means of controlling the growth of banks' balance sheets, because they now tend to respond to reserve assets pressure by bidding for funds in the money markets, rather than by cutting back on their assets. The Reserve Assets/Special Deposits position now therefore affects short term interest rates. But we have not needed the mechansim to raise short term rates: that can be

achieved by the use of MLR and the Bank's intervention in the money markets. Indeed, we have tended to do the reverse, releasing special deposits to avoid upward pressure on very short term interest rates. So the Reserve Assets/Special Deposits arrangement does not perform a useful function in either of these roles.

3. There are, indeed, two positive reasons for wanting to abolish the requirement. The first is that we could some day reach the situation in which we had refunded all the special deposits, and had no way of relieving reserve assets pressure - we came close to that point once in the last 12 months, and it may arise again this year if we are successful in funding the PSBR largely outside the banking system. If that happens, the requirement then becomes a positive embarrassment to the authorities. The other is that the requirement cuts across the prudential need of banks to hold a certain level of "primary liquidity" althought most of the reserves assets are very liquid, they cannot be used by a bank needing liquidity, just because of the minimum reserve assets requirement. On prudential grounds, there is, therefore, a good case for shifting to a prudential "norm" rather than a rigid minimum requirement.

4. Mr Middleton and I have, however, a major doubt about whether this autumn is the right time to launch the initiative. For the remaining monetary role of the Reserve Assets scheme is to reduce the ability of banks to ease their position in relation to the SSD scheme, through the Discount Market, to which the Prime Minister referred several times on Wednesday. As long as there is some reserve assets pressure on the banks their ability to exploit that leak is limited. It would seem imprudent, to put in mildly, to remove the reserve assets requirement at a time when we may be looking to the SSD scheme to put continuing downward pressure on bank lending. Neither of the Governor's arguments for pressing ahead with this change are particularly convincing. As far as the primary banking sector is concerned, the Banking Act will give a statutory backing to the present supervisory system exercised by the Bank and will not involve a fundamental change in kind: there is therefore no need for the change to a prudential ratio to coincide with the coming into operation of the Banking Act. As far as meeting the

criticism of the Reserve Assets system from the advocates of monetary base control is concerned, the Governor's arguments on Wednesday were most unconvincing - the advocates are recommending that the Reserve Assets system should be reformed into a monetary base system, not abolished! The one argument for not delaying on this is the risk, referred to above, that we could be faced with a reserve assets pressure in the banking system which we had no means of relieving effectively.

5. Clearly it would be wrong to form a definite view on this, until we have seen the Bank's paper and discussed it with them. But you may want to indicate to the Governor that we will need to look at the timing of any changes in relation to the possible effect on the efficacy of the SSD scheme.

Monetary Base and Exchange Control

6. I understand that the general view amongst Bank officials is that it would not be possible to operate either the existing SSD scheme or any "type" form of monetary base control system, if exchange control is demolished completely. The effect of either the SSD scheme or a monetary base scheme is that, at times when the money supply is tending to grow too fast, United Kingdom banks are caused to move their interest rates in a way which reduces both the demand for advances and the infl of deposits to finance them: this means in practice that they widen their margins. When this happens at present under the SSD scheme, it causes some real cut back in the level of liquidity and credit in the economy, and some disintermediation into channels outside the banking system, eg into acceptances or into other forms of inter-company market. But if there were no exchange control, there would be a very real risk that the disintermediation would be into offshore banks, including foreign associates of UK banks. If, for example, a British clearer found itself with pressure under the corset, or found that it was having to bid a very high price for "base money" under a monetary base system, it might encourage some of its customers to deposit their sterling with its French associated company, and other customers to

[illegible] of the Reserve Assets system from the advantages of [illegible] control is concerned, the Governor's arguments [illegible] [illegible] [illegible] Reserve Assets system should be extended into a [illegible] [illegible]. The [illegible] argument for not [illegible] [illegible] referred to above, that we would be faced with [illegible] pressure in the [illegible] system which we had no means of [illegible] effectively.

4. [illegible] I would be wrong to take a definite view on these until we have seen the Bank's paper and discussed it with them. But [illegible] [illegible] to the Governor that we [illegible] [illegible] of any changes in relation to the possible [illegible] of the SSD scheme.

Monetary Base and Exchange Control

5. I understand that the general view amongst Bank officials is that it would not be possible to operate either the existing SSD scheme or the "light" form of monetary base control system, if exchange control is [illegible]. [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible]. [illegible] [illegible] [illegible] [illegible]

borrow from that French associate, who would be able to have a narrower margin between its deposits and lending rates. The Bank, and I think also the Government, would have grave misgivings about a monetary control whose effect was to cause disintermediation, fostering offshore banking at the cost of the UK financial system. Moreover, such disintermediation would be a serious gap in the monetary control, because the sterling deposits held abroad in those circumstances, would be intended for UK use, and so therefore really part of the UK money supply. In many ways this is the problem which the United States has with the euro-dollar markets, and I think it would be worse relatively for us.

7. The response of officials in the Bank to this is to revert to the 1971 doctrine that one should rely on interest rates as a means of monetary control, and not have any form of direct control, even if the latter was primarily directed at ensuring the interest rates move as required. They would argue that as a matter of principle it is wrong to have a monetary control which discriminates against one part of the financial system, namely the banks. But if you follow this approach, it means that the instruments of monetary control which remain to the authorities are only the size and composition of the PSBR, short term interest rates and, subject to the limitations discussed in the paper on the Gilt-edged Market, long term interest rates.

8. I think that some of us in the Treasury have doubts whether these weapons are sufficient to control the growth of the money supply, if adherence to the monetary target is a critical element in the Government's macro-economic strategy, for the reasons set out in the brief for Wednesday's meeting. If this is correct, something like the SSD scheme or the monetary base control is necessary. And it may well be that these do require the retention of exchange control over residents' sterling bank deposits abroad, and possibly, over residents borrowing from abroad.

banks (and their French associates, who would be able to keep a secondary margin between the deposits and lending rates). The Bank, and I think also the Government, would have grave misgivings about a development whose effect was to cause disintermediation, including offshore banking at the cost of the UK financial system. Moreover, this disintermediation would be a serious gap in the monetary controls, because the sterling deposits held abroad in this circumstances, would be excluded from UK use, and so [illegible] exactly [illegible] the United States did with the euro-dollar markets, and I think it would be hardly desirable for us.

7. The response of officials in the Bank to this is to recur to the CCC doctrine that one should rely on interest rates as a means of monetary control, and not take any form of direct control. When is the latter was primarily directed at ensuring the interest rates are so required. They would argue that as a matter of principle it is wrong to have a monetary control which discriminates against one part of the financial system, namely the banks. But if the [illegible] approach, it means that the maintenance of monetary control relies wholly or predominantly on the rise and negotiation of the MLR, which have increased quite [illegible], subject to the fluctuations attendant on the growth of the money supply target, from time to time.

8. I think that some of us in the Treasury have [illegible] [illegible] of [illegible] the [illegible] of the [illegible].

9. We have not had time to work this through properly amongst ourselves, or to discuss it with the overseas side. But I think that there are strong grounds for saying that we do need to carry forward our thinking about the future of monetary control, while there is still time to take account of it in relation to future decisions on exchange control. The Governor's timetable, with its proposed seminar with outside interests in December before anything further was done between the Bank and ourselves, clearly risks that the decisions on exchange control would have had to be taken long before any firm view had been reached on monetary control.

10. You may therefore like to make the point to the Governor that you do want the further thinking between the Bank and the Treasury on forms of monetary control to have been carried to a point at which th interaction between future alternative monetary control regimes and future alternative exchange control regimes had been properly evaluated, before the time comes to take further decisions on exchang control.

J M BRIDGEMAN
20 July 1979

87

EF2 CS

Chief Secretary
Financial Secretary
~~Minister of State~~ - Co[illegible]
Minister of State - L
Sir Douglas Wass
Sir Lawrence Airey
Sir Fred Atkinson
Sir [illegible]
Sir [illegible]
Mr [illegible]t
Mr [illegible]
Mr [illegible]
Mr [illegible]
Mrs Hedley-Miller
Mr Gill
Mr Hodges
Mr Ilett
Mr McIntyre

Mr Ridley

19/vii

EXCHANGE CONTROL RELAXATIONS

The Secretary of State for Trade's letter of 13 July commented on the new exchange control package. As before, Mr Nott would have liked you to go further and he made a particular plea for the complete relaxation of the control on the use of sterling for the finance of third country trade.

2. He acknowledged that there would not be time for you to act on his recommendation without delaying the July package; but he asked that work be put in hand on third country trade with a view to relaxation in the autumn "assuming of course that sterling remained strong".

3. I attach a draft reply which assures Mr Nott that the work is already in hand. If you agree, I would suggest that the letter should authorise us to consult officials of the FCO and Departments of Trade and Industry at the appropriate stage.

D.H.

D J S HANCOCK
19 July 1979

202/7

68

[illegible]

TO: The Rt Hon John Nott MP
Secretary of State for Trade
1 Victoria Street
LONDON SW1

COPIES TO: Prime Minister
Foreign and Commonwealth Secretary
Industry Secretary
Governor of the Bank of England
Secretary to the Cabinet

Thank you for your letter of 13 July about the relaxation of exchange controls.

2. As you recognise, the business involved in putting together a larger package would have delayed implementation of measures announced on 18 July. I have already set work in hand on preparing a third step in the dismantling of the controls which, if sterling remains strong, I would hope to take in the autumn; and this work will include studying further the question of extending sterling facilities for third-country to the banks, on which I have noted the views recently expressed to you by your British Overseas Trade Advisory Council.

3. As you say, this proposal raises rather fundamental questions about the role of sterling as an international currency. This is one of the points that my officials are now examining. I have asked them to keep the FCO and the Departments of Trade and Industry in touch with their work.

4. I am sending copies of this letter to the Prime Minister, the Foreign and Commonwealth Secretary, the Secretary of State for Industry, the Governor of the Bank of England and Sir John Hunt.

49

PRINCIPAL PRIVATE SECRETARY

cc PS/Financial Secretary
Mr Unwin
Mr P G Davies
Mr Hodges
Mr Ritchie
Mr Ridley
Mr Cropper
Mr Cardona

FINANCIAL TIMES CONFERENCE

I should like to suggest a small amendment to Mr Ritchie's draft - his minute to the Chancellor dated 18 July refers.

2. The references to exchange control on page 8 seem to me to understate the importance of the steps that have been taken. I therefore suggest that the second sentence of the second paragraph on page 8 be amended to read:-

"We took an important first step towards dismantling these controls in the Budget. A second major step was announced last week."

D. H.

D J S HANCOCK
19 July 1979

EF(2)CS

10 MAR 1980

MR WILSON

cc Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Mr Cropper
Mr Cardona
Mr Davies
Mr Hancock

MR BRITTAN - LUNCH AUGUST 6TH

I am sure that Mr Brittan is quite likely to recommend the total abolition of exchange control to the Chancellor. He will do so in some considerable ignorance of the complex issues that have to be resolved before controls are dismantled further. Mr Hancock has already submitted a paper - to the FS/T I seem to remember - outlining what these issues are. It might be helpful to dig it out again so that the Chancellor can refresh his memory of them.

AR

ADAM RIDLEY
2 August 1979

C 51

PS/CHANCELLOR

cc Sir D Wass
Sir K Couzens
Mr Barratt
Mr Hancock
Mr Hodges

EXCHANGE CONTROL

The Financial Secretary has seen your note of 24 July commenting on Mr Hodges' of 20 July which takes up Mr Higgins' supplementaries on 19 July.

On the marking of passports, the Financial Secretary has commented that this practice should end with the dismantling of the remaining controls of outward portfolio investment. He very much hopes that this can be done in the autumn.

PCD

P C DIGGLE
26 July 1979

EFCS
pa - general relaxing
JPM
21.9

CONFIDENTIAL

1. MR HANCOCK
2. SIR KENNETH COUZENS

c.c. Mr Middleton
Mr Gill
Mr Hodges
Mr ~~McIntyre~~

DISMANTLING EXCHANGE CONTROLS AND THE INTERNATIONAL ROLE OF STERLING

I attach below a draft minute for Sir Kenneth Couzens to send to the Chancellor covering the papers on dismantling exchange controls and the international role of sterling.

2. The paragraphs dealing with exchange control have been provided by Mr Hodges and Mr McIntyre. I have drafted the paragraphs on the official sterling balances and agreed them in general terms with Mr Payton on the telephone.

3. We shall be letting you have later today the papers on exchange control and sterling.

DC Maughan

D C MAUGHAN
14 September 1979

CONFIDENTIAL

58

DRAFT MINUTE

CHANCELLOR OF THE EXCHEQUER

c.c. Chief Secretary
Financial Secreta
Minister of State
Minister of State
Sir Douglas Wass
Mr Barratt o/r
Mr Jordan-Moss
Mr Hancock
Mrs Hedley-Miller
Mr Middleton
Mr Unwin
Mr Gill
Mr Hodges

Govenor)
Mr McMahon) Bank
Mr Payton) of
Mr Dawkins) Engla
Mr Walker)
Mr Willetts)

Mr Armitage - T.

Mr Ridley
Mr Cropper
Mr Cardona

DISMANTLING EXCHANGE CONTROL AND THE INTERNATIONAL ROLE OF STERLING

I attach below papers prepared in the Treasury with the cooperation of the Bank of England on the further dismantling of exchange controls and on the international role of sterling. They raise a number of major questions on which you will wish to take decisions in the near future, in particular how far we should go in the next stage of exchange control relaxations and what our policy should be for the official sterling balances.

2. On the international role of sterling, our view is that we should not encourage the use of sterling as an international currency and that we should continue to ask other countries to hold sterling only to the extent that it is required for working purposes. We have been remarkably successful todate

in persuing this policy, the nominal amount of central bank holdings being less now than at the end of 1976, despite the revival of confidence in sterling (in real terms, of course, the decline in the reserve role of sterling has been even more marked). The Treasury and the Bank are at one in recommending that we should continue with our policy for the official sterling balances; not to do so would be seen by our friends overseas as an extra-ordinary turnabout, given the experiences of 1976 and their participation in the Basle Facility. Under the terms of an exchange of letters annexed to the Treaty of Accession, we are also under an obligation to our Community partners to manage our affairs so as to deminish the reserve function of sterling.

3. I should also report that the official holdings of two countries have recently increased by substantial amounts. In the normal course, the Bank of England would have advised the holders concerned of our wish to see the balances restricted to working purposes. As it is, we thought it right to first secure your authority for this action. If we allow these cases to go by default, the whole of our policy on the official balances will be undermined. And with the CFM and IMF meetings upon us, we may well be asked what our policy is. I should be grateful therefore if you could give your authority for the Bank of England to approach the excess official holders forthwith.

4. The paper on exchange control begins with the assumption that Ministers will wish to press ahead with the next step in the dismantling process after Parliament reassembles and that it should be a major step. This would have to include the removal of the remaining restrictions on outward portfolio investment, there being no further intermediate step which seems sensible or practical. The paper goes on to argue that because the portfolio controls are so very much the corner-stone of the system, there is a strong case for removing the remaining controls in other areas as well. In other words, we have almost certainly reached the stage in the programme of relaxations where the next step has to be all or nothing.

5. The paper also draws attention to problems arising from the various other purposes for which the exchange control machine and powers have been used. These include their role in implementing sanctions against Rhodesia, on which we are consulting the FCO, and their support for domestic monetary control, in which context the implications are being further studied. Both issues, of course, also have a bearing on the future of the Exchange Control Act 1947.

CONFIDENTIAL

6. If you agree with the conclusions of the paper, we will plan accordingly and prepare a draft minute for you to send to the Prime Minister and other Ministers concerned.

SIR KENNETH COUZENS

CONFIDENTIAL

Mr Flatt

Mr McIntyre
Mr Raynell
Mr Hodges

cc Chief Secretary
Financial Secretary
Sir Douglas Wass
Sir Lawrence Airey
Sir Anthony Rawlinson
Sir Fred Atkinson
Mr Barratt
Mr Jordan Moss
Mr Littler
Mr Hancock
Mrs Hedley Miller
Mr Middleton
Mr Bridgeman
Mr Unwin
Mr Gill
Mr Hodges
Governor) Bank of
Mr McMahon) England
Mr Ryrie - UKTSD
Mr Armitage - T.Sol.
Mr Ridley
Mr Cropper
Mr Cardona

CHANCELLOR OF THE EXCHEQUER

DISMANTLING EXCHANGE CONTROL AND THE INTERNATIONAL ROLE OF STERLING

I attach papers prepared in the Treasury with the cooperation of the Bank of England on the further dismantling of exchange controls and the international role of sterling.

2. The paper on exchange control begins with the assumption that conditions will continue to be favourable to further relaxation in the autumn and that Ministers will therefore wish to take a major step in the dismantling process. A major step has to include removal of the remaining restrictions on portfolio investment. And because the portfolio controls are so very much the cornerstone of the system, there is a strong case for removing the remaining controls in other areas as well. Some control of access by overseas borrowers to the London market could however continue as a matter of administration or under other powers.

3. We are proposing here a major and historic step - the ending of system of controls which have applied for 40 years. It is unlikely that we can foresee correctly all the main consequences of this, let alone assess their scale. We have however done our limited best to

58

discuss some of these in paragraphs 11-19 of the paper. I should draw your attention to the piece about monetary policy and the banki system in paragraphs 15-18. Here is an example of our uncertainties about whether the effects will be large or small, but it looks as if abolition of exchange control could narrow the options open to the Government on methods of monetary control. If so, we think that is a price which in the end has to be accepted: we can hardly found our monetary controls on everlasting exchange controls.

4. The paper also draws attention to problems arising from the various other purposes for which the exchange control machine and powers have been used. These include their role in implementing sanctions against Rhodesia, on which we are consulting the FCO. Because these complications will have to be sorted out and still more because we think it would be unwise to rush into the abolition of all exchange control powers without a trial period in which the effects of total relaxation could be seen, we think you might say simply, when announcing the new package, that the future of the Exchange Control Act 1947 would now be reviewed - rather than that would be repealed at an early date.

