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RELAXATION OF EXCHANGE
CONTROL MEASURES
1979.

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1980

25.9.80

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DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

SECRET

Secretary of State for Industry

22 October 1979

The Rt Hon Sir Geoffrey Howe QC
Chancellor of the Exchequer
HM Treasury
Whitehall
London SW1

TOTAL COPIES 10

COPY No. 1

Dear Geoffrey.

EXCHANGE CONTROL : FOREIGN LEASING

Thank you for copying to me your letter of 19 October to Peter Carrington.

I agree with you that it would be quite wrong to announce any change in the tax treatment of export leasing without full consideration of the implications. Although the amounts involved may, in aggregate, be small, leasing is an important source of finance for some export projects.

I am copying this to Peter Carrington, John Nott and Michael Havers.

Yours.

Keith

CH/EX. REF. NO. [illegible]
REC. 22 OCT 1979
ACTION Mr Hancock
COPIES TO CST
FST
MST(C)
MST(L)
SIR D WASS
SIR K COUZENS
MR LITTLER
MR BARRATT
MR HODGES
MR R ARMITAGE TR
MR D A DAWKINS B
MR D C BECKETT

150/10

22 APR 1980. till 4pm 23 October 1979

PRINCIPAL PRIVATE SECRETARY

cc to: PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State (C)
PS/Minister of State (L)
Sir Douglas Wass
Sir Kenneth Couzens
Sir Lawrence Airey
Mr Barratt
Mr Jordan-Moss
Mr Lovell
Mr P G Davies
Mr Unwin
Mr Ridley
Mr Cardona
Mr Ilett
Mr McIntyre
Mr J Lippitt (DOI
Mr G Lanchin (DOI
Mr D A Dawkins (
Mr W C Beckett (I
Mr R Armitage (T
Mr A J G Isaac (
Mr N Godfrey (C
Mr N F Bayne (FC

EXCHANGE CONTROL: DRAFT STATEMENT

You showed me this morning the Chancellor's alterations to the draft which Sir K Couzens gave you yesterday evening. I attach a revise which I hope re-order and amends as he wished. The MS change on Rhodesia is at FCO's request.

The Press Notice should quote the statement and, if we are to have it ready for distribution in time, we must get an approved text to the Central Reproduction Unit not later than noon today.

C H W HODGES
23 October 1979

S E C R E T

UNTIL 4 P.M. ON 23RD OCTOBER

STATEMENT ON REMOVAL OF EXCHANGE CONTROLS

With permission, Mr. Speaker, I wish to make a statement about exchange control.

In my Budget Statement on 12th June I announced our intention progressively to dismantle these controls. I made a number of relaxations at that time; and again on 18th July, when I informed the House of the first major move towards liberalising outward portfolio investment.

I have now decided to remove all the remaining exchange control restrictions from midnight tonight, apart from those still needed, I hope not for long, in relation to Rhodesia.

With that single exception, 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 be wholly freed; and the requirement to deposit foreign currency securities with an Authorised Depositary is abolished. Foreign currency accounts can be held here or abroad. Passport marking for travel funds can now be abolished. The necessary Treasury Orders are being laid this afternoon.

The removal of controls 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. I would like to thank all those who have had the task of administering the controls - not only in the Treasury, the Bank of England and Customs and Excise, but also those in the private sector, whose co-operation has enabled the system to work.

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.

From tomorrow, we shall be meeting in full our Community obligations on the freedom of capital movements.

Exchange controls have been with us in one form or another for just over forty years. They have now outlived their usefulness. The essential condition for maintaining confidence in our currency is a Government determined to maintain the right monetary and fiscal policies. This we shall do.

SECRET

DRAFT LETTER TO:

Mr George Colley
Minister of Finance
Republic of Ireland

You may recall that I said in my Budget Statement on 12 June that I intended progressively to dismantle our exchange controls, and that I announced further steps to this end on 18 July.

I have now decided to dispense with all of the remaining controls, apart from those needed to maintain sanctions in relation to Rhodesia with effect from 24 October. I am announcing this decision to the House of Commons today.

In letting you know about this, I want to take the opportunity of expressing our gratitude to the Irish exchange control authorities for their cooperation and help in ensuring the effectiveness of our controls over a period of many years, during which the Republic has been part of the United Kingdom's Scheduled Territories. For technical reasons the Scheduled Territories will remain in existence for the time being but without exchange control significance.