5. Procedure. You would clearly not want to proceed with abolitio remaining controls at the end of October if at that time sterling were under significant pressure or the situation had otherwise changed markedly for the worse. I recommend that anything you say to colleagues about this package be subject to that caveat. Although we are submitting the papers now, we would not think it necessary for you to write to your colleagues about this plan befor the early part of October. If you wrote by the middle of the month, it ought to be possible to make an announcement by end-October. There is no point in letting the proposals lie about Whitehall too long. None of this need prevent you from explaining the plan to the Prime Minister however. So our reference in paragraph 28 of the paper to preparing a minute to the Prime Minister and other Minister does not mean that the minute need go before you leave for Malta.

59

I should add however that while we can arrange to proceed with or defer the main package on this basis, it might be difficult to devise lesser package at short notice for an October announcement. Probably that does not matter - if circumstances imposed deferment of a main package they would be unsuitable for a smaller one.

International Role of Sterling

6. On the international role of sterling, our advice is that, to th rather limited extent that we can influence matters, we should not encourage the use of sterling as an international currency and that should continue to ask other countries to hold sterling in their reserves only to the extent that it is required for working purposes. We have been remarkably successful hitherto with this policy, the nominal amount of central bank holdings being less now than at the e of 1976, despite the revival of confidence in sterling. In real ter the decline in the reserve role of sterling has been much more marke The Treasury and the Bank agree in recommending that we should conti with this policy for the official sterling balances. Our friends overseas would see it as a very important and surprising development we did not do so, giving the experiences of 1976 and their participa in the Basle Facility. We also agreed with our Community partners a the time of accession to manage our affairs so as to diminish the reserve function of sterling and I suppose it might be regarded as a step away from the EMS if we appeared to be "encouraging" some reviv of it. History apart, our present policy is in fact similar to that the Germans, who do all they can to obstruct the growth of mark hold by central banks.

7. I should report that the official holdings of two countries have recently increased by substantial amounts. The Bank of England under present policy would advise the holders concerned of our wish to see balances restricted to working purposes. We thought it right however first to secure your authority for this action. If we allow these ca to go by default, that would be taken as a signal that we have abando the policy on official balances, which would thus be undermined. And with the CFM and IMF meetings upon us, we might well be asked what ou policy is. I should be grateful therefore for your agreement that th Bank should approach the excess official holders.

60

8. Conclusions. We seek your agreement to an announcement of the virtual abolition of exchange control at about the end of October, provided the state of sterling and conditions generally are suitable a the time; and authority to plan accordingly. And we seek your confirmation that we may continue to apply the "sterling balances" policy.

K E COUZENS
17 September 1979

EFCS-1

CONFIDENTIAL

61

EF(2)CS
10 MAR 1980

FINANCIAL SECRETARY TO THE TREASURY

CHANCELLOR OF THE EXCHEQUER

Chief Secretary
Sir D Wass
Sir L Airey
Sir A Rawlinson
Sir F Atkinson
Mr Barratt
Mr Jordan-Moss
Mr Littler
Mr Hancock
Mrs Hedley-Miller
Mr Middleton
Mr Bridgeman
Mr Unwin
Mr Gill
Mr Hodges
Governor) B/E
Mr McMahon)
Mr Armitage T. Sol.
Mr Ridley
Mr Cropper
Mr Cardona

DISMANTLING EXCHANGE CONTROL

The recommendations embodied in the paper attached to Sir Kenneth Couzens' minute of 17 September represent the full fruits of the meeting I held with officials on 15 August. The matter has been gone into with exemplary thoroughness, and I strongly endorse the conclusion reached - in effect that the remaining apparatus of exchange control should be abolished in a single package as soon as Parliament returns next month.

Provided the market is reassured that we are not in the business of making a 'U-turn' in our fundamental economic and monetary strategy, the current setback for sterling is unlikely to go any further, and certainly constitutes no reason for deferment of this historic step.

NL

NIGEL LAWSON
18 September 1979

CONFIDENTIAL

Copy on 197/213/01

62

FINANCIAL SECRETARY

84/04

Copies enclosed for:
~~Chancellor of the Exchequer~~
Chief Secretary
cc. Sir Douglass Wass O/R
Sir Lawrence Airey
~~Sir Kenneth Couzens O/R~~
Mr Barratt O/R
Mr F Jones
Mr Littler
Mr Bridgeman
Mr Hancock O/R
Mr Monck
Mr Unwin
Mr Gill
~~Mr Wicks~~
~~Mr Ilett~~
Mr McIntyre
Mr D A Dawkins (B/E)
Mr E George (B/E)
Mr R Armitage (T Sol)
Mr G E Hosker (T Sol)

TIMING OF EXCHANGE CONTROL PACKAGE AND BP STOCK SALE

We mentioned to you last month (in a background paper on portfolio liberalisation) the possibility of the Government's being criticised if exchange controls on outward portfolio were relaxed shortly after a BP stock sale and this was followed by a fall in the BP price. I have heard from Mr Wicks, who is minuting you separately on the mechanics of the BP sale, that this matter was discussed yesterday by Sir Lawrence Airey with the Bank of England.

2. They agreed that there is a real problem. The exchange control relaxation on portfolio might have a marginally depressing effect on the shares of UK companies with high overseas earnings, like BP. If the relaxation were announced shortly after a Government sale of BP stock and the BP price fell, whether on account of the relaxation or for some quite different reason, there could well be complaints from aggrieved stockholders and accusations of sharp practice by the authorities. Such complaints might be expected to be taken to the Council of the Stock Exchange or to the Council for the Securities Industry or to an MP or to the Press. In the last resort, legal action could not be ruled out. There could be a special problem with th US Securities and Exchange Commission even though the sale will be confined to the London market.

63

CONFIDENTIAL

3. On the timing, we have envisaged a final exchange control package more or less as soon as Parliament returns on 22 October, if the state of sterling and conditions generally are suitable at the time. If unexpectedly they were to be judged unsuitable. I suppose that any but a minimal tidying-up package would have to be postponed for at least several weeks. For the BP sale, separate advice is being submitted but I understand that a convenient date would be 30 October and that there would be serious technical difficulties in postponing it for more than a week or two beyond that if the sale is to take place before December.

4. If an exchange control announcement can be made on 22 or 23 October, this would give the market a week to settle down and there should be no problem. But more than a very few days' delay could upset the BP sales timing. I think that you will wish to bring this point to the Chancellor's notice now, and that it could usefully be mentioned to the Prime Minister in advance of any formal minute to her and other colleagues about exchange control, since it introduces a new time constraint into the process of decision.

C H W HODGES
20 September 1979

EFCS-29 C G

CONFIDENTIAL

CHANCELLOR OF THE EXCHEQUER

c.c. Chief Secretary
Sir D. Wass
Sir K. Couzens
Sir A. Rawlinson
Mr. Barratt
Mr. Jordan-Moss
Mr. Littler
Mr. Hancock
Mrs. Hedley-Miller
Mr. Middleton
Mr. Bridgeman
Mr. Unwin
Mr. Gill
Mr. Hodges
Mr. Cassell
Mr. Shepherd
Mr. Ridley
Mr. Cropper
Mr. Cardona

DISMANTLING EXCHANGE CONTROL

In his minute of 18th September the Financial Secretary called the proposed abolition of remaining exchange controls an historic step. I agree it would be a fairly momentous decision, in view of the amount of money that might want to leave in certain circumstanc Since not everybody is willing to see a weaker exchange rate it is important to be aware of the risks. I do not think we can be at al sure that the current set back for sterling will not go further. Our inflation rate and trade performance may well lead to further depreciation without any U-turn in policy.

My own disposition nonetheless would be to go ahead on two grounds. First, we should be able to do as other countries do and give our investors more freedom, considering we have the advantage of North Sea oil. Secondly, more export of capital will help the current account of the balance of payments and build up some counter part asset to the oil we are using up, as well as making life more profitable for British industry.

FJA

(F. J. ATKINSON)

20th September, 1979.

CONFIDENTIAL

Mr Ramell o.r.

65

FINANCIAL SECRETARY TO THE TREASURY

MR WICKS

cc Principal Private Secretary
PS/Chief Secretary
Sir D Wass
Sir L Airey
Sir K Couzens
Mr Barratt
Mr F Jones
Mr Littler
Mr Bridgeman
Mr Hancock
Mr Monck
Mr Unwin
Mr Gill
Mr Hodges
Mr Ilett
Mr McIntyre
Mr D A Dawkins -B/E
Mr E George -B/E
Mr R Armitage -(T Sol)
Mr G E Hosker -(T Sol)

EE(2)CS
11 OCT 1979

TIMING OF EXCHANGE CONTROL PACKAGE AND BP STOCK SALE

The Financial Secretary agrees strongly with Mr Hodges' minute of 20 September recommending that the possible conflict between a slightly delayed exchange control package and the BP stock sale should be brought to the Prime Minister's attention. I should be grateful if you could provide a draft minute for this purpose.

PCD

P C DIGGLE
21 September 1979

66

cc: Chief Secretary
Financial Secretary
Sir Douglas Wass
Sir Lawrence Airey
Sir Anthony Rawlinson
Sir Fred Atkinson
Mr. Barratt
Mr. Jordan Moss
Mr. Littler
Mr. Hancock
Mrs. Hedley-Miller
Mr. Middleton
Mr. Bridgeman
Mr. Unwin
Mr. Gill
Mr. Hodges 24/ix

Governor)
Mr. McMahon) Bank of England

Mr. Armitage (Tsy. Sol.)

Mr. Ridley
Mr. Cropper
Mr. Cardona

Mr. Ryrie (UKTSD)

SIR KENNETH COUZENS (o/r)

INTERNATIONAL ROLE OF STERLING

Your minute of 17th September referred the Chancellor to papers prepared within the Treasury with the help of the Bank dealing with the further dismantling of exchange controls and with the international role of sterling. On the latter, with which this minute is concerned, you drew the Chancellor's attention specifically to the fact that official holdings of two countries have recently increased by substantial amounts in contravention of existing policy on the sterling balances.

2. You should know that when the Chancellor and the Governor discussed this matter recently, the Governor explained that present policy could be called in question unless these increases were challenged. The Chancellor confirmed that he did not favour any change of policy on the sterling balances and he subsequently agreed that the Governor should take appropriate action in approaching the two countries concerned. I accordingly confirmed this position in a telephone call to the Governor's Private Secretary.

/3.

17/9

67

3. The Chancellor will wish to have a full discussion with Ministers and officials in due course about the exchange control aspects of the papers you sent him. He has noted the views expressed by the Financial Secretary in his minute of 18th September on the subject.

(A.M.W. BATTISHILL)
21st September, 1979

68

FINANCIAL SECRETARY

cc Chancellor of the Exchequer
Chief Secretary
Sir D Wass
Sir L Airey
Sir K Couzens
Mr Barratt
Mr F Jones
Mr Littler
Mr Bridgeman
Mr Hancock
Mr Monck
Mr Unwin
Mr Gill
Mr Hodges
Mr Thornton/
Mr Willetts
Mr Ilett
Mr McIntyre
PECS

TIMING OF EXCHANGE CONTROL PACKAGE AND BP SHARE SALE

I understand that you wish to minute the Prime Minister about the link between these operations.

2. I attach a draft.

23 OCT 1979
46/79
FP

N.L.W.

N L WICKS
24 September 1979

69

DRAFT MINUTE FOR THE FINANCIAL SECRETARY TO SEND TO

Prime Minister

TIMING OF EXCHANGE CONTROL PACKAGE AND BP SHARE SALE

You ought to be aware that there is a link between the timing of the sale of BP shares and the announcement of further steps in dismantling exchange controls.

2. The link arises because an exchange control relaxation on portfolio investment might have a marginally depressing effect on the shares of UK companies with high overseas earnings, like BP. If the relaxation were announced shortly after a Government sale of BP shares and the BP price fell, whether on account of the relaxation or for some quite different reason, there could well be complaints from aggrieved shareholders that the Government had deliberately held up the exchange control announcement so as not to affect the share price before the sale.

3. Such complaints might be expected to be taken to the Council of the Stock Exchange or to the Council for the Securities Industry or to an MP or to the Press. In the last resort legal action could not be ruled out. There could be a special problem with the US Securities and Exchange Commission even though the sale will be confined to the London market.

4. This suggests that the exchange control announcement should be made before the BP sale and plans are being made on this basis.

 70

5. The Chancellor expects to be consulting you early next month about the exchange control package and its timing. Our thinking has been that it should be announced more or less as soon as Parliament returns on 22 October, assuming that the state of sterling and conditions generally are suitable at the time. We have not come to conclusions on the timing of the BP sale, but we think that it ought to take place as quickly as possible. The Chancellor will consult you later about the precise date, but it looks as if 30 October would be a convenient date, provided market conditions are right. There would be serious technical difficulties in postponing it for more than a week or so beyond that if the sale is to take place before December.

6. We will keep you in close touch with developments on the timing of both the exchange control package and the BP sale, but I thought you might wish to be aware at this stage of the link between the two operations.

SECRET

71

CST
Sir D. Wass
Sir F Atkinson
Sir K Couzens
Mr Barratt
Mr F Jones
Mr Littler
Mr Bridgeman
Mr Hancock
Mr Monck
Mr Unwin
Mr Gill
Mr Hodges
Mr Thompson
Mr Willetts
Mr Lett
Mr McIntyre

FINANCIAL SECRETARY TO THE TREASURY

EF(2)CS
17 OCT 1979
53/79

PRIME MINISTER

TIMING OF EXCHANGE CONTROL PACKAGE AND BP SHARE SALE

You will be aware that there is a link between the timing of the sale of BP shares and the possible announcement of further steps in dismantling exchange controls.

The link arises because an exchange control relaxation on portfolio investment might have a marginally depressing effect on the shares of UK companies with high overseas earnings, like BP. If the relaxation were announced shortly after a Government sale of BP shares and the BP price fell, whether on account of the relaxation or for some quite different reason, there could well be complaints from aggrieved shareholders that the Government had deliberately held up the exchange control announcement so as not to affect the share price before the sale.

Such complaints might be expected to be taken to the Council of the Stock Exchange or to the Council for the Securities Industry or to an MP or to the Press. In the last resort legal action could not be ruled out. There could be a special problem with the US Securities and Exchange Commission even though the main sale will be confined to the London market.

This suggests that any announcement about exchange control relaxations should be made before the BP sale and our preliminary plans reflect this.

The Chancellor intends to consult you early next month about the possibility of a further exchange control package and its timing. We have not come to conclusions on the timing of the BP sale, but we think that it ought to take place as quickly as possible. The

Chancellor will consult you later about the precise date, but it looks as if 30 October would be a convenient date, provided market conditions are right. There would be serious technical difficulties in postponing it for more than a week or so beyond that if the sale is to take place before December. This would suggest that, provided conditions generally are suitable for such a move, the ideal timing for the Exchange Control package would be more or less as soon as Parliament returns on 22 October.

We will keep you in close touch with developments on both these points, but I thought you might wish to be aware at this stage of the link between the two operations.

NL.

NIGEL LAWSON
25 September 1979

PO CH/GH/159
Part B

PART B

Relaxation of exchange
control Measures 1979.

22-10-79

DD's 25yrs NA&B 13-3-97

1979

BoE / Cabinet Office

SECRET

10 DOWNING STREET

CH/EXCHEQUER
REC. 26 SEP 1979 73
ACTION Mr Bridgeman
COPIES TO CST, FST, MST(C), MST(L), Sir D Wass, Sir L Airey, Sir K Couzens, Mr Barratt, Mr Middleton, Mr Hodges 26/ix

ry

25 September 1979

Mr Lily
Mr McIntyre
To me & return pl.
26/ix

Dear Martin,

The Prime Minister gave a lunch yesterday for Treasury Ministers and the Governor. They had a wide-ranging discussion. The following is a summary of some of the points covered.

The Domestic Monetary Situation

The Governor said that the monetary prospect was now a little more encouraging. This was for three reasons. First, the Government's funding requirements would be rather lower over the next few months. Secondly, while lending to the private sector was still strong, there were signs that it might begin to edge down soon. Some of the recent lending had been to finance early repayment of foreign currency loans, and this had increased the level of total lending over what it otherwise would have been. Thirdly, the August figures for lending to persons suggested that this category of lending was beginning to moderate.

On the other hand, there were several anxieties. In the first place, there was the engineering dispute, which was causing uncertainty in the market. Secondly, it was still possible that lending to the private sector would continue at a high level - especially if corporate liquidity worsened in response to big pay settlements. Thirdly, there was concern that sterling might fall further. Insofar as this would worsen the inflationary outlook, this would make gilt sales that much more difficult. Finally, there was pressure from rising interest rates overseas.

The Prime Minister asked whether, against this background, interest rates were likely to fall in time to avoid the increase in the mortgage rate in January. The Governor responded that, although the outlook was very uncertain, it seemed more likely that interest rates would stay up than that they would turn down soon enough.

The Prime Minister then asked whether it would not be possible to tighten the "corset" in order to hold back bank lending. The Chancellor explained that, while the "corset" arrangements could in principle be changed so as to eliminate the existing leakages, the banks and borrowers would almost certainly find new ways of evading the controls. For example, inter-company lending would probably increase. There might also be increased borrowing from abroad. Ultimately, the authorities had to rely on interest rates to bring the level of credit creation to the private sector within the desired limits.

43/9

SECRET

/Exchange Controls

76

Exchange Controls

The Chancellor said that a decision would have to be taken within the next few weeks on the further dismantling of exchange controls. A firm decision one way or the other was needed partly in connection with the sale of BP shares. His own preliminary view was that the remaining controls should be dismantled.

The Prime Minister said that she would be glad to discuss this after the Chancellor returned from the IMF/Bank meetings: but her initial view was that there should be no further relaxation for the time being. She felt that it would be a mistake to relax the controls further until the Government's market philosophy was being seen to work. To move any further now could all too easily lead to a large outflow of funds.

I am sending a copy of this letter to John Beverly (Bank of England).

Tim Lankester.

M.A. Hall, Esq.,
HM Treasury.

75

Financial Secretary

Mr Hett
Mr McIntyre

cc Chancellor of the Exchequer
Chief Secretary
~~Financial Secretary~~
Sir Douglas Wass
Sir Lawrence Airey
Sir Fred Atkinson
Sir Kenneth Couzens
Mr Ridley
Mr Littler
Mr Barratt
Mr Unwin
Mrs Gilmore
Mr Hodges
Mrs Lomax
Mr Riley
Mr Cardona
Mr Bridgeman
Mr Hancock

Mr Fforde)
Mr McMahon)
Mr George) B/Eng
Mr Goodhart)
Mr Holland)

EXCHANGE CONTROLS, THE EXCHANGE RATE AND INTEREST RATES

1. When coming to decisions about a further relaxation of exchange controls, you will wish to make an assessment of the risks to other Government objectives in the monetary field. Mr Bridgeman's minute of 1 October deals with the complications which result for monetary control. This note is intended to help you get a feel for the implications of exchange control relaxation for interest rates and the exchange rate over the coming winter - ie for the rest of the financial year 1979-80. It does not deal with complications for monetary control arising from the possible discontinuation of the SSD scheme which is considered in Mr Bridgeman's note.

2. Perhaps I could start by repeating the rather obvious point with which all these submissions begin. Relaxing exchange controls offers a new opportunity to purchase overseas assets. The extent to which this happens depends on confidence in the UK economy. Confidence is a very difficult concept to get hold of and almost impossible to quantify. But let us start by assuming that confidenc remains about as strong as it has been so far this year.

3. The relaxations which were announced in June effectively removed control over the financing of direct investment, the

76

purchase of securities in EEC currencies and the repayment of foreign currency borrowing. Limited experience so far seems to indicate that there is a substantial interest on the part of UK residents in taking advantage of these relaxations. We are of course uncertain about this; the time period is short and though we have some evidence concerning actual transactions the most complete and up-to-date information relates to authorisations. But it seems not unreasonable to think in terms of an outflow from the private sector of some £1 billion for the rest of this financial year on account of these relaxations.

4. It is not easy to carry this thinking forward and apply it to portfolio investment. As the note attached to Sir Kenneth Couze submission indicated the outflow could be in the region of £1½-2½ billion a year over the next two years. Of this it might be reasonable to think that an initial £1 billion or so could take place in the present financial year. So, taking the existing and proposed relaxations together we could experience an outflow of some £2 billion over the winter months on account of exchange controls, given the present degree of confidence.

5. With an outflow of this size, there is likely to be downward pressure on the exchange rate. Such pressure could only be avoided if confidence actually strengthened. This might both reduce the size of the private sector outflow or compensate for it by inflows from the rest of the world. There is of course nothing impossible about a strengthening in underlying confidence. If the markets judge the Government's policies increasingly favourably in a world plagued with inflation, or if there are disturbances in the oil market, sterling could remain very strong - though it would still be somewhat lower than it would have been had the relaxations not taken place. If the rate does remain firm, there need be no serious worries about the overall effect on £M3 of exchange control relaxation. It is difficult to predict exactly which way the monetary effects would go; but though the effect on £M3 would probably be small, the situation would be characterised by a strong growth in domestic credit offset by large negative externals.

6. This combination of circumstances is not however the one to

purchases of securities in the currencies and the repayment of foreign currency borrowing. Similar experience in the [illegible] seems to indicate that there is a substantial interest on the part of UK residents in taking advantage of these relaxations. [illegible] uncertain [illegible] the first period is short and though we have some evidence [illegible] without [illegible] the more complete and up-to-date information relating to [illegible]. But it seems not unreasonable to think in terms of an outflow from the private sector of some £3 billion for the rest of this financial year as a result of these relaxations.

4. It is not easy to carry this thinking forward very readily to portfolio investment, as the main [illegible] is that it [illegible] [illegible] [illegible] the outflow would be [illegible] of £2-£3 billion a year over the next few years. If this is right, it [illegible] be [illegible] than an outflow of £3 billion or so [illegible] take place in the present financial year. And, though the [illegible] and proposed [illegible] relaxation would [illegible] an outflow of some £3 billion over the [illegible] months as a result of exchange controls, given the present [illegible] of confidence.

5. With an outflow of this size, there is likely to be downward pressure on the exchange rate. Some pressure could only be [illegible] if confidence [illegible] strengthened. This would [illegible] reduce the size of the private sector outflow or [illegible] the [illegible] from the rest of the world. Those of us [illegible] [illegible] [illegible] [illegible] a [illegible] [illegible] is [illegible] [illegible] of the markets [illegible] the Government's policies [illegible] [illegible] and [illegible] with inflation, [illegible] [illegible] the [illegible] on the [illegible], [illegible] [illegible] [illegible] [illegible] though it would of [illegible] [illegible] than it would have been had the relaxations not taken place. If the [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] of exchange control [illegible]. It is [illegible].

6. [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] the [illegible]

77

concentrate on when considering risks. In the absence of an underlying improvement in confidence, the exchange rate could fall as the large initial flows referred to in para 4 take place. This would, in turn, affect prices and perhaps activity so that the demand for money would increase - requiring higher interest rates to keep the money supply within the target than if the relaxation of controls had not taken place.

7. There would, in any case, be some upward pressure particularl on long rates from the relaxation of exchange controls:

a. UK residents will finance the outflows resulting from the relaxation of exchange controls to some extent by bank lending, but mainly by reducing their demand for UK assets. Substitution between gilts and overseas assets is likely to be high so we should expect a considerable fall in the demand for gilts. In particular, the relaxation of exchange control might substantially reduce the extent to which the institutic channel new funds into the gilt market. The institutions wil of course reduce their bank deposits to some extent to financ their portfolio diversification. But they have in the past financed their holdings of overseas assets largely by foreign currency borrowing. We think that they will be very keen to repay this, and the easiest way of financing such transactions would be at the expense of buying gilts. We are not too sure yet about the likely size of this effect; some of the overseas transactions will have been financed by back to back loans - (the borrower secures his foreign currency loan by making a fixed sterling deposit with a bank) - which as they are unwound will produce a compensating reduction with the banks. But taking all these factors into account the effect on gilt sales this year might be of the order of £1 billion.

b. This will come at a time when, during the rest of the financial year, the gilt market is also likely to be adversely affected by:

i. The £1 billion of public sector asset and oil sales.

ii. Substantial redemptions of maturing stock totalling £2¼ billion. This is likely to cause considerable

78

indigestion and perhaps lead to some awkward monthly figures for DCE and money.

In these conditions it will not be easy to manage the monetary system over the remainder of the present financial year and monetary growth may not be very smooth. If, in addition the SSD scheme has to be abandoned without replacement, the growth of the money stock would be increased both because of the effect on expectations and reintermediation adding further to the upward pressure on interest rates.

8. All this has been on the basis of continuing good but not improving confidence. If the Government sticks to its monetary targets throughout the winter, and if its resolve to pursue its declared fiscal and monetary policies in the medium term remains, there is no reason to dwell on a situation in which confidence weakens. But of course there is always the risk that this might happen temporarily; in this case the flows out might be larger, the exchange rate lower and the interest rate higher at least for a time.

9. In conclusion I should perhaps point out two further things:

a. This is not a forecast. I am simply trying to paint the prospect in such a way that the risks implied by a further relaxation of exchange control in October can be appraised in a timely way. The short term forecast to be delivered shortly will provide a more comprehensive background against which to assess them. Meanwhile it seems safe to say that a further package of exchange control relaxations would significantly increase the risk of a lower exchange rate, and higher interest rates than otherwise particularly at the long end of the market.

b. These risks do not in any way suggest a crisis. The markets will appreciate that high DCE and some temporary fall in the exchange rate would be the result of a once-for-all effect of the relaxation of exchange control. They would also probably accept that rather more intervention than normal was an appropriate response to the once and for all effects resulting from the effective end of exchange controls. We may however have to go in for some public education to ensure that if the money supply has a rapidly growing domestic

74

component offset by a large negative external, this does not itself lead to adverse expectations of the sort which we have seen develop - for example in 1976 - when the circumstances were very different.

pp E. K. Clarke
P E MIDDLETON
1 October 1979

80

CONFIDENTIAL

FI NCIAL SECRETARY

Mr Holt
Mr McIntyre

cc Chancellor of the Exchequer
Chief Secretary
Sir Douglas Wass
Sir Lawrence Airey
Sir Fred Atkinson
Sir Kenneth Couzens
Mr. A. Ridley
Mr. Cardona

without enc.

cc Mr. Barratt
Mr. Middleton
Mr. Unwin
Mrs. Gilmore
Mr. Hodges
Mrs. Lomax
Mr. Riley

Mr. Fforde) Bank of England
Mr. McMahon)
Mr. George)
Mr. Goodhart)
Mr. Holland)

EXCHANGE CONTROL AND DOMESTIC MONETARY CONTROL

Work over the last two months on the proposed relaxation of exchange control over portfolio investment has shown that the only sensible way of making the move involves such extensive dismantling of exchange control over borrowing and lending between UK residents and non-residents that there would be no possibility of continued effective use of the Supplementary Special Deposit scheme (even at its present dubious level of real effectiveness) or the future use of "tight" forms of monetary base control.

2. Mr. Bridgeman's minute of 1 October below explores the implications, and the paper attached to his minute discusses more generally the potential role and value of direct monetary controls.

3. I hope that there will be a good opportunity for you to reflect further on the long-term implications when we present to you a study of the possible merits of a variety of forms of monetary base control. (This is a joint Bank of England/Treasury study, in which we are looking to the Bank of England for the basic analysis: I am afraid we shall not have it ready for about a fortnight.) On the basis of our discussions so far, I cannot think that we shall find sufficient net and durable value in any of the forms of direct control which have been used or considered to warrant indefinite retention of exchange control to protect them.

81

4. But there is a more difficult and immediate question of timing. It is our judgement that, once the proposed exchange control relaxations have been made, the current Supplementary Special Deposit scheme would have to be allowed to fade out: in the new circumstance it could so readily be by-passed and this would be so widely recognis that it would simply not be plausible for the Government to appear to attach importance to it; moreover many of the ways in which it would be by-passed would benefit foreign institutions or undesirably build up off-shore operations by UK institutions.

5. We need therefore to consider the implications of more or less simultaneously making the exchange control move and dropping the "corset". I think there are at least three:-

(a) The dropping of the "corset" would mean that the Government would have to rely more directly and overtly on interest rate movements to control the growth of bank lending: I think it would be sensible to recognise this publicly, but obviously to do so would be more or less embarrassing depending on circumstances and timing.

(b) We must expect a good deal of re-intermediation, and have indeed estimated that it could increase the growth of recorded £M3 by 2 percentage points or so: we might hope, just as we have made no attempt to hide the acceptance leakage, etc., in recent months, we could command some respect for the argument that reality was not being changed; but it would of course be embarrassing if the result was to carry money supply growth during the present important first financia year for this Administration beyond the target.

(c) We must expect substantial portfolio-switching, not least from the big institutions, probably with the net effect of reducing £M3 while leaving a perhaps high DCE figure untouched: it is certainly arguable that this kind of portfolio-switching makes a once-for-all difference in the definition of the statistics without immediately and significantly affecting the underlying reality of liquidity and credit - there would be many side-effects but we cannot hope to trace them all through in advance. It might be sensible to sound some warnings about the impact of the move on future monetary figures.

6) I am not myself persuaded that the proposed exchange control move will of itself greatly affect immediate monetary conditions in the UK or our future ability to influence them. What we shall be dealing with will mainly be presentational problems. We shall need to consider what, given prevailing circumstances, the Government can plausibly say and how the markets will receive it. I do not think we need any ideal "fair weather" in which there is plentiful slack in the rate of money supply growth and no pressure on interest rates, but I would prefer a rather more auspicious moment than any over the last few months. The development which would be most helpful would be some clear sign of an abatement of the pressure of bank lending. If that occurred, there could be several consequences in markets and I would be inclined to recommend taking the opportunity to make the exchange control move rather than, as one possible alternative, encouraging a reduction in interest rates.

(J.G.LITTLER)

2 October, 1979

Mr Hett
Mr McIntyre
Mr Barrett
Mr Hodgeson 8/x

83

CHANCELLOR OF THE EXCHEQUER

Chief Secretary
Sir D Wass
Sir L Airey
Sir F Atkinson
Sir K Couzens
Sir A Rawlinson
Mr Barratt
Mr Jordan-Moss
Mr Littler
Mr Bridgeman
Mr Hancock
Mrs Hedley-Miller
Mr Middleton
Mr Unwin
Mr Butt
Mr Gill
Mr Hodges Ht. 8/x
Mrs Lomax
Mr Wicks
Mr Ridley
Mr Cropper
Mr Cardona
Governor)
Mr Fforde) B/E
Mr McMahon)
Mr Dawkins)
Mr Ryrie - UKTSD

DISMANTLING EXCHANGE CONTROL

You asked me to consider the recommendation put forward by Sir Kenne Couzens with his minute to you of 17 September which we are to discu next Tuesday afternoon, 9 October. I have been into this matter with officials. An important implication for domestic monetary poli in 1979-80 has been identified which could affect the timing. Subje to what I say about that below, my conclusion remains that we should go ahead with the plan to remove virtually all remaining exchange controls in a single package on Tuesday 23 October.

Exchange control and exchange rate policy

2. From the point of view of exchange control policy, there is everything to be said for moving now to virtually complete abolition No partial dismantling of controls over outward portfolio investment has been devised that makes any sense at all. And any intermediate

84

position between the abolition of control over outward portfolio investment and total abolition of controls would be riddled with leakages and liable sooner or later to bring the system to discredit

3. The choice therefore, as I see it, lies between taking the radi step of total abolition as soon as possible and deferring it until later without any certainty that a better occasion will arise. We must recognise the risk that complete dismantling would add signifi to downward pressure on the exchange rate. If we could be sure tha at some future point we would enter a period in which we could incur that risk with greater confidence than at present, that would be an argument for postponement on exchange rate grounds. But it is not realistic to think in these terms. There will always be reasons wh sterling may fall.

4. No one can say for sure what the effects of abolition on the exchange rate will be. Perhaps the crucial question is this: if we do drop exchange controls in October and confidence seriously weake in the winter, how far will the abolition of exchange controls add to pressure on the pound?. In my view, it is our determination to persist with our financial and monetary policies that is crucial to the underlying strength of sterling and not the presence of exchange control. There are so many means available within the present excha control system of getting out of sterling - for example, leading anc lagging by residents and the withdrawal of funds by non-residents - that I do not believe that the abolition of controls will make a fundamental difference to the exchange rate.

5. By contrast, a decision to abolish controls now would unquestionably assist one important Government policy: namely to cut the size of the public sector. To go ahead in October would permit a rapid rundown of staff at the Bank of England over this winter. To postpone the decision would delay the achievement of these staff savings.

Implications for domestic monetary policy

6. Paragraphs 15 to 18 of the paper on exchange control attached to Sir Kenneth Couzens' minute of 17 September describes the implications of exchange control relaxation for domestic monetary policy.

95

The point is there made that, once the remaining exchange controls had gone, it would be easier for banks to avoid direct controls over the money supply (such as the present corset and various versions of the monetary base control system which officials are examining) by switching business to overseas banks.

7. This aspect has now been examined in detail. Mr Bridgeman's minute and paper dated 1st October dealt with the implications for monetary controls, while Mr Middleton's minute of the same date deals with the other implications for domestic monetary conditions. On the former the conclusion reached is that, without exchange controls, the use of direct monetary controls would be severely limited. To have one without the other would have the effect both of driving part of the British banking system offshore and of reducing, if not eliminating, the effectiveness of monetary control. But retaining exchange control would not be an acceptable price to pay for the possible advantages (which are not undisputed) of adding direct controls to the more general monetary controls - name fiscal policy and interest rate policy at both the short and long ends of the market. Officials have examined the possibility of keeping a few directly relevant exchange controls so as to preserve the option of retaining the corset or introducing the relevant form of monetary base control; but they have concluded that, once portfolio controls and the associated monitoring procedures had gone, it would not be possible to sustain an effective scaled-down control of this sort.

8. Neither I nor officials believe that this is a reasons for abandoning our plan to dismantle exchange control. But it is releva to the timing of the final move. If we abolish controls in October there will be a strong case for allowing the corset to lapse in December. The ending of the corset could be followed by an addition to the sterling M3 statistic which might, depending on other developments, jeopardize the achievement of the target during the relevant 10 month period. Also the banks have been holding back on certain forms of marketing, such as the Lloyds home loan scheme, and

they would press ahead if the corset lapsed. It is possible that such developments, together with the possible effect as the exchange rate explined in Mr Middleton's note might require a further upwar move in both long and short term interest rates to protect the target by further deterring bank lending and by securing most gilt sales in what may be uncertain conditions. This would strictly speaking reduce even further the already slim chance of interest rates falling sufficiently for building societies to stop the increase in their mortgage rate.

9. None of this is conclusive and it may well be that other devel ments will permit us to accept the consequences of the lapse of the corset (which, sooner or later, is inevitable anyway) at the end of the year. Much turns on the outlook for the PSBR over the month ahead and in particular the question of how soon we shall see the downturn in bank lending which we have been expecting for so long.

10. Further information on these points will be available for consideration at your meeting on Tuesday afternoon which is why it has been postponed to that time. My conclusion is that, if the out look for the monetary aggregate is reasonably secure and the implic ions for interest rates acceptable, we should go ahead with the abolition of exchange control in October and the lapse of the corse in December. But, if the figures are likely to be disappointing to the market, there may be a case for postponing the abolition of exchange control, probably until the spring.

Other points

11. Three otherpoints are relevant to the decision on exchange control. The first concerns the European Monetary System. It would be difficult to join the EMS until controls had been fully dismantle and the foreign exchange market had absorbed the consequences of any stock-shift that might follow. This is an argument for abolishin controls at the earliest practicable moment - ie to bring forward the time at which the Government would at least have the option of joining the EMS at a realistic rate and without incurring the extra

87

risks due to the short-term effect of the abolition of controls on the exchange rate. The Prime Minister might think this a relevant factor in the context of the changes that we are seeking in the European Budget arrangements.

12. Second, it would be necessary to have special arrangments for continuing exchan ge controls against Rhodesia if the general control are removed and sanctions cannot be lifted. Officials have preparations in hand for this. So long as these controls remain in place, we shall not be able to repeal the Exchange Control Act. But, in any case, I accept officials' advice that we should consider more carefully the case for retaining or replacing that legislation before we made any policy announcement about its future, and that for the time being at least the Act should remain on the statute book even if all the remaining controls were abandoned.

13. Third, the timing of the exchange control package needs to be related to that for the sale of BP shares because, if portfolio liberalisation came fairly soon after the sale and the BP share price fell, the Government would be seriously open to criticism (and might even be liable to be sued). In your absence, I have already drawn the Prime Minister's attention to this link. The best time for the BP sale seems likely to be about the end of October so the exchange control ammouncment should come about one week earlier - for that reason Tuesday 23 October has been identified for planning purposes. If 23 October is ruled out, we should have to postpone the package for at least 2 months after the BP sale: however, as explained in paragraph 10, postponement for monetary policy reasons probably means postponement until the spring.