GEOFFREY HOWE

SECRET

SECRET

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CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Sir D Wass
Sir K Couzens
Mr Barratt
Mr Hancock or
Mrs Hedley-Miller
Mr Hodges
Mr Dawkins, Bank
Mr Free-Gore, FCO
Mr Bayne, FCO

REMOVAL OF EXCHANGE CONTROLS : IRELAND

As part of the UK's Scheduled Territories for exchange control purposes, the Republic of Ireland has supported our controls with her own. You may agree that it would be appropriate if you were to write a short letter to the Irish Minister of Finance informing him of the decision to end controls and thanking the

announcement.

3. A draft letter is attached.

Paul McIntyre

J P MCINTYRE
23 October 1979

SECRET

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H. M. TREASURY

Parliament Street, London SW1P 3AG, Press Office: 01-233-3415
Telex 262405

23.10.79

REMOVAL OF EXCHANGE CONTROLS

The Chancellor of the Exchequer made the following statement to the House of Commons this afternoon:

"With permission, Mr Speaker, I wish to make a statement about exchange control.

In my Budget statement on 12 June I announced our intention progressively to dismantle these controls. I made a number of relaxations at that time and again on 18 July, when I informed the House of the first major move towards liberalising outward portfolio investment.

I have now decided to remove all the remaining exchange control restrictions from midnight tonight, apart from those still needed, I hope not for long, in relation to Rhodesia.

With that single exception, 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 be wholly freed and the foreign currency securities need no longer be deposited with an Authorised Depositary. Foreign currency accounts can be held here or abroad. Passport marking for travel funds can now be abolished. The necessary Treasury Orders are being laid this afternoon.

The removal of controls 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. I would like to thank all those who have had the task of administering the controls - not only in the Treasury, the Bank of England and Customs and Excise but also those in the private sector whose cooperation has enabled the system to work.

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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.

From tomorrow, we shall be meeting in full our Community obligations on the freedom of capital movements.

Exchange controls have been with us in one form or another for just over forty years. They have now outlived their usefulness. The essential condition for maintaining confidence in our currency is a Government determined to maintain the right monetary and fiscal policies. That we shall do."

PRESS OFFICE
H M TREASURY
PARLIAMENT STREET
LONDON SW1P 3AG
01-233-3415

155/79

NOTES FOR EDITORS

The Chancellor announced in his Budget speech on 12 June a number of exchange control relaxations and said that he intended to take further steps in the progressi dismantling of the controls. The measures announced on 12 June mainly concerned the financing of outward direct investment, including the repayment of outstanding foreign currency borrowing, and the levels of personal allowances (e.g. emigration) which were substantially increased. Further measures were announced on 18 July, among them the decision to allow complete freedom in the financing of outward direct investment. The first significant steps in the liberalisation of outward portfolio investment were also taken. Official exchange was made available for purchase of most securities denominated and payable solely in EEC currencies and of foreign currency securities issued by international organisations of which the UK is a member. In addition, provision was made to allow certain foreign currency borrowing, taken to finance outward portfolio investment, to be repaid with officia exchange.

The effect of today's announcement is that, except in relation to Rhodesia, all the remaining controls are lifted from tomorrow. The main controls being removed (to some of which the Chancellor referred) are those on:

(i) Buying and retaining of foreign currency, whether in the United Kingdom or abroad.

(ii) Outward portfolio investment.

(iii) Sterling lending to non-residents.

There will be complete freedom to retain and use foreign currency for any purpose. For example, foreign currency bank accounts may be kept, here or abroad Applications need no longer be made to the Bank of England for travel funds, as in the absence of other controls this check on the genuineness of travel needs is unnecessary. Similarly, passport-marking for travel funds is abolished.

As far as investment is concerned, it will no longer be necessary to apply fo permission to make inward or outward direct investments. For outward portfolio investment, investment currency will cease to exist, and the requirement to deposi foreign currency securities with an authorised depositary is also abolished.

The monitoring procedures on current payments abroad and the requirements relating to receipts for exports are being withdrawn. Exchange controls by Customs Officers at the frontier are being ended. Gold bullion may now, like gol coins since the Budget, be freely bought and sold.

The Bank of England are issuing an Exchange Control Notice accordingly.