<u>Conclusion</u>

14. Unless any new information available at your meeting on Tuesday shows that it would be too risky to allow the corset to lapse in December, I would recommend that you confirm the present plans for an announcement of the virtual abolition of exchange control on

23 October. The announcement could, of course, be aborted at any time between now and then if a new assessment of monetary condition or devlopments in the foreign exchange market made that appropriate

15. The next step after your meeting on Tuesday should, I suggest be a minute to the Prime Minister with copies to the other Minister directly concerned, in which you will no doubt wish to rehearse the positive benefits of Exchange Control abolition, which I have deliberately omitted from this already over-long minute.

NL.

NIGEL LAWSON
4 October 1979

89

Chancellor of the Exchequer

cc Financial Secretary
Chief Secretary
Sir Douglas Wass
Sir Lawrence Airey
Sir Fred Atkinson
Mr Kenneth Couzens
Mr Ridley
Mr Littler
Mr Barratt
Mr Bridgeman
Mr Hancock
Mr Unwin
Mrs Gilmore
Mr Hodges 29/x
Mrs Lomax
Mr Riley
Mr Cardona
Mr Spencer
Mr Bell
Mr Grice
Mr Williams

Mr Fforde)
Mr McMahon)
Mr George) B/Eng
Mr Goodhart)
Mr Holland)

MONETARY PROSPECTS FOR 1979-80

My minute of 1 October to the Financial Secretary points to some of the risks inherent in the decision to remove exchange controls. The attached note outlines our central view of the prospects assuming that the decision is in fact taken in October, but that the SSD scheme is extended beyond the end of 1979 on the same basis as at present. It is consistent with the note on the Economic Prospect which you received today. It takes account of the September banking figures and has benefitted from a very close look by the Bank and the Treasury at the prospects for the October-December quarter.

PEM

P E MIDDLETON
8 October 1979

Enc

1/10

90

MONETARY PROSPECTS IN 1979-80

Introduction

1. The forecast shows monetary growth of some 9% for the financial year as a whole; this implies growth towards the bottom end of the target range of 7-11% at an annual rate from mid-June.

2. The prospects for output, inflation, the PSBR and the current account of the balance of payments are important determinants of monetary prospects. The background is of output falling between now and the end of the financial year while the rate of inflation, measured in terms of the increase on a year earlier in the RPI, continues to increase. Most importantly also, the PSBR in the second half of the financial year is expected to be much lower than in the first half - about £2½ billion compared with £6 billion - as public sector asset sales are realised and the Post Office receives delayed payment of telephone bills. The current account is expected to remain in substantial deficit over the period.

3. The forecast for the exchange rate for the rest of this financial year is heavily influenced by the exchange control assumption. Against a background of somewhat weaker confidence and firm or rising foreign interest rates, this puts steady downward pressure on the exchange rate over the winter months - though without precipitating a crisis. In view of the largely once-for-all nature of the immediate outflow, we have assumed that some of this pressure will be taken on the reserves; there is therefore some supporting intervention by the authorities. Even so, the effective rate is forecast to fall to around 65 by the end of the financial year.

The External Forecast, Exchange Controls and Overseas Monetary Assumptions

4. Though we do not anticipate any very dramatic reversal of confidence, some weakening in underlying exchange rate expectations seems possible. North Sea oil and recent sharp rises in the real oil price have made it hard to reach a view on an appropriate rate for sterling. But the effective exchange rate is currently high in relation to all the conventional indicators, such as relative money supplies and price and cost competitiveness. And the view

that sterling is, at present levels, rather overvalued, is gaining ground among economic commentators and may command wider acceptance during the winter months, against the background of cotninued current account weakness and high UK inflation. Demonstrable success in meeting the monetary target is the main factor producing a good underlying state of confidence.

5. Interest rate differentials are likely to continue moving against the UK, but the evolution of monetary policy in the United States and, to a lesser extent, other OECD countries is difficult to predict. We have assumed that United States monetary policy will not be significantly relaxed even if there is a fiscal boost next spring. United States interest rates are assumed to peak in the fourth quarter of thsi year, but to remain at a high level in 1980. We do not envisage any reductions in European and Japanese interest rates in the rest of this financial year. The growth of broad money in major OECD countries on a weighted average is expected to be very similar to the UK.

6. On the limited evidence of exchange control authorisations since July, the measures already taken may give rise to substantial outflows both to repay outstanding foreign currency debt and to provide sterling finance for new investment. The consequences of abolishing the investment currency pool depend critically on the strength of the underlying demand for sterling. Even if no pronounced expectations of a flal in the rate were to develop, we would expect some short term outflow, as investors purchase foreign assets to replace the premium element in their existing foreign currency portfolios. Taking 25% as a "normal" level of the premium, this alone could produce flows of about £1 billion. In addition, investors may want to increase the proportion of their wealth invested in overseas assets.

7. So we should expect a further relaxation of exchange controls, on top of measures already taken, to exert significant downward pressure on the exchange rate during the rest of the financial year. The forecast allows for outflows of private capital about £2 billion on this account in the second half of 1979-80. Much of this outflow is a once-for-all stock shift, as portfolios are rearranged. We have therefore assumed that the impact on the exchange rate is cushioned by official intervention totalling about £½ billion over the same period.

92

Domestic Monetary Prospects and Interest Rates

8. The much smaller PSBR expected over the remainder of the financial year implies a quite favourable domestic monetary outlook and the probability that interest rates would come down before the end of the year. This is so in spite of continuing large increases in bank lending and the depressing effect on the gilts market that can be expected to result from public sector asset sales, the relaxation of exchange controls (especially on portfolio) and the heavy redemptions which are due to occur during the period. The forecast suggests that the monetary target for the period to mid-April 1980 can be met with short rates falling to 12% by the beginning of December and remaining there throughout the rest of the financial year, though there would be little change in long rates. This respite on interest rates would only be temporary if the PSBR rises to the forecast £10 billion in 1980-81.

9. External factors in the money supply are substantially negative in the second half of the financial year, perhaps by as much as £1½ billion. These are the combined result of the continuing current account deficits and the outflows projected as a consequence of the abolition of exchange controls. These outflows are only partly offset by capital inflows to the non-bank private sector.

10. The attached table shows the forecast of £M3 and its counterparts on a calendar quarterly basis for 1979-80. Apart from the low PSBR and substantially negative external factors in the second half of the year already noted, the main features of the forecast are:

a. Exchange control relaxations substantially reduce the extent to which the institutions channel new funds into gilts. Outflows of £1½ billion in the second half of the financial year reduce gilt sales by about £1¼ billion.

b. The gilts market is also likely to be adversely affected by sales of public sector assets and oil sales totalling £1 billion over the period; and by maturing stock of £2¼ billion. These together might be expected to reduce gilt sales by £1¼ billion.

c. In spite of these adverse influences on the gilts market we expect the underlying state of expectations to remain

93

reasonably strong. In particular the markets will be aware of the reduction in public sector borrowing, and the reduction in short rateswill, temporarily at least, lead to favourable expectations at the long end of the market. We forecast sales of about £1½ billion in the second half of the year, which although considerably less than the sales of nearly £5 billion recorded in the first half should be very satisfactory given the adverse factors noted above.

iv. The growth of bank lending, which has been very rapid indeed in recent months, must eventually slow down. But the timing is difficult to predict and we have been fairly cautiou on this. We expect the underlying increase to remain strong during this year, although less so than in the first half of the financial year.

v. Bank lending will be boosted to some extent by the exchange control relaxations, and in particular the relaxation of controls over financing of direct investment already announced. These are forecast to add £½ billion in the second half of the year.

vi. The SSD scheme is expected to continue to exercise a restraining influence over bank lending during the remainder of the financial year and we expect that the extent of disintermediation will continue to increase. So far this has taken the form of a continuing increase in holdings of bank acceptances outside the banking system, and possibly other less visible forms, but the relaxation of exchange controls is likely to add a new dimension to the possibilities for disintermediation. We have not attempted to forecast in detail the forms in which disintermediation will take place after exchange control abolition, but total additional disintermediation over the next six months might be of the order of £½ billion.

11. The timing of any reduction in interest rates in the remainder of the financial year will depend among other things on the likely outturn for the money supply in the next few months. Monetary growth in banking September was a little over ½% and, given the anticipated development of the CGBR, the prospect is for a fall

in £M3 in banking October even if the growth in bank lending remains fairly strong. This would take cumulative monetary growth since mid-June, the beginning of the current target period, to near the bottom of the 7-11% range. The October money supply figures will be published on 15 November and if our expectations prove correct, a reduction in interest rates before Christmas could be possible.

95

THE MONEY SUPPLY AND DCE IN 1979-80

(£bn)	1979(2)	1979(3)	1979(4)	1980(1)	1979-80
PSBR	2.8	3.3	1.0	1.4	8.6
Sales of Gilts	- 2.5	- 2.2	- 0.8	- 0.7	- 6.2
Other public debt	- 0.3	- 0.3	-	- 0.3	- 0.9
£ bank lending to residents	2.3	1.2	1.7	1.9	7.2
Overseas	-	0.2	- 0.1	-	-
DCE	2.4	2.2	1.8	2.3	8.7
External factors	- 0.2	- 1.1	- 0.9	- 0.8	- 2.9
Non deposit liabilities	- 0.2	- 0.3	- 0.3	- 0.4	- 1.1
Change in £M3	2.0	0.9	0.6	1.2	4.7
(%)	(3.8)	(1.7)	(1.1)	(2.2)	(9.0)*

*Money supply on a banking month basis may be slightly higher

96

SECRET

Note of a meeting held in the Chancellor of the Exchequer's office at 2.30pm on 9 October 1979.

THE RELAXATION OF THE EXCHANGE CONTROLS

Present : Chancellor of the Exchequer (In the chair)
Financial Secretary
Sir Douglas Wass
Sir Kenneth Couzens
Mr Littler
Mr Bridgeman
Mr Hancock
Mr Middleton
Mr Unwin
Mr Hodges
Mr Ridley

The Governor of the Bank of England
Mr McMahon B/E
Mr Fforde "
Mr Dawkins "

The Chancellor expressed his appreciation of the lucid analysis presented by officials, and noted that no further sensible intermediate stage in the dismantling of exchange controls could be devised. He accepted that there would be some inevitable side-effects, for example on the production of statistics. More substantial problems had however recently appeared on the monetary policy front (notes dated 8 October by Mr Bridgeman and Mr Middleton). He wondered why these had not emerged earlier.

2. Sir Douglas Wass said that these difficulties had been largely shown up more or less incidentally by the examination of different methods of monetary base control. In retrospect they might have been anticipated by looking at the Germans' experiences with offshore banking. Mr Bridgeman added that it had only become apparent in August that the next exchange control package would remove all controls, so it was only then that this link between monetary control and exchange control had come under scrutiny.

3. In further discussion of the implications of exchange control relaxation for monetary controls, the Governor pointed out that any policy which gave more freedom of choice and more room to look for alternatives would inevitably have some cost. Attempts to control markets drove them offshore, as the UK kept

10/10

BoE

pointing out to Germany and the USA. One could do no more than control one's own system. Mr McMahon added that there were already plenty of ways round the monetary controls.

4. The Chancellor noted that the monetary control issue was clearly important.

5. The Governor said that much of the discussion had been against the background of the nominal M3 figures. He, however, saw little point in claiming that the target had been reached when there was clearly a gap of 2 to 3% and commentators knew this.

6. Sir Douglas Wass thought that the corset had been intended to a certain extent to conceal the credit creation mechanism, admittedly in a cosmetic fashion; the spread of acceptance credits showed that this had happened.

7. Mr Fforde reported the latest monetary figures (to be released on 19 October). The September figures would show a seasonally adjusted increase in sterling M3 of 0.6%, equivalent to 10.1% annually; but if the leakage through acceptance credits (the "bill leak") were included the annual figure rose to 15.3%. Although the borrowing requirement was very high (£1.6b) sales of debt amounted to £1b, and a high DCE (nearly £900m) was offset partly by a private sector outflow of £490m; so the result was a low money supply figure.

8. The outlook for the next 3 months was for futher low M3 figures. The borrowing requirement looked like being low, particularly in November; gilt issues would be modest. Relatively high DCE seemed likely to continue to be offset by outflows, producing money supply figures running along the bottom of the 7-11% range with the possibility of lower short term interest rates for a time.

9. Mr Fforde had these reservations;

i) The bill leak had now reached £900m and was continuing to grow, though more slowly. If this was allowed for we would be running along the top of the target, not the bottom, as commentators would notice.

ii) It was very difficult to predict the performance of the borrowing requirement. The September figures had turned out £300m higher than forecast. Estimates for the future should be treated with particular caution.

iii) Bank lending (£170m) was gratifyingly low; but there was the bill leak, and VAT and PAYE posed particular problems. The engineering dispute might be causing companies to borrow less. An increase in lending to £600m (£500m for domestic use) might be round the corner; while this would compare favourably with figures of £700/800m earlier in the year, it would be wrong to accept the present £170m without qualification.

The Governor commented that this boiled down to so far so good but not so very good.

10. Turning to the question of the timing of the removal of exchange controls, the Chancellor said that the choice was between moving now and waiting at least two months, probably more. To go ahead now would be a logical consequence of changes already implemented and would accord with the Government's stated policy. It would reaffirm faith in their medium-long term strategy. The decision could also be taken in relative isolation from other economic policy decisions.

11. On the other hand, one area where the Government were clearly in reach of success was in bringing the money supply under control. It might be that to relax exchange control now would significantly impair the chances of success here and at the same time bring down the exchange rate and so push up inflation. If this was so it would be difficult to justify acting now; it might be better to wait to the Budget, where this might be just one of a number of eye-catching measures.

12. Sir Douglas Wass wondered whether the decision would be any easier at the time of the Budget; and Sir Kenneth Couzens remarked that the counterpart of presenting the removal of exchange control in the context of the Budget was

that it would place a constraint on the rest of the Budget. While it would be relatively easy to postpone action until the Budget, it would be harder to delay much longer. Mr Hancock recalled that the Government had already aroused expectations.

13. The Financial Secretary saw advantage in keeping the exchange control out of the Budget. The long-awaited fall in bank lending had now materialised. The money supply figures looked good. Dropping controls was a leap in the dark, but then it would always be. Mr McMahon agreed. Early action could increase confidence and would leave the Government with the initiative.

14. The Governor pointed out that the question was one of timing. The possible facilities for outflows were already enormous; £6b private sterling balances, £6b borrowing that could be repaid at any time, and a potential daily leading and lagging of £300 million. There were risks; but an immediate substantial stock shift seemed unlikely. The US market presented the only real danger, and it had been less attractive than the UK market for the past 6 years. Discreet approaches to leading investment institutions suggested that they would react cautiously to opportunities to move into the USA.

15. In addition, the Governor felt it likely we would join the EMS, which could hardly be done while controls remained. This was a marginal reason for moving now. A further point was that unless we took the opportunity to allow the private sector to acquire additional overseas assets next year's North Sea oil gain would simply be consumed; the accumulation of domestic assets was unlikely given the outlook for the next 18 months. For two years debt had been repaid ahead of schedule; this policy was now coming to an end as repayment possibilities ran out. Sir Douglas Wass doubted that relaxation would have much effect on the current account in the short term; but the Governor explained that he favoured a current account surplus which would allow the private sector to invest; they would make better use of the money.

16. Sir Douglas Wass did not doubt the merits of abolition. On timing, he thought that on balance the situation would be more difficult next year. Exchange control relaxation might or might not sit easily with the Budget;

but it would be awkward if it was announded at the same time as fiscal measures with which it seemed inconsistent. At present it might attract a ritual protest from the TUC; but this would not be linked to other live issues. The next three months were likely to be relatively trouble-free. Not to move now would be a vote of no confidence in the policy. Sir Douglas Wass added that he felt that the likely stock shift might have been overestimated. As for the SSD scheme, this was already under great strain and dropping exchange control would be one more nail in its coffin.

17. In further discussion there was widespread agreement that controls should be lifted now rather than later; it was difficult to see when a better moment would present itself. Sir Kenneth Couzens agreed that the monetary difficulties had to be faced. The SSD scheme was in any event at the end of its useful life. If the absence of exchange control meant marginally higher interest rates this was a price which had to be paid sooner or later, unless exchange controls were retained as a permanent instrument of policy. Mr McMahon added that if it was intended to allow the private sector to accumulate more overseas assets it would be logical to respond to a stock shift by spending reserves. Mr Fforde and Mr Hancock agreed.

18. The Financial Secretary emphasised that monetary policy could be managed without exchange controls. He acknowledged the political sensitivity of the mortgage rate. But it was now most unlikely (as the Governor confirmed) that the decision to raise mortgage rates would now be rescinded. The Financial Secretary added that it would be much worse politically if interest rates fell slightly and then had to go up again than if they stayed at their present level throughout. Mr Littler thought that it would be dangerous to give industry any signal that interest rates might be eased just when they seemed to be accepting the Government's determination to hold to present policies; and Mr Fforde commented that this would be particularly unpropitious in the context of movements in external interest rates.

19. Mr Ridley had some doubts. He was a little surprised that no further thought appeared to have been given to the possibility of an intermediate

stage, though Mr Hancock explained that this option was ruled out by technical considerations. Mr Ridley also wondered whether it was not premature to take this decision before the work on monetary base controls had been completed. Monetary policy was of fundamental importance and must not be endangered; he was impressed by the grounds for concern set out in Mr Bridgeman's paper. Nor should the effects of sustained outflows on the RPI be overlooked. Unlike Mr Middleton, he saw advantage in further work on simulating the effects of a substantial outflow as an aid to judgement. The Financial Secretary felt however that a decision now had to be taken on the basis of the available information and the very thorough work that had been done.

20. The Chancellor noted that it would be appropriate to leave an announcement until the House returned; BP sale considerations suggested 23 October. In discussion, it was generally agreed that a plan was needed on how to handle the announcement and the related point about the future of the corset. The exercise could be set in the context of exposing the economy to competition; and it would be important to retain the initiative. If the rate fell unacceptab the Government should make it clear that it was happy to intervene.

21. The Chancellor concluded that, given the complications of Conference week, he would send a minute to the Prime Minister advocating the removal of all exchange controls (except on Rhodesia) after her speech to the Conference on Friday 12 October; and he would hope to discuss this with her over the weekend. If the Prime Minister was content, he would then consult the Foreign and Commonwealth Secretary and the Secretaries of State for Trade, Industry and Defence. It would be necessary to make it clear that the monetary base difficulties had been properly thought through, and to stress the positive benefits of this historic step.

N.J. Ilett.

N J ILETT
10 October 1979

Distribution

Those present
CST
Mr Barratt

102

CONFIDENTIAL

EXC/84/04 (N)

0701 100 01.

FINANCIAL SECRETARY

cc Principal Private Secretary
Sir Douglas Wass
Sir Kenneth Couzens
Mr Barratt
Mr Hancock
Mr Unwin
Mr P G Davies
Mr Drane
Mr Ilett
Mr McIntyre (o.r.)
D A Dawkins (B/E)
Mr R Armitage (T Sol)

EXCHANGE CONTROL: RESTRICTIONS ON ASSETS OF UK RESIDENTS LEAVING THE SCHEDULED TERRITORIES

Section 40 of the Exchange Control Act 1947 gives the Treasury power to place restrictions on the assets of a UK resident who leaves the scheduled territories. This has long been used as part of the control over emigration, to restrict for a period (4 years) sterling assets in excess of the current total (£200,000 since last June) allowed out through the official foreign exchange market. It is also used to assist exchange control enforcement, in certain cases where a person we need to investigate leaves the country. Then complete restrictions may be imposed perhaps indefinitely. This sometimes has the effect of bringing the person back to answer questions or even face a charge; and it may also serve to prevent a loss to the balance of payments from the transfer abroad of ill-gotten gains.

2. Our legal advisers are very doubtful whether we could validly maintain directions given under Section 40 in respect of suspected offenders departed to countries in relation to which exchange control was completely relaxed. In any case, it would be idle to suppose that, if we have complete worldwide relaxation, such restrictions could be made effective. In that event, therefore, I propose to revoke all existing Section 40 directions.

3. I draw attention to this because there are a few quite notorious names among the three dozen or so people currently subject to complete Section 40 restrictions.

It is possible that, all of whom have been featured by the media at various times. It is possible that, if we do relax exchange control completely, the media will get on to the fact that such people's assets are being released from restriction and give the matter some publicity. I believe that the reasons in paragraph 2 above provide an adequate explanation if one is needed.

C H W HODGES
10 October 1979

EXC/54/04

103

Treasury Chambers, Parliament Street, SWIP 3AG
01-233 3000

PRIME MINISTER

EXCHANGE CONTROL

We must now take a crucial decision on the future of the remainder of the exchange controls. As explained in the Financial Secretary's minute to you of 25th September, we must either announce any new package before the BP sale or postpone it for at least 2 months, ie. almost certainly beyond the end of the year. The effect of this is that we have probably to choose between an announcement this month when Parliament returns, and deferment of the next stage of our programme of dismantling these controls at least until the 1980 Budget. In this situation I have authorised preparations for an announcement of further exchange control relaxations on Tuesday, 23rd October. They can be countermanded at any time.

DH.
12/

2. There is a clear case for completing the process of abolition in one step (leaving only controls affecting Rhodesia which must remain while sanctions last). The great bulk of the remaining controls relate to portfolio investment outside the EEC i.e. in practice mainly to investment in US securities. Direct investment is already wholly free and remaining restrictions on individuals are not of great economic significance.

3. Completing abolition would show our determination to implement the policies to which we are committed. It would sweep away another set of controls that has outlived its

/ usefulness.

104

usefulness. It would enable individuals and firms to take investment decisions on commercial grounds and so further our aim of freeing the market economy to operate efficiently. It would reduce public expenditure by the cost of about 750 staff (mainly Bank of England staff) now borne on the Treasury's Vote. It would end a large burden in the private sector on banks, firms and individuals, and there would for example be no more marking of passports. It would fulfil our obligations on capital movements under the EEC Treaty and you could take credit for this at the Dublin Council. And it would please the Americans who do not like the present discrimination in favour of EEC securities that resulted from the relaxations we made in July.

4. We must first consider the implications for the exchange rate. These are exceedingly difficult to predict. Obviously the effect of abolishing exchange controls would be to remit outflows which, especially if they proved substantial, would cause the rate to be lower than otherwise. That is a necessary consequence of the achievement of our aim to abolish exchange control. The question thus is whether the present is a good time to accept the consequence or whether it would be better to wait. In my view, the present is as good a time as we are likely to get. First though we must expect an adjustment of portfolios over a period, this is not a particularly attractive moment to buy U.S. securities. The outflow may, therefore, be gradual. Secondly, sterling has fallen back from the very high level it reached in the immediate aftermath of Iran and the oil developments in the summer. But, at its present level, it is not under pressure. The effect of last weekend's US package is an illustration of this point since, if the market had had serious doubts about the present rate for sterling, they would have shown

permit

/ themselves

themselves when the dollar revived. In fact, the effective rate and the cross-rates against the strong non-dollar currencies stood up well. Sterling seems to have come through this limited dollar rebound unscathed. Obviously this situation could change, but, provided we continue to show our determination to persist with our financial and monetary policies, I would not expect any downward pressure on sterling to get out of control. And the maintenance of the remainder of our exchange control regime will not be crucial since there are so many ways of getting out of sterling as things are at the moment.

5. A further point is that our reserves are very high - $24 billion spot and forward. I would be opposed to sustained intervention to support an exchange rate that the market had com fundamentally to doubt. But in this case I could see a case for heavier intervention than we would normally think appropriate to finance any initial outflows following a relaxation of exchar control. We could explain that the effect of our intervention was to exchange public sector assets in the reserves for assets acquired by the private sector as a result of our change of policy; and I believe that this explanation would be accepted by the markets. If therefore, sterling showed signs of falling too far we could exercise the option to mitigate the fall by intervention.

6. The exchange control decision also has several implications for domestic monetary policy.

7. First, it would make it impossible for us to use effectively certain types of direct control over domestic banks - essentially because the alternative of "offshore" banking would become a readily available substitute. The only direct control we currently use is the "corset", and you will

/ have seen

106

have seen the growing leakage into acceptances which bypass this control and are bringing it into disrepute already. The alternative direct controls which would be similarly ineffective in the absence of exchange control are some of the direct "penalty" versions of monetary base control. In their studies of this following your July seminar, however, the Bank of England and my officials have failed to identify any direct monetary base control which would be robust for any length of time even with full exchange controls. Our main monetary policy instruments: interest rates, PSBR management, management of gilt markets; would be unaffected by the removal of the remaining exchange controls.

8. There could be effects both ways on the \$M3 figures in the ensuing months. These will need to be explained but are likely to be well understood by the commentators as part of a switch in the stock of assets. If the outflow is modest, the effects will be small. And the outlook for the money supply in the next 3 months or so is much better than in the recent past. This is therefore a good time to accept the risk of some impact on the money supply figures arising from exchange control relaxation. This will also be a time when, in the light of the favourable M3 outturn, domestic pressures on interest rates should be a little less. That would help us to accommodate any slight upward pressure on interest rates arising from an outflow.

el

9. I conclude therefore that, unless there are new unfavourable developments before 23rd October, we should go ahead with the abolition of exchange controls on that date. Very careful consideration would need to be given to the presentation of this decision in relation to the whole of our

/ monetary policy,

107

monetary policy, both on 23rd October when the exchange control package is announced and subsequently when we roll forward the target - probably after the announcement of the banking October money supply figures on 15th November. At that stage we would need to consider the future of the corset, due to end in December, and it may be better in the circumstances to let it lapse. It is already losing effectiveness anyway.

CONCLUSION

10. This subject has many ramifications. To keep this minute short I have concentrated on the main points. I hope that we may have an early opportunity to discuss the matter. In the light of the points I have made above, I hope you will agree that, unless there are any untoward developments in either the foreign exchange or the domestic monetary markets, we should go ahead as planned with the total abolition of exchange controls (except for those affecting Rhodesia) on 23rd October.

11. I am not sending copies of this minute to any of our colleagues at this stage. My officials have been in touch with officials of the Departments chiefly concerned and work is in hand, on a strictly contingency basis, for dealing with a number of consequences of abolition for other departments' policies.

(G.H)

11th October 1979

108

cc: Financial Secretary
Sir Douglas Wass
Sir Lawrence Airey
Sir Fred Atkinson
Mr. Barratt
Mr. Littler
Mr. Bridgeman
Mr. Middleton
Mr. Shepherd
Mr. Unwin
Mr. Hodges
Mr. Gill
Mr. Ilett
Mr. Ridley
Mr. Cardona

Governor of the Bank
Mr. Dawkins - B of e

MR. HANCOCK

EXCHANGE CONTROL

The Chancellor approved the minute to the Prime Minister in the form attached below, and it is now in the Prime Minister's hands. It is possible (though by no means certain) that the Chancellor will have an opportunity to discuss it with her when they meet at the weekend.

(A.M.W. BATTISHILL)
12th October, 1979

109

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

EXCHANGE CONTROL

We must now take a crucial decision on the future of the remainder of the exchange controls. As explained in the Financial Secretary's minute to you of 25th September, we must either announce any new package before the BP sale or postpone it for at least 2 months, ie. almost certainly beyond the end of the year. The effect of this is that we have probably to choose between an announcement this month when Parliament returns and deferment of the next stage of our programme of dismantling these controls at least until the 1980 Budget. In this situation I have authorised preparations for an announcement of further exchange control relaxations on Tuesday, 23rd October. They can be countermanded at any time.

2. There is a clear case for completing the process of abolition in one step (leaving only controls affecting Rhodesia which must remain while sanctions last). The great bulk of the remaining controls relate to portfolio investment outside the EEC i.e. in practice mainly to investment in US securities. Direct investment is already wholly free and remaining restrictions on individuals are not of great economic significance.

3. Completing abolition would show our determination to implement the policies to which we are committed. It would sweep away another set of controls that has outlived its

/ usefulness.

usefulness. It would enable individuals and firms to take investment decisions on commercial grounds and so further our aim of freeing the market economy to operate efficiently. It would reduce public expenditure by the cost of about 750 staff (mainly Bank of England staff) now borne on the Treasury's Vote. It would end a large burden in the private sector on banks, firms and individuals, and there would for example be no more marking of passports. It would fulfil our obligations on capital movements under the EEC Treaty and you could take credit for this at the Dublin Council. And it would please the Americans who do not like the present discrimination in favour of EEC securities that resulted from the relaxations we made in July.

4. We must first consider the implications for the exchange rate. These are exceedingly difficult to predict. Obviously the effect of abolishing exchange controls would be to permit outflows which, especially if they proved substantial, would cause the rate to be lower than otherwise. That is a necessary consequence of the achievement of our aim to abolish exchange control. The question thus is whether the present is a good time to accept the consequence or whether it would be better to wait. In my view, the present is as good a time as we are likely to get. First though we must expect an adjustment of portfolios over a period, this is not a particularly attractive moment to buy U.S. securities. The outflow may, therefore, be gradual. Secondly, sterling has fallen back from the very high level it reached in the immediate aftermath of Iran and the oil developments in the summer. But, at its present level, it is not under pressure. The effect of last weekend's US package is an illustration of this point since, if the market had had serious doubts about the present rate for sterling, they would have shown

/ themselves

themselves when the dollar revived. In fact, the effective rate and the cross-rates against the strong non-dollar currencies stood up well. Sterling seems to have come through this limited dollar rebound unscathed. Obviously this situation could change, but, provided we continue to show our determination to persist with our financial and monetary policies, I would not expect any downward pressure on sterling to get out of control. And the maintenance of the remainder of our exchange control regime will not be crucial since there are so many ways of getting out of sterling as things are at the moment.

5. A further point is that our reserves are very high - $24 billion spot and forward. I would be opposed to sustained intervention to support an exchange rate that the market had come fundamentally to doubt. But in this case I could see a case for heavier intervention than we would normally think appropriate to finance any initial outflows following a relaxation of exchange control. We could explain that the effect of our intervention was to exchange public sector assets in the reserves for assets acquired by the private sector as a result of our change of policy; and I believe that this explanation would be accepted by the markets. If therefore, sterling showed signs of falling too far we could exercise the option to mitigate the fall by intervention.

6. The exchange control decision also has several implications for domestic monetary policy.

7. First, it would make it impossible for us to use effectively certain types of direct control over domestic banks - essentially because the alternative of "offshore" banking would become a readily available substitute. The only direct control we currently use is the "corset", and you will

/ have seen

CHANCELLOR OF THE EXCHEQUER

have seen the growing leakage into acceptances which bypass this control and are bringing it into disrepute already. The alternative direct controls which would be similarly ineffective in the absence of exchange control are some of the direct "penalty" versions of monetary base control. In their studies of this following your July seminar, however, the Bank of England and my officials have failed to identify any direct monetary base control which would be robust for any length of time even with full exchange controls. Our main monetary policy instruments: interest rates, PSBR management, management of gilt markets; would be unaffected by the removal of the remaining exchange controls.

8. There could be effects both ways on the £M3 figures in the ensuing months. These will need to be explained but are likely to be well understood by the commentators as part of a switch in the stock of assets. If the outflow is modest, the effects will be small. And the outlook for the money supply in the next 3 months or so is much better than in the recent past. This is therefore a good time to accept the risk of some impact on the money supply figures arising from exchange control relaxation. This will also be a time when, in the light of the favourable M3 outturn, domestic pressures on interest rates should be a little less. That would help us to accommodate any slight upward pressure on interest rates arising from an outflow.

9. I conclude therefore that, unless there are new unfavourable developments before 23rd October, we should go ahead with the abolition of exchange controls on that date. Very careful consideration would need to be given to the presentation of this decision in relation to the whole of our

/ monetary policy,

monetary policy, both on 23rd October when the exchange control package is announced and subsequently when we roll forward the target - probably after the announcement of the banking October money supply figures on 15th November. At that stage we would need to consider the future of the corset, due to end in December, and it may be better in the circumstances to let it lapse. It is already losing effectiveness anyway.

CONCLUSION

10. This subject has many ramifications. To keep this minute short I have concentrated on the main points. I hope that we may have an early opportunity to discuss the matter. In the light of the points I have made above, I hope you will agree that, unless there are any untoward developments in either the foreign exchange or the domestic monetary markets, we should go ahead as planned with the total abolition of exchange controls (except for those affecting Rhodesia) on 23rd October.

11. I am not sending copies of this minute to any of our colleagues at this stage. My officials have been in touch with officials of the Departments chiefly concerned and work is in hand, on a strictly contingency basis, for dealing with a number of consequences of abolition for other departments' policies.

(G.H)

11th October 1979

Exc/54/04 (P) 114

CONFIDENTIAL

EF(2)CS

24 OCT 1979

cc Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir Douglas Wass
Mr Barratt
Mr Hancock
Mr Unwin
Mr P G Davies
Mr Hodges
Mr Ilett

Mr Dawkins (B/E)
Mr R Armitage (T Sol)

CHANCELLOR OF THE EXCHEQUER

EXCHANGE CONTROL AND RHODESIA

Because of the political aspects, you may like to have some more det about Rhodesia and our proposed exchange control package before you discuss this with the Prime Minister.

2. The way that the exchange control operation would work is as follows. The Treasury would lay a number of exempting Orders, which would be subject to negative resolution procedure. These would incl complex provisions for maintaining the present very restrictive regi over transactions involving Rhodesian residents. There would also b a re-issue of the Bank of England Exchange Control Notice about Rhodesia, and another short Notice about removing controls, which would mention the Rhodesian exclusions. I do not know how the gener business of Rhodesian sanctions is likely to develop. However, if sanctions generally were allowed to lapse on 15 November, the questi would arise whether we wished to end exchange controls on Rhodesia a that time also. Certainly the Treasury from a purely departmental point of view would not want to keep them. So the possibility is th the residual controls for Rhodesia could come to an end three weeks after the 23 October announcement.

3. It is clear that in order to bring the residual controls agains Rhodesia to an end on or about 15 November we would have to lay a ne unconditional Exemption Order. We have explored very thoroughly with the Treasury Solicitor whether this second Order could be avoided by saying in the first one that the retention of exchange controls for

Rhodesia would last only so long as the general sanctions were in force. The Treasury Solicitor is quite clear that this is not possible. I attach a note which Mr Armitage of the Treasury Solicitor has kindly given us on this.

4. As you know, the proposed timing of the BP shares sale prevents us from delaying the exchange control announcement until 15 November or shortly afterwards.

5. I think this means that we are stuck with the 2-stage operation and the second Order if Rhodesian sanctions lapse on 15 November. It may be that there is no political problem here. Certainly, if the ending of sanctions were a quite deliberate Government act defended as such, then no special problem arises about our consequential exchange control Order. Nevertheless I think you may like to be aware of the details because it looks as if we have to face both an Order which maintains part of the Rhodesian sanctions as late as 23 October and perhaps a second Order which ends them 3 weeks later.

KEC

K E COUZENS
12 October 1979

The only way that we can relax exchange control except in relation to Rhodesia is by making Exemption Orders under Section 31 of the Act limiting the exemptions so that the transactions in relation to Rhode are not covered by them. There is no power to include in any such Or a provision that it shall lapse in a particular event or on a particu date.

Even if there was such a power it would not help us in this dilemma becau the lapsing of these Orders on a particular date or in a particular event would simply restore exchange control into operation as it was 22 October in relation to the whole world including Rhodesia.
A fortiori there is no power to include in the Orders a provision tha on a specified date or in a certain event they will continue to opera subject to a whole string of complicated amendments.

If the Sanctions Order goes on 15 November the only way in which excha control can be relaxed in relation to Rhodesia is to revoke all these Orders and replace them with an absolutely unconditional Exemption Ord covering transactions with the whole world.

117
EF 2 CS

FINANCIAL SECRETARY TO THE TREASURY

MR HODGES

Principal Private Secretary
Sir D Wass
Sir K Couzens
Mr Barratt
Mr Hancock
Mr Unwin
Mr P G Davies
Mr Drane
Mr Ilett
Mr McIntyre
D A Dawkins B/E
Mr R Armitage T. Sol

EXCHANGE CONTROL: RESTRICTIONS ON ASSETS OF UK RESIDENTS LEAVING THE SCHEDULED TERRITORIES

The Financial Secretary has seen your minute of 10 October and has remarked that we would, if possible, wish to avoid giving what amounted to an amnesty to the sort of people you mention. The Financial Secretary wonders whether there might be other powers for example under the Income Tax Acts, which we could use against these people.

H COTTRELL
15 October 1979

118

EF2 CS

PS/CHANCELLOR

cc PS/Financial Secretary
Sir Douglas Wass
Sir Lawrence Airey
Sir Fred Atkinson
Sir Kenneth Couzens
Mr Barratt
Mr Littler
Mr Bridgeman
Mr Middleton
Mr Shepherd
Mr Unwin
Mr Hodges
Mr Gill
Mr Ilett
Mr Ridley
Mr Cardona

EXCHANGE CONTROL

You told me this morning that a meeting was being arranged to discuss exchange control under the Prime Minister's chairmanship on Wednesday 17 October. The Foreign Secretary, the Secretary of State for Trade and the Governor would certainly be invited; and probably the Secretary of State for Industry as well.

2. You also told me that the Chancellor had said that he did not mind copies of his minute to the Prime Minister going to these other colleagues; but that he asked officials to check whether there was anything particularly sensitive in it. I have consulted HF and we see no objection to copies going to these Ministers provided that the sensitivity of the subject is fully appreciated.

3. I attach a draft Private Secretary letter which stresses this point.

D.H.

D J S HANCOCK
15 October 1979

119

WRITE TO:

Private Secretary to the
Foreign and Commonwealth Secretary

COPIES TO:

Private Secretaries to:-
Prime Minister
Secretary of State for Trade
Governor of the Bank of England
Sir John Hunt

If appropriate:

Secretary of State for Industry

EXCHANGE CONTROL

As you know, a meeting has been arranged to discuss exchange control under the Prime Minister's chairmanship on Wednesday 17 October. The /Secretaries of State for Industry and Trade/Secretary of State for Trade/ will also be present. The Chancellor of the Exchequer who is in Luxembourg today has asked me to send to the Private Secretaries of the Ministers who will be present at the meeting copies of a minute on this subject which he sent to the Prime Minister last week. This is attached.

2. As you will appreciate the fact that plans exist for announcing the virtual abolition of exchange control on 23 October is market sensitive - so also are the plans for a sale of BP stock referred to in the opening paragraph of the Chancellor's minute. I should therefore be grateful if you and the other recipients would ensure that further distribution of this minute is confined to those who really need to be consulted.

120

3. I am sending copies of this letter and its attachment to the Private Secretaries of the/Secretary of State for Industry/ the Secretary of State for Trade, the Governor of the Bank of England and Sir John Hunt, with a copy also for information to Tim Lankester at No 10.

CONFIDENTIAL

121

FINANCIAL SECRETARY TO THE TREASURY

PRINCIPAL PRIVATE SECRETARY

cc PS/Chief Secretary
PS/Minister of State (C)
PS/Minister of State (L)
Sir D Wass
Sir K Couzens
Mr Barratt
Mr Hancock
Mr Unwin
Mr P Davies
Mr Hodges
~~Mr~~ Ilett
Mr Dawkins - B/E
Mr Armitage - T Sol

EF(2)CS
24 OCT 1979

EXCHANGE CONTROL AND RHODESIA

The Financial Secretary has seen Sir K Couzens' minute of 12 October and has commented that, assuming that the decision to completely abolish exchange controls is made, he sees no difficulty in practice in having an order on 23 October retaining controls on transactions with Rhodesia, followed by a second order rescinding the first, on 15 November. He regards the first of these two orders as a mere consequential, and thinks that it would attract very little attention in the context of the other measures.

PCD

P C DIGGLE
15 October 1979

SECRET

122

cc PS/Financial Secretary
Sir Douglas Wass
Sir Lawrence Airey
Sir Fred Atkinson
Sir Kenneth Couzens
Mr Barratt
Mr Littler
Mr Bridgeman

Mr Middleton
Mr Shepherd
Mr Unwin
Mr Hodges
Mr Gill
Mr Ilett
Mr Ridley
Mr Cardona
D J S Hancock

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

15th October, 1979

Dear George,

EXCHANGE CONTROL

As you know, a meeting has been arranged to discuss exchange control under the Prime Minister's chairmanship on Wednesday, 17th October. The Secretaries of State for Industry and Trade, the Governor of the Bank of England and Sir John Hunt will also be present. The Chancellor of the Exchequer who is in Luxembourg today has asked me to send to their Private Secretaries copies of a minute on this subject which he sent to the Prime Minister last week. This is attached.

As you will appreciate the fact that plans exist for announcing the virtual abolition of exchange control on 23rd October is market sensitive - so also are the plans for a sale of BP stock referred to in the opening paragraph of the Chancellor's minute. I should therefore be grateful if you and the other recipients would ensure that further distribution of this minute is confined to those who really need to be consulted.

I am sending copies of this letter and its attachment to the Private Secretaries to the Secretary of State for Industry, the Secretary of State for Trade, the Governor of the Bank of England and Sir John Hunt, with a copy also for information to Tim Lankester at No.10.

Yours ever,

MAH

(M.A. HALL)
Private Secretary

G. Walden, Esq.,
Private Secretary,
Foreign and Commonwealth Office

 123

1. MR HANCOCK if you agree:
2. CHANCELLOR OF THE EXCHEQUER

cc for: Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir Douglas Wass
Sir Lawrence Airey
Sir Fred Atkinson
Sir Kenneth Couzens
Mr Barratt
Mr Jordan-Moss
Mr Littler
Mr Ridley
Mr Cardona
Mr Dawkins (B/E)
Mr Armitage (T Sol)

cc to: Mr Bridgeman
Mrs Hedley-Miller
Mr Middleton
Mr Shepherd
Mr Unwin
Mr Gill
Mr Wicks
Mr Ilett
Mr McIntyre
Mr Rayner

DISMANTLING OF EXCHANGE CONTROL:
PRIME MINISTER'S MEETING ON 17 OCTOBER 1979

1. The meeting under the Prime Minister's chairmanship tomorrow, 17 October, is to discuss not only EMS (as earlier arranged) but also your minute to her of 11 October on exchange control, which has now been sent also to the others invited: the Governor, the Foreign Secretary, the Industry and Trade Secretaries and Sir John Hunt. (You discussed both subjects with the Prime Minister on 14 October though not in any detail.)

Further arguments for total abolition

2. Your minute explained and concentrated on the main points of a complex matter. You could enlarge, if necessary, on the case for total abolition (except for Rhodesia while sanctions last) as follows:

a. The portfolio relaxations for EEC - currency securities announced in your 2nd package on 18 July took dismantling to a point where the present system could, if necessary, continue with reasonable credibility. But no further partial liberalising of outward portfolio can be devised which makes any sense. And any intermediate position between the abolition of portfolio controls and the removal of all restrictions would be riddled with leakages and liable sooner rather than later to bring the system into complete discredit.

/b...

b. Until portfolio controls can go, the nature of the system means that direct investments must still be individually monitored by the Bank of England, even though their financing has been fully liberalised. This ties up about 150 staf in the Bank and continues a burden on companies and their advisers. Abolishing all restrictions will relieve Treasury Votes of the cost of all 750 or so Bank staff involved (currently about £14m a year) and the private sector of much greater costs and also inconveniences. (You referred in your minute as an example, to getting rid of passport-marking: this is something we cannot credit do while the remaining controls continue.)

c. If we cannot have total abolition now, we might have to wait for at least another year since we cannot rely on finding a suitable occasion in the meantim eg in the 1980 Budget. Apart from the effect on confidence in the Government' determination, such delay could, for different reasons, cause real problems wit the EEC and with the Americans.

Timing the BP sale and Rhodesia

3. The sale of BP shares now planned for 31 October is an inevitable constraint on the timing of an exchange control move in the immediate future. Colleagues will no doubt have understood that, if portfolio controls were relaxed after the sale and th BP price fell, the Government would be open to serious criticism and perhaps legal action. (If it were decided not to relax controls before the sale, it would be important for the record that Ministers should not decide beforehand to do it at som later date but should only agree to revert to considering the matter in the light of conditions then prevailing.)

4. The BP constraint means that an exchange control package cannot wait till next month in order to coincide with a possible lifting of sanctions against Rhodesia. But having to lay Orders maintaining the Rhodesian restrictions while removing all others, and then, if sanctions can shortly come off, soon revoking them and laying a second fully exempting Order should create no serious difficulties: the Government would simply be abolishing controls generally as soon as they can without knowing when sanctions could be lifted and, till then, maintaining the status quo on Rhodesi

Other implications of abolishing controls

5. Paragraphs 7 to 9 of your minute to the Prime Minister discussed the implicatio for domestic monetary policy. There is however a gloss by HF in Annex A attached to what was said about the possibility of some form of direct monetary base control.

/6...

6. Separate consequences of abolishing exchange controls are referred to in paragraph 11 of your minute. The main implications of concern to other Ministers are those covered by the note put to the Financial Secretary on 8 October, namely:

(i) balance of payments statistics, and
(ii) monitoring and controlling inward investment.

While other Ministers may raise points on these matters, we do not expect them to suggest that they would justify abandoning, or even postponing, relaxations thought right on wider grounds; and of course any postponement to give time for making alternative arrangements would run into the snags about timing explained in paragraphs 3 and 4 above. The fact that it is not proposed at this stage to repeal the Exchange Control Act 1947 does not help with these matters because of vires problems if all restrictions have been removed.

7. In addition, there are some consequentials affecting Inland Revenue, particula those concerned with foreign-to-foreign leasing to which their submission of 12 October refers and on which the Law Officers will shortly be advising. Given t vires problem in this case, it would seem premature to mention these at the Prime Minister's meeting.

8. For operational purposes, it would be most helpful to have a clear decision as soon as possible whether or not abolition is to be announced as proposed on 23 October. (The later we know this week, the more likely that a positive decisio will mean asking you and perhaps the PM to sign the necessary Orders as Lords Commissioners.)

C H W HODGES
16 October 1979

SECRET

ANNEX A

Domestic Monetary Effects

If the Prime Minister asks you to expand further on paragraphs 7 and 8 you might draw on the following points:-

a. the types of control which would be ruled out would be ones which could generate avoidance devices outside the banking system on any significant scale. If there were no exchange control, they would stimulate avoidance through "offshore banking" - which would be relatively costless for some: such avoidance would make the controls ineffective in relation to the underlying conditions of liquidity and credit, minimise any intended effect on domestic interest rates (one of the objects of a monetary base system) and make it impossible to monitor what was happening because we would not know how much of the growth in the euro-sterling market was due to them. Such controls would therefore put British banks at a competitive disadvantage with offshore competitors to no good purpose;

b. the advantages of having direct controls which caused avoidance on any scale were in fact limited - some would go so far as to say that they were entirely illusory. But the advantages certainly did not justify the retention of virtually all the remaining exchange controls, and the staff to police them, which is what would be required, if offshore avoidance was to be minimised;

c. it would almost certainly be necessary to announce the end of the SSD scheme "corset" - in November if exchange control were ended now;

d. it would almost certainly not be possible to have some of the variants of monetary base control in the absence of exchange control - but that factor is not relevant to a decision on timing of the ending of exchange control,

since any new domestic monetary control introduced would need to be designed to work in the absence of such a control, given the commitment to end exchange control sooner or later;

e. the Bank and Treasury are continuing their examination and evaluation of those monetary base schemes which might not have the effect of stimulating significant disintermediation, and so offshore banking;

f. the ending of exchange control and the SSD scheme would have two distinct effects on the £M3 monetary statistic:

   i. the underlying monetary effects of any outflows- these will tend to add to DCE and to cause interest rates to be higher than otherwise, but not have much effect on £M3;

   ii. the effect of the unwinding of some of the avoidance devices after the ending of the SSD scheme - this would effectively mean that some of the monetary growth of recent months which has not so far been included in the £M3 statistic would now feed through.

Both effects would have to be explained - the first probably at the time of the announcement on exchange control, the second at the time of announcing the end of the SSD scheme;

g. the coming 6 months appear to offer an opportunity to absorb these effects with less risk of needing to raise interest rates than would be run at another time. Underlying monetary growth might be at the bottom end of the target range, with the £M3 statistic growing at the top end because of the ending of the avoidance devices;

h. indeed, while you have not yet had a chance to consider this fully with the Governor, you might want to end the SSD scheme anyway, or to set the guideline so that "the corset hangs loose", even if exchange control were not lifted, given that the "corset" will have to be replaced soon and the next few months look like being the best time to have the unwinding of the avoidance devices.

BoE /
Cabinet office

Whole Document

129

NOTE OF MEETING 17/10/79

Summing up this part of the discussion, the Prime Minister said that she agreed that the time was not yet ripe to join the exchange rate regime. She was particularly concerned about the potential conflict between the Government's monetary targets and the EMS intervention requirements. Adherence to the monetary targets was absolutely crucial if inflation was to be brought down, and the Government's monetary objectives must remain paramount. She herself was not optimistic that sufficient stability in the exchange rate would be achieved to make joining possible even over the next year. She did not intend to mention EMS in her Luxembourg lecture the following day, nor did she intend to offer any kind of commitment to the UK's joining EMS as a full member at the Dublin Council.

Exchange Controls

The Chancellor said that he had considered long and hard the final dismantling of controls, and had come to the conclusion that action next week would probably provide the last opportunity for some time. If the decision were postponed beyond next week, it would have to wait for at least two months until after the sale of the BP shares. By the New Year, it could well be more difficult, and it would probably be hard to present the abolition of controls at the time of the next Budget since the background to the Budget was likely to be difficult. He believed it was inherently right to dismantle the remaining controls. Failure to do so would be represented as a failure of confidence by the Government in its own policies; and there was a strong economic case for using part of the benefits of North Sea oil to purchase overseas assets which would yield foreign exchange earnings when North Sea oil began to run out. There were admittedly risks for the exchange rate and possibly for monetary policy; but on balance he was sure that it was right to go ahead.

The Secretary of State for Trade said that he strongly supported the Chancellor. In addition to the points which the Chancellor had made, he added that the Government were rightly trying to create a new climate of greater freedom, and it would be illogical to refrain from the final dismantling of exchange controls: to do so now could well unsettle the markets. A decision in favour would enable the Prime Minister to say something positive at the Dublin Council; it should also help the Government's position vis-a-vis the trade unions, by showing that the Government were determined that investors should be allowed to put their money where they can earn the best return. The Governor said that he, too, was strongly in favour of the Chancellor's proposals.

The Prime Minister said that, while she accepted the advantages of further dismantling of the controls (and, in particular, she favoured overseas investment in general), she was worried about the risks of moving at this time. The Chancellor's minute had suggested that the outlook for the money supply in the next few months was favourable; and that therefore the risk of an adverse impact on the money supply should be accepted. However, she understood that the October money supply figures were likely to be a good deal worse than the figures for September - and, moreover, worse than the Treasury had been forecasting.

/ Commenting on

Commenting on this point, the Governor said that the latest estimates for the Central Government Borrowing Requirement suggested that the October figure was going to be perhaps £1 billion higher than had earlier been forecast; this was indeed likely to make for worse money supply figures for October. The reasons for the high Central Government Borrowing Requirement for October were not yet entirely clear but it appeared that delays in VAT payments were a substantial contributing factor, and also possibly repayment of debt by nationalised industries. Both of these factors were likely to be temporary. On the other hand, the September figures for lending to the private sector were well down on earlier months' figures, and there was still a reasonable prospect that - notwithstanding the high Central Government Borrowing Requirement - the money supply figures for October would be within the Government target range. It was important not to concentrate simply on one month's figures: looked at on a three-monthly basis, M3 was moving in the right direction. Against this background, the Governor did not think it would be right to hold up the decision on exchange controls because of worries about the money supply.

Asked by the Prime Minister about the exchange rate risks, the Governor replied that these too were not sufficient to postpone a decision. The relaxation of controls in the summer had not resulted in a weakening of sterling. There was no indication that the institutions were likely to take precipitate action in moving funds out of sterling into currencies on which the controls still operated; for Wall Street in particular was not immediately attractive. Moreover, if there were to be a loss of confidence in sterling, this would result in movement into other currencies in any case: the Chancellor's proposals would not add very much overall to the scope for sterling outflows in the short term.

The Foreign and Commonwealth Secretary pointed out that exchange controls in relation to Rhodesia could not be lifted separately from sanctions generally. It would have been better from his point of view if the decision could have been held over until after a decision on sanctions had been taken in November; but in view of the difficulties which this would pose for the Chancellor, he would not press for any delay. There would remain a presentational problem which would have to be resolved.

Summing up, the Prime Minister said that - despite the risks involved - she agreed with the Chancellor's proposals.

As a postscript to the discussion on EMS, I should add that the Prime Minister has decided that she does not wish there to be a further discussion of this issue in OD Committee, and that the Chancellor's paper should not after all be circulated to OD.

I am sending copies of this letter to George Walden (FCO), Stuart Hampson (Department of Trade), Ian Ellison (Department of Industry), John Beverly (Bank of England) and Martin Vile (Cabinet Office). It goes without saying that the decisions recorded in this letter are highly sensitive, and therefore it should be circulated on a strictly "need to know" basis only.

Yours ever,

Tim Lankester

A. M. W. Battishill, Esq.,
H.M. Treasury

EXC/134/04 (F)

EF(2)CS.

22 APR 1980

SECRET

131

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Sir D Wass
Sir K Couzens
Mr Barratt
Mr Hancock
Mrs Hedley-Miller
Mr P G Davies
Mr Ilett
Mr McIntyre
Mr Fitchew UKREP Brussels
Mr Dawkins (B/E)

REMOVAL OF EXCHANGE CONTROLS: INFORMING THE COMMISSION

You will no doubt wish to write to the Commission about the announcement to be made on Tuesday.

2. You informed M Ortoli in advance of both the June and July relaxations, and the Commission appreciate advance notice, partly because it gives them an opportunity to prepare a press statement of their own. It is therefore suggested that UKREP deliver your letter during Tuesday morning.

OK!

3. You will see that the attached draft makes no mention of the Commission Decision of December 1977 which has authorised our controls under Article 108 of the EEC Treaty. It is for the Commission to decide how to deal with that Decision in the light of your announcement.

C H W HODGES
18 October 1979

SECRET

132/19/10

DRAFT LETTER TO (Vice President) ~~M~~ ORTOLI

When I wrote to you on 17 July to give you advance notice of thesecond stage in our programme of exchange control relaxations, I said that I could not predict when any further steps would be taken. I am now pleased to be able to tell you that I shall be announcing to Parliament on 23 October the virtual abolition of our controls.

The only controls which will remain in effect from 24 October will be those required to maintain sanctions against Rhodesia.

My officials will be sending the Commission a copy of the Press Notice to be issued by the Treasury on 23 October.

I shall be making the announcement to the House of Commons at [1600] hours Brussels time on 23 October. I should be grateful if, as on previous occasions, you could treat this information as strictly confidential until after the announcement.

GEOFFREY HOWE

Reference 133

SECRET

cc PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State (
PS/Minister of State (
Sir Douglas Wass
Sir Kenneth Couzens
Mr Barratt
Mr PG Davies

PRINCIPAL PRIVATE SECRETARY

TREASURY
23 APR
BF/ OG

EXCHANGE CONTROL : Q+A BRIEFING

A draft Written Answer has been put up separately, assuming this is still the method to be used. You may think that, if he has time over the weekend, the Chancellor may like to see the attached Question and Answer briefing which reflects comments from Mr Hancock and others here ~~[illegible]~~ and has been seen by the Bank of England. (We plan wider circulation on Monday).

C H W HODGES

19 October 1979

CODE 18-77

END OF EXCHANGE CONTROLS (UNTIL 5PM 23 OCTOBER 1979)

QUESTION AND ANSWER BRIEF

Q1. Why have all exchange controls been dropped?

A1. In order to free the country from expensive, time-consuming and unnecessary controls which limit freedom of choice and distort the economy. /Any additional overseas investment which results will yield an income that will benefit the current account later when the benefit from North Sea Oil begins to decline./

Q2. Why have all remaining controls been dropped at once?

A2. Technically, there is no way of further reducing the controls and still retaining a sensible and internally consistent control. We have already had the experience of two substantial reductions in the controls (12 June and 18 July). Economically, there is anyway no point in retaining any control.

Q3. What are the controls being dropped today?

A3. Mainly the requirement to use investment currency to purchase foreign currency securities (except those in EEC currencies or issued by certain international organisations which were liberalised on 18 July); the controls on lending to non-residents; and the controls on buying and keeping foreign currency, whether in the UK or abroad. The monitoring procedures on payments for imports and exports are being withdrawn; so is the need to apply for permission to make inward or outward direct investments. Gold bullion may now be freely purchased (the control on gold coins was lifted in June) and both may now be exported freely.

Q4. Exchange Rate Consequences

The effect of the relaxations on the exchange rate is highly uncertain and we are providing no forecast. Controls have been abolished to allow investors greater freedom in the choice of how and where to invest, in line with our election pledge. We are not trying to

influence the exchange rate in one direction or another. The most important influences on the exchange rate are the Government's monetary and fiscal policies and events in world markets - including the world oil market.

Q5. Balance of Payments Consequences

A5. The effects on the balance of payments are uncertain: most of these controls have been in force for forty years and so it is not possible to estimate precisely how people will react in their absence. There will presumably be some capital outflows as portfolios are adjusted but - as with the relaxations which have already been made - these may be easily matched by capital inflows without producing any substantial impact on the exchange markets.

Q6. What effects have the relaxations which have already been made had on outflows?

A6. It is almost impossible to judge, from the incomplete information now available. Judging by the level of exchange control applications, quite a lot of firms may have taken advantage of the opportunity to repay outstanding foreign currency loans. But it is almost impossible to disentangle the effects of exchange control relaxations from other influences on capital flows and the exchange rate. The earlier relaxations were widely welcomed and have not caused any obvious problems.

Q7. Rhodesia? /MATERIAL MARKED IF PRESSED SHOULD ONLY BE USED IN RESPONSE TO SPECIFIC QUESTIONS_7

A7. Exchange controls needed to maintain economic sanctions are being maintained. (If pressed: the complexity of the Exchange Control Act makes it necessary for 9 Statutory Instruments to be made in order to retain the sanctions control on the present basis, but this does not mean that sanctions controls are being either tightened or loosened. The SIs are subject to the negative resolution procedure. A successful prayer in Parliament against the Orders would not mean that exchange controls against Rhodesia would be dropped. It would mean that the relaxations as a whole would be cancelled and the controls against Rhodesia maintained under previous orders.

(Also if pressed). The opportunity of the reissue of the Exchange Control notice on Rhodesia (EC79) has been taken to raise certain limits on payments that can (with the specific permission of the Bank) be made to Rhodesia for humanitarian and family reasons. These limits were last raised in 1972. The rules have also been simplified. This does not represent any change in policy towards Rhodesia, but merely takes account of inflation since 1972. Other technical changes have had to be made to the sanctions arrangements as a result of the removal of all other exchange controls; but their effect is to maintain the status quo.

Q8. Repeal of the Exchange Control Act 1947?

A8. The Exchange Control Act will remain in force for the time being. The Government is now considering the future of this legislation. For the present it is needed to continue sanctions against Rhodesia and for certain other technical purposes (primarily connected with stamp duty).

Q9. Enforcement?

A9. Past offenders are still liable to prosecution (this would be so even if the Act were repealed). (If pressed: the Treasury have revoked all directions imposed under section 40 of the Act, including directions which block the UK funds of certain individuals, because they are advised that it might be wrong in law to maintain them now that the great bulk of controls have been removed. The purpose of the directions was to prevent on illicit outflow where the authorities had good reason to suspect that this was likely, not to punish suspected offenders before trial. Now that unlimited foreign exchange is available generally on demand these retrictions are inappropriate. If pressed on individuals in the House; no comment on individual cases. Press Officers should consult the Treasury Enforcement Section on individuals).

Q10. What savings will be made?

A10. Some expenditure on controls against Rhodesia will continue while sanctions last. Apart from this the entire apparatus of control will be run down saving public expenditure by about £14½ million a year. This represents the cost of about 750 staff at present employed on exchange control work mainly at the Bank of England and about 25 at the Treasury.

Q11. How fast will these savings be made?

A11. As soon as possible - the bulk of the savings should be achieved within a few months.

Q12. Monitoring of inward investment

A12. There is no balance of payments reason to maintain this control. There are some powers to prevent unwelcome inward investment in the Industry Act 1975 (now under review).

Q13. Wrong to lift supervision of bureaux de change?

A13. The Bank controlled bureaux in order to prevent evasion of exchange control rules on eg travel allowances and the surrender of foreign currency. Now that exchange controls generally are being lifted this supervision is no longer needed and is being withdrawn. No permission is now needed to open a bureau de change (except for planning permission etc). It would not be appropriate to use the Exchange Control Act for this purpose in the absence of general exchange controls.

Q14. Wrong to abandon control over outward direct investment?

A14. Outward direct investment benefits the domestic economy by increasing export opportunities etc. Controls on the financing of outward direct investment were lifted entirely on 18 July; now that outward portfolio has been liberalised completely there is no need to monitor individual applications to make direct investments in order to prevent the evasion of the portfolio controls.

Q15. EEC obligations?

A15. We are now meeting our EEC obligations:- indeed, in some areas, going beyond what our obligations under the EEC Treaty strictly require. The Commission have been informed.

Q16. What are the main consequences for individuals?

A16. Full freedom to buy, retain and use foreign currency for travel, property purchase, investment, gifts etc. (except where Rhodesian sanctions apply). This includes the ability to hold foreign currency accounts, here or abroad. Passport marking is abolished and Customs controls at the frontier are being withdrawn. The requirement to deposit foreign currency securities with an Authorised Depository is also abolished.

Justification: these restrictions on personal freedom that have applied since 1939 but are no longer required.

Q17. What happens to the investment currency market?

A17. Now that investment currency ("premium dollars") is no longer required to be used for any purpose there will presumably cease to be a special investment current market (ie a market in the foreign currency proceeds of the sale of certain privately owned foreign currency assets). The investment currency market is a private market in which the authorities are not involved.

Q18. Do the Government accept responsibility for losses in the investment currency market/the consequences of the fall in the sterling value of ex-premium-worthy foreign currency securities?

A18. Certainly not. No such guarantee has ever been given and no responsibility was accepted or compensation paid when the rules were liberalised on the purchase of private property in June and of most EEC securities in July, and the premium had in consequence to be withdrawn on sale.

Q19. Is not the UK encouraging instability by allowing UK residents to speculate in the gold markets?

A19. No. We are simply allowing UK residents the freedom which residents of many other countries, including the US, have to buy and sell gold if they wish to do so. The exchange control relaxations earlier this year allowed UK residents to buy gold coins: we are merely extending this freedom to encompass all forms of gold.

Q20. <u>Is not the UK encouraging those who want to see the international role of gold enhanced?</u>

A20. No. The exchange control relaxations relate to the ability of UK residents to buy and sell gold. They do not mean that the UK authorities wish to see a greater role for gold in the international monetary system.

Q21. <u>Could the controls be reimposed?</u>

A21. The Government have no intention of re-imposing controls and are reviewing the future of the Exchange Control Act.

Q22. <u>Is this a prelude to joining the EMS?</u>

A22. No decision has been taken on whether we should join the exchange-rate mechanism of the EMS.

Q23. <u>What will the government do in the face of speculation against Sterling if there are no controls?</u>

A23. Confidence in sterling depends not on the existence of exchange controls but on the government's basic economic policies, which it is determined to carry through.

Q24. <u>What are the likely domestic monetary effects of relaxations?</u>

A24. (i) The domestic monetary situation will be affected by the effects of the relaxations on the pattern of capital movements into and out of the UK. It is difficult to be precise about the timing and net effect of these flows, which will depend on a number of factors, in particular on the strength of confidence in sterling following the relaxation.

(ii) Some of the flows arising, such as the refinancing of foreign currency debt, will tend to add to DCE (at given interest rates). But there are other factors which will tend to offset the rise in DCE. There is likely to be a net capital outflow from the non-bank private sector: the outflows generated by the relaxation will probably be largely from the non-banks, but some of any offsetting inflows may be to the banking and public sectors. Thus there are likely to be net

contractionary external influences on £M3, but whether these will exceed or fall short of the increase in DCE is difficult to assess. The effect on £M3 could go either way, but in any event is likely to be fairly small.

Q25. Effect on interest rates?

A25. The impact on interest rates will clearly also depend on the effects on confidence, but given the relatively small monetary effects that can be expected the impact should be small.

Q26. Uncertainty increases interest rates?

A26. Potential size of flows could mean some uncertainty about future interest rates. Much will depend on state of confidence. No reason why any substantial change of rates will be necessary to meet the Government's monetary objectives.

Q27. Future of SSD Scheme?

A27. [For use only in response to specific question as to whether relaxations will make it easier for banks to avoid the scheme.] The effects of the relaxation will be one of the factors to be taken into account in considering the roll forward of the scheme.

Q28. Effects on Gilts market?

A28. Abolition of controls over portfolio investment may lead to investment overseas at the expense of gilts and other domestic securities. But this will be largely a once-for-all effect and there is no reason why it should undermine market confidence or adversely affect inflationary expectations. As a result it should not significantly affect our ability to meet the monetary target.

Q29. Bank lending?

A29. There is likely to be some increase in bank lending as a result. But this is only one of the factors affecting money supply growth. The net effect on £M3 is expected to be small.

Q30. Why is the relaxation being made by 9 Statutory Instruments?

A30. The Act prohibits a very wide range of transactions and the only way of relaxing its effect on this scale is by giving exemptions in Statutory Instruments or by permissions. In the past permissions have been given through Authorised Dealers (banks) and Depositaries also are now relieved of all their functions under the Act so that it is essential to legislate by Statutory Instrument.

LEASING

Q31. Why could not exchange control powers continue to be used in the interim until the next Finance Act, rather than the new legislation's acting retrospectively?

A31. This would have been impracticable in the absence of other controls.

Q32. Will the new legislation to be introduced in the next Finance Bill treat leasing transactions any differently from the way exchange control has?

A32. The intention is that the new legislation will have broadly the same effect. Particulars are given in the Inland Revenue press notice being issued today (23 October). Enquiries about specific leasing proposals should be made to Inland Revenue.

Q32. What about the leasing of British made goods to foreign lessess?

A32. The proposal announced today relate only to transactions involving the leasing of foreign made goods to foreign lessess. /If pressed on the possibility of other changes on leasing: these would be a matter for consideration in the context of the Budget./

(142)

SECRET
(UNTIL 4PM 23 OCTOBER 1979)

END OF EXCHANGE CONTROLS

NOTES FOR SUPPLEMENTARIES

1. Why have all remaining controls been dropped at once?

We have already had the experience of two substantial reductions in the controls (12 June and 18 July); economically, there is anyway no point in retaining any control; and technically, there is no way of further reducing the controls and still retaining a sensible and internally consistent control.

2. Rash to leave exchange rate unprotected?

Not at all. We have minimised risk by dismantling controls in stages this is the third and last stage. Rate depends on positive factor of confidence in our policies, not on the negative factor of controls.

3. What will the government do in the face of speculation against Sterli if there are no controls?

Confidence in sterling depends not on the existence of exchange contr but on the government's basic economic policies, which it is determin to carry through.

4. Exchange Rate Consequences

The effect of the relaxations on the exchange rate is highly uncertai We are providing no forecast. Controls have been abolished to allow investors greater freedom in the choice of how and where to invest, i line with our election pledge. We are not trying to influence the exchange rate in one direction or another. The most important influences on the exchange rate are the Government's monetary and fiscal policies and events in world markets - including the world oil market.

5. Balance of Payments Consequences

The effects on the balance of payments are uncertain: most of these controls have been in force for forty years and so it is not possible to estimate precisely how people will react in their absence. There

/presumably

143

presumably be some capital outflows as portfolios are adjusted but - as with the relaxations which have already been made - these may be easily matched by capital inflows without producing any substantial impact on the exchange markets.

6. What effects have the relaxations which have already been made had on outflows?

~~Difficult to judge, from the incomplete information now available~~. Almost impossible to disentangle the effects of exchange control relaxations from other influences on capital flows and the exchange rate. The earlier relaxations were widely welcomed and have not cause any obvious problems.

7. Monitoring of inward investment

There is no balance of payments reason to maintain this control. Ther are some powers to prevent unwelcome inward investment in the Industr Act 1975. [NOTE the Industry Bill being published today (Tuesday) doe not ~~cover~~ alter this.]

8. Wrong to abandon control over outward direct investment?

Outward direct investment benefits the domestic economy by increasing export opportunities etc. The bulk of the evidence suggests that far from displacing domestic employment investment overseas by British investors increases employment at home. Controls on the financing of outward direct investment were lifted entirely on 18 July; now that outward portfolio has been liberalised completely there is no need to monitor individual applications to make direct investments in order tc prevent the evasion of the portfolio controls.

9. Rhodesia?

Exchange controls needed to maintain economic sanctions are being kept Policy on the future of sanctions is a matter for the Lord Privy Seal and his Noble Friend. If pressed - various technical changes have ha to be made to exchange control rules on Rhodesia as a result of the removal of all other exchange controls; but their effect is to mainta the status quo. Positive Point The Cons~~ervative~~titutional Conference has made gc progress and we hope that we are approaching the time when we will be a to lift all sanctions against Rhodesia but until agreement is reached t necessary measures must remain in place.

/10.

EXP/34/04 (P)

144

10. Enforcement?

Past offenders still liable to prosecution (this would be so even if the Act were repealed). Cases will be considered on their merits. If pressed on individuals; no comment on individual cases.

11. What happens to the investment currency market?

Now that investment currency is no longer required to be used for any purpose there will presumably cease to be a special investment curren market in which foreign currency will command a premium. The investm currency market is a private market in which the authorities are not involved.

12. Do the Government accept responsibility for losses in the investment currency market/the consequences of the fall in the sterling value of ex-premiumworthy foreign currency securities?

No. No responsibility was accepted or compensation paid when the rul were liberalised on the purchase of private property in June and of m EEC securities in July, and the premium had in consequence to be withdrawn on sale. These losses are the inevitable consequence of th removal of restrictions.

13. Wrong to deny investment currency ("dollar") premium on sale of privat property as announced in June Budget (and subject of many complaints)

It would not have been possible to operate the control in any other w and no undertaking has ever been given that the premium, once paid, could be recovered. This is unfortunately the other side of the coin to the removal of restrictions.

14. Too generous to the rich (foreign bank accounts, property etc)

These restrictions on personal freedom that have applied since 1939 ar no longer required.

15. Is not the UK encouraging instability by allowing UK residents to speculate in the gold markets?

No. We are simply allowing UK residents the freedom which residents many other countries, including the US, have to buy and sell gold if they wish to do so. The exchange control relaxations earlier this yea allowed UK residents to buy gold coins: we are merely extending this freedom to encompass all forms of gold.

16. Is not the UK encouraging those who want to see the international role of gold enhanced?

No. The exchange control relaxations relate to the ability of UK residents to buy and sell gold. They do not mean that the UK authorit wish to see a greater role for gold in the international monetary syst

17. Could the controls be reimposed?

The Government have no intention of re-imposing controls and are reviewing the future of the Exchange Control Act.

18. Is this a prelude to joining the EMS?

No decision has been taken on whether we should join the exchange-rate mechanism of the EMS.

19. EEC obligations?

We are now meeting our EEC obligations: indeed, in some areas, going beyond what our obligations under the EEC Treaty strictly require. Th Commission have been informed.

20. MONETARY EFFECTS

(i) (General)

The domestic monetary situation will be affected by the effects of the relaxations on the pattern of capital movements into and out of the UK It is difficult to be precise about the timing and net effect of these flows, which will depend on a number of factors, in particular on the strength of confidence in sterling following the relaxation.

(ii) (Specific effects on DCE(M3)

Some of the flows arising (such as the refinancing of foreign currency debt) will tend to add to DCE (at given interest rates). But there are other factors which will tend to offset the rise in DCE. There is likely to be a net capital outflow from the non-bank private sector: the outflows generated by the relaxation will probably be largely from the non-banks, but some of any offsetting inflows may be to the bankin and public sectors. Thus there are likely to be net contractionary external influences on £M3, but whether these will exceed or fall shor of the increase in DCE is difficult to assess. The effect on £M3 could go either way, but in any event is likely to be fairly small.

/21

21. Effect on interest rates?

The impact on interest rates will clearly also depend on the effects o confidence, but given the relatively small monetary effects that can b expected the impact should be small.

22. Uncertainty increases interest rates

Potential size of flows could mean some uncertainty about future interest rates. Much will depend on state of confidence. No reason why any substantial change of rates will be necessary to meet the Government's monetary objectives.

23. Future of SSD Scheme?

The effects of the relaxation will be one of the factors to be taken into account in considering the roll forward of the scheme.

24. Effects on Gilts market?

Abolition of controls over portfolio investment may lead to investmen overseas at the expense of gilts and other domestic securities. But will be largely a once-for-all effect and there is no reason why it should undermine market confidence or adversely affect inflationary expectations. As a result it should not significantly affect our ability to meet the monetary target.

25. There is likely to be some increase in bank lending as a result. But this is only one of the factors affecting money supply growth. The net effect on £M3 is expected to be small.

LEASING

26. Why could not exchange control powers continue to be used in the inter until the next Finance Act, rather than the new legislation's acting retrospectively?

This would have been impracticable in the absence of other controls.

27. Will the new legislation to be introduced in the next Finance Bill tre leasing transactions any differently from the way exchange control ha

The intention is that the new legislation will have broadly the same effect. Particulars are given in the Inland Revenue press notice bein issued today (23 October). Enquiries about specific leasing proposals should be made to Inland Revenue.

/28.

SECRET
(UNTIL 4PM 23 OCTOBER 1979)

28. What about the leasing of British made goods to foreign lessees?

The proposal announced today relate only to transactions involving the leasing of foreign made goods to foreign lessees. [If pressed on the possibility of other changes on leasing: these would be a matter for consideration in the context of the Budget.]

148

EXCHANGE CONTROL

Additional supplementaries

Future of Exchange Control Act

The Exchange Control Act will remain in force for the time being. We are now considering its future. For the present it is needed to continue sanctions against Rhodesia, I hope not for long, and for certain other technical purposes, primarily connected with stamp duty.

149

SECRET

CST
FST
SIR D WASS
SIR K COUZENS
MR BARRATT
MR HANCOCK
MRS HEDLEY-MILLER
MR UNWIN
MR McINTYRE
MR HODGES

Treasury Chambers, Parliament Street, SWIP 3AG
01-233 3000

19th October, 197

Dear Bill,

I enclose the signed copy of the message I imagine you will already have delivered to the Treasury Secretary. For the form, could you please deliver i

Yours ever,

Mike Hall

(M.A. HALL)
Private Secretary

W.S. Ryrie, Esq., CB.,
UKTSD

SECRET

149/10

150

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

23 October, 1979

Dear Bill

I wrote to your predecessor on 18th July to give him advance notice of the exchange control liberalisation measures which I announced to Parliament later that day.

In that letter, I explained that, temporarily, we would have to limit the scope of the changes affecting outward portfolio investment, allowing official foreign exchange in general only for investment in securities denominated in the currencies of other EEC countries and in bonds issued by international organisations of which the UK is a member. I know that this form of partial liberalisation has been a source of some concern to you.

I am now, therefore, pleased to be able to tell you that I have decided that, with effect from 24th October 1979, virtually all of our remaining controls will be abolished. Only those controls necessary to maintain sanctions against Rhodesia will remain in place. This means, of course, among other things that UK investors will be free to use official foreign exchange to buy securities denominated in dollars or any other currency.

I am announcing this decision in the House of Commons today.

Yours

Geoffrey

GEOFFREY HOWE

Mr G. William Miller.

SECRET

151

THE BOARD ROOM
INLAND REVENUE
SOMERSET HOUSE

19 October 1979

MINISTER OF STATE (COMMONS)

EXCHANGE CONTROL: FOREIGN TO FOREIGN LEASING

... 1. We attach drafts of:

a. a short piece to be added to the Written Answer on the ending of exchange control dealing with the tax points and

b. a Press Notice explaining the point in more detail, and foreshadowing the tax legislation in the 1980 Finance Bill.

2. The final text of the Press Notice needs to be available by mid-day on Monday.

3. There is clearly an obligation when Ministers legislate by announcement to make the announcement as full as possible so that those concerned know where they stand. We have made the final part of the Press Notice as full as possible, but there are two significant points which have to be left imprecis at present, namely what is meant by "foreign" equipment and what is a "financial" lease. We will consider urgently how these

---

cc Chancellor of the Exchequer
Chief Secretary
Financial Secretary
Minister of State (Lords)
Sir Douglas Wass
Sir Lawrence Airey
Sir K Couzens
Mr Littler
Mr Barratt
Mr Dixon
Mr Hancock

Mr Lavelle
Mr Lovell
Mr Butt
Mr Cowdy
Mr Hodges
Mr Kerr
Mr Moore
Mr Corlett
Mr Bonney
Mr Wilson
Mr Tyler
Mr Dyer

Sir William Pile
Mr Dalton
Mr Adams
Mr R S Boyd
Mr Isaac
Mr Southall (2)
Mr J P O Lewis
Mr P Lewis

Mr Dawkins (Bank)
Mr Armitage (Treasury Solr)
Mr Beckett (Law Officers' Dept)

148/10

terms should be defined. We know that other countries have found it necessary to have complex and/or discretionary rules for determining which leases are financial; we are not familiar with defining the origin of goods but suspect that that also may not be easy.

4. It is difficult to judge whether Ministers may be criticise for any lack of detail in the Press Notice. On the one hand this is a very specialised field in which few companies are interested. On the other, leasing is a subject which generates much interest in the Press (we understand yet another article is to appear in the FT next week); and companies with exchange control applications already in the pipeline will understandabl be anxious to know whether or not their particular circumstance will be covered by the new legislation.

5. In reply to any general criticisms, Ministers could make two points. First, as the announcement makes clear, the new tax rules will essentially be aimed at continuing an existing arrangement rather than introducing an entirely new scheme - and in practice those affected already know the broad working rules Second, the scheme has hitherto been based on the Banks' discretionary exchange control powers with no published rules. The rules will now become public knowledge as part of the tax code and consequently, for the first time, appealable. This is obviously a more "open" arrangement.

6. We shall be briefing our tax representative in Brussels in case the Commission take any immediate interest in the tax aspects of the announcement.

7. We shall now be working on details of the provision as a matter of urgency, and will minute you again as necessary.

Private Secretary
Inland Revenue

157

CHANCELLOR'S STATEMENT (WRITTEN PQ)

[Q. To ask the Chancellor of the Exchequer when he expects to take further steps in removing exchange controls.

TREASURY DRAFT*

A. I have decided to remove all the remaining exchange control restrictions from tomorrow, 24 October, apart from those still needed for the sanctions against Rhodesia. The necessary Orders under the Exchange Control Act 1947 are being laid this afternoon. The Commission of the European Communities has been informed.]

Under arrangements announced in 1971, exchange control has been used to prevent the export of our UK tax incentives through the leasing abroad of foreign equipment. I propose introducing provisions in the 1980 Finance Bill, which will take effect from tomorrow, to continue the present restrictions. Further details are available in the Vote Office.

*We understand this has now been revised.

SECRET

DRAFT PRESS NOTICE

ENDING OF EXCHANGE CONTROL: CONSEQUENTIAL TAX LEGISLATION

The Chancellor of the Exchequer announced the ending of exchange control restrictions this afternoon in a Written Answer to a Parliamentary Question. He said that legislation will be introduced in the 1980 Finance Bill to ~~continue the restrictions~~ previously operated through exchange contro ~~on the export of~~ United Kingdom tax incenti ~~through~~ the leasing abroad of foreign equipment. This Press Notice gives further details.

Leasing companies resident in the United Kingdom are usually entitled to 100 per cen first year allowances on their capital expenditure on plant and equipment acquired for leasing. Their lease rental charges ar lower than they would otherwise be on accou of the tax relief they obtain through first year allowances.

When the present system of capital allowanc was introduced in 1971, the Government was concerned that the benefit of the new high rates of capital allowances (then generally 60 per cent in the first year) might, throug reduced lease rentals, be exported by UK companies leasing foreign made equipment to overseas companies. (A similar problem had arisen in the 1960s when UK investment grants had been claimed on ships built abroa for the ultimate benefit of foreign owners.)

The Government decided to deal with this problem through existing exchange control powers. It was announced during the 1971 Finance Bill debates (Official Report: Standing Committee H 15 June 1971 Column 600) that exchange control consent would not be given for such transactions. This arrangement was subsequently modified. Subject to other conditions being satisfied exchange control consent was given provided the leasing company limited its claim to capital allowances in the first year to 25 per cent (instead of 100 per cent).

The Chancellor has announced that the 1980 Finance Bill will contain provisions to continue the ~~present restrictions~~ on the export of capital allowances. The proposed legislation will provide that expenditure on foreign assets for leasing (directly or indirectly) to non-resident lessees will qualify for allowances at 25 per cent in the first year, and the balance of expenditure will be written off in subsequent years at 25 per cent on the reducing balance basis (ie the normal arrangement where 100 per cent first year allowances are disclaimed).

The new provisions will apply only to financial leases ie leases under which substantially the whole economic interest in the asset is transferred to the lessee./ It is proposed that the new provisions should apply to capital expenditure incurred on and after 24 October 1979, except where it is incurred under a contract entered into before that date.

SECRET

156

THE BOARD ROOM
INLAND REVENUE
SOMERSET HOUSE

22 October 1979

CHANCELLOR

ENDING EXCHANGE CONTROL: TAX ASPECTS

We understand that you will be making a statement on the ending of exchange control tomorrow. We attach:-

a. A copy of the Press Notice which we shall be issuing tomorrow, and which should be available in the Vote Office immediately after your statement.

b. Briefing on points which may be raised about foreign leasing.

Private Secretary

---

cc Chief Secretary
Financial Secretary
Minister of State (Commons)
Minister of State (Lords)
Sir Douglas Wass
Sir Lawrence Airey
Mr Littler
Mr Lovell
Mr C W Hodges 23/x
Mr N J Ilett

Sir William Pile
Mr Dalton
Mr Isaac (origin)
Mr Lewis

Press Release

INLAND REVENUE PRESS OFFICE, SOMERSET HOUSE, STRAND, LONDON WC2R 1LB
PHONE: 01-438 6692 OR 6706

[3X]

23 October 1979

ENDING OF EXCHANGE CONTROL: CONSEQUENTIAL TAX LEGISLATION

The Chancellor of the Exchequer announced the ending of exchange control restrictions this afternoon in a statement to the House of Commons. He said that legislation will be introduced in the 1980 Finance Bill to replace the arrangements, previously operated through exchange control, which prevented United Kingdom tax incentives being used to support the leasing abroad of foreign equipment. This Press Notice gives further details.

Leasing companies resident in the United Kingdom are usually entitled to 100 per cent first year allowances on their capital expenditure on plant and equipment acquired for leasing. Their lease rental charges are lower than they would otherwise be on account of the tax relief they obtain through first year allowances.

When the present system of capital allowances was introduced in 1971, the Government was concerned to ensure that the new high rates of capital allowances (then generally 60 per cent in the first year) should not, through UK-based leasing arrangements, be used to support the acquisition of foreign made equipment by overseas companies. (A similar problem had arisen in the 1960s when UK investment grants had been claimed on ships built abroad for the ultimate benefit of foreign owners.)

The Government decided to deal with this problem through existing exchange control powers. It was announced during the 1971 Finance Bill debates (Official Report: Standing Committee H 15 June 1971 Column 600) that exchange control consent would not be given for such transactions. This arrangement was subsequently modified. Subject to other conditions being satisfied, exchange control consent was given provided the leasing company limited its claim to capital allowances in the first year to 25 per cent (instead of 100 per cent).

The Chancellor has announced that the 1980 Finance Bill will contain provisions to replace the arrangements previously operated through exchange control. The proposed legislation, on which the Revenue will be consulting those principally concerned, will provide that expenditure on foreign assets for leasing (directly or indirectly) to non-resident lessees will qualify for allowances at 25 per cent

in the first year, and the balance of expenditure will be written off in subsequent years at 25 per cent on the reducing balance basis (ie the normal arrangement where 100 per cent first year allowances are disclaimed).

The new provisions will apply only to financial leases ie leases under which substantially the whole economic interest in the asset is transferred to the lessee. The leasing or hiring of equipment to overseas customers on a short-term basis will not therefore be affected. It is proposed that the new provisions should apply to capital expenditure incurred on and after 24 October 1979, except where it is incurred under a contract entered into before that date.

159

FOREIGN LEASING: TAX ASPECTS

1. What is the problem requiring tax legislation? In the absence of special provisions, UK tax incentives for expenditure on equipment - which are intended to encourage the modernisation of British industry - would enable UK leasing companies to offer attractive leasing terms to overseas companies wishing to lease foreign-made equipment. This is at present limited through exchange control arrangements since consent is conditional on the leasing company agreeing to take a reduced rate of tax allowances. The new tax provisions will operate directly to have broadly the same effect now that the exchange control powers are being ended.

2. Why couldn't exchange control continue to be used for this purpose? It would have been impracticable to keep exchange control for this purpose when other restrictions are being ended.

3. How will the new tax rules differ from the previous arrangements? The main features of the arrangements - which are described in the Inland Revenue Press Notice - will be the same, but there will inevitably be some differences in detail since exchange control has operated on a case by case basis without specific statutory rules.

4. Will British-made goods leased abroad be affected ("export" leasing)? The present announcement deals only with the legislation necessary following the ending of exchange control. [If pressed, you might say that any further changes required in connection with leasing would be a matter for the Budget.]

5. Will the new powers be contrary to EEC, OECD etc rules in discriminating in favour of UK-made goods? The new provisions are not designed to promote British-made goods, but simply to stop the benefit of UK tax incentives flowing abroad in transactions which provide little benefit to the UK economy. The proposed tax provisions are not a new departure - they are intended to replace, and will be similar to, the working arrangements previously operated by the Bank of England through exchange control procedures.

6. Will lessees resident in Ireland be affected? The proposed tax provisions will apply to equipment leased to companies resident in Ireland [CONFIDENTIAL exchange control powers were often ineffective in relation to leasing to Ireland. It is believed that this gap in the present provisions was being increasingly exploited.]

7. Consultation. The Inland Revenue will be consulting with the main interested parties on the details of the new provisions.

Covering ~~S E C R E T~~

VIC now

161

cc Sir K. Couzens
Mr Barratt
Mr Bridgeman
Mr Dixon
Mrs Hedley-Miller
Mr Lavelle
Mr Middleton
Mr Ive
Mr Mountfield
Mr D.A. Dawkins (BK
Mr R. Armitage (Tsy. Sol.
Mr P. Lewis (IR)
Mr J.R. Mallinson (Law Officers)
Mr N.F. Bayne (FCO)
Mr G. Hamilton (DOT)

EF2 CS

p.a.

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

22nd October 1979

Dear Brian,

EXCHANGE CONTROL

I enclose, as requested, a copy of the draft of a statement on exchange control in the form in which we are putting it to the Chancellor for approval overnight. I should be grateful if you would draw this to the Attorney General's urgent attention.

You will see that the draft differs in some respects from the copy attached to Hodges' note of today's date which I understand was sent to Mallinson earlier in the day.

Yours ever,

Tony Battishill

(A.M.W. BATTISHILL)

W.C. Beckett, Esq., CB
Law Officers' Department

Covering S E C R E T

TILL 4.00 p.m. ON 23 OCTOBER 1979

DRAFT STATEMENT ON REMOVAL OF EXCHANGE CONTROLS

With permission, Mr. Speaker, I wish to make a statement about exchange control. The House will recall that in my Budget Statement on 12th June I announced our intention to carry out the progressive dismantling of the exchange controls. I made a number of relaxations at that time; and, on 18th July, I informed Parliament of significant further steps, including a first major move towards liberalising outward portfolio investment.

2. I have now decided to remove all the remaining exchange control restrictions from tomorrow, 24th October, apart from those still needed, I hope not for long, for the sanctions against Rhodesia. I am satisfied that the time has come to make a clean sweep in this way. I have been dismantling by stages because the controls have been with us in one form or another for over 40 years; and it would have been imprudent to abolish them all overnight without giving people a chance to adjust to such a historic change. But the controls have now clearly outlived their usefulness. The essential condition for maintaining confidence in our currency for the future is a Government determined, as we are, to carry out the appropriate monetary and fiscal policies.

3. By abolishing exchange control, we are taking yet another step in restoring freedom of choice and eliminating rules and regulations which distort the economy. It will lead to public expenditure savings of about £14½ million a year, which represents the current cost of about 750 staff at present employed on exchange control work at the Bank of England and about 25 at the Treasury. It will also relieve individuals, firms and financial institutions of the costs and inconveniences of having to comply with the rules.

/4.

4. Except in relation to Rhodesia, there will from tomorrow be full freedom to buy, retain and use foreign currency for travel, gifts and loans to non-residents, buying property overseas and investment in all foreign currency securities. Portfolio investment will thus be wholly freed. Foreign currency accounts can be held here or abroad. It will no longer be necessary to apply for permission to make inward or outward direct investments. Passport marking for travel funds can now be abolished and exchange controls by Customs Officers at the frontier are being ended, together with monitoring of payments for imports and exports. The requirement to deposit foreign currency securities with an authorised depositary is also abolished. The necessary Treasury Orders are being laid this afternoon.

5. The Exchange Control Act 1947 will remain in force for the time being. The Government is considering the future of this legislation. For the present, it is needed to continue sanctions against Rhodesia and also for certain technical purposes which may need to be served by other means. In that connection, under arrangements announced in this House in 1971, exchange control has been used to prevent United Kingdom tax incentives supporting the leasing abroad of foreign equipment. I propose to introduce in the 1980 Finance Bill provisions which will take effect from tomorrow, to continue to prevent this. Further details on this matter are available in the Vote Office.

6. From tomorrow, we shall be meeting in full our Community obligations on the freedom of capital movements. We shall in fact be going well beyond what Community law requires.

7. I have called this a historic change and so it is. I think the House will agree with me that we should not let the moment pass without some tribute to those on whom the burden

of administering the controls has largely fallen. I refer not only to those in the Treasury but also to the skilled and dedicated staff of the Exchange Control Department at the Bank of England and to the officers of HM Customs and Excise who have carried out exchange control tasks as part of their regular duties for many years.

8. I also wish to record, on behalf of my predecessors as well as myself, the importance of the co-operation and support which the authorities have received over the years from the banks and from other bodies and individuals, such as solicitors, to whom exchange control functions have been delegated. Over the years, the control has depended very largely on their integrity and common sense; and indeed without their help no effective control would have been possible. I end this statement with my thanks to them.