Rhodesia

The exchange controls necessary to maintain economic sanctions in relation to Rhodesia are being retained. Some technical alterations to the former exchange control rules on Rhodesia are needed in order to reflect the removal of all other exchange controls; but the effect is to maintain the special rules which apply to Rhodesia on essentially the same basis as at present. The Bank of England are reissuing their Exchange Control Notice (EC79) on Rhodesia; and this opportunity has been taken to simplify some of the arrangements and to raise, to take account of inflation, the limits on the size of payments which may with the prior permissic of the Bank of England be made to residents of Rhodesia for humanitarian or family reasons. These limits were last raised in 1972.

International Obligations

Today's announcement means that the United Kingdom is now meeting in full her obligations on capital movements under the EEC Treaty, and the Commission have been informed. We are also now meeting our obligations under the OECD Code on Capital Movements.

Effect on Balance of Payments

Neither the size nor the timing of the effect can be predicted at all precisely. It will depend to a large extent on confidence in sterling. Some outflow on capital account may be expected which would not otherwise have taken place. But, over time, any capital outflow should be offset by an improvement in the current account.

Leasing

More information on the Chancellor's announcement as far as it concerns certain kin of international leasing transactions is available in a separate Press Notice being issued today by the Inland Revenue.

SECRET

until 4pm today

For file

PS/MINISTER OF STATE (LORDS)

84/04

cc Principal Private Secretary (for information without attachment)
PS/CST
PS/FST
PS/MST (C)
Sir D Wass
Sir L Airey
Sir F Atkinson
Sir A Rawlinson
Mr Barratt
Mr Jordan-Moss
Mr Lovell
Mr P G Davies
Mr Unwin
Mr Hodges
Mr Ridley
Mr Cardona
Mr McIntyre
Mr Middleton

EXCHANGE CONTROLS

NOTES FOR SUPPLEMENTARIES

I attach the notes for supplementaries as they were submitted to the Chancellor last night.

N J ILETT
23 October 1979

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 Sterling if there are no controls?

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.

4. Exchange Rate Consequences

The effect of the relaxations on the exchange rate is highly uncertain. 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.

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

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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 caused any obvious problems.

7. Monitoring of inward investment

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. [NOTE the Industry Bill being published today (Tuesday) does not ~~aover~~ 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 to 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 had 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 maintain the status quo. Positive Point The ~~Conservative~~ Constitutional Conference has made goo progress and we hope that we are approaching the time when we will be ab to lift all sanctions against Rhodesia but until agreement is reached th necessary measures must remain in place.

/10.

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 current market in which foreign currency will command a premium. The investme 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 rule were liberalised on the purchase of private property in June and of mc EEC securities in July, and the premium had in consequence to be withdrawn on sale. These losses are the inevitable consequence of the removal of restrictions.

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

It would not have been possible to operate the control in any other wa 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 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.

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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 authorities wish to see a greater role for gold in the international monetary system

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. The 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 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.

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21. Effect on interest rates?

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.

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 investment overseas at the expense of gilts and other domestic securities. But th 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 'interi 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 trea leasing transactions any differently from the way exchange control has?

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.

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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.]

that the report will be published. Perhaps even now, before the inquiry has reported, British Rail will look again at its safety procedures. It has an excellent safety record, but there have been a number of disturbing incidents recently. It would be reassuming to the public if, even now, British Rail were to give that sort of assurance.

Mr. Fowler: I am grateful to the right hon. Gentleman. It is important to emphasise that British Rail's safety record is extremely good. If British Rail's internal inquiry reveals the need for immediate changes in practice, those changes will be implemented.

EXCHANGE CONTROLS

The Chancellor of the Exchequer (Sir Geoffrey Howe): With permission, Mr. Speaker, I wish to make a statement about exchange controls.

In my Budget Statement on 12 June I announced our intention progressively to dismantle these controls. I made a number of relaxations at that time; and again on 18 July, when I informed the House of the first major move towards liberalising outward portfolio investment.

I have now decided to remove all the remaining exchange control restrictions from midnight tonight, apart from those still needed, I hope not for long, in relation to Rhodesia.

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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.

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[Sir G. Howe.]

From tomorrow, we shall be meeting in full our European Community obligations on the freedom of capital movements.

Exchange controls have been with us in one form or another for just over 40 years. They have now outlived their usefulness. The essential condition for maintaining confidence in our currency is a Government determined to maintain the right monetary and fiscal policies. This we shall do.

Mr. Healey: The Chancellor made an important statement. It betrayed a baffling sense of priorities. He has just given Britain the highest inflation rate in the industrial world. He started unemployment moving up again after two years of continuous decline. He has produced a collapse of industrial investment. The whole of British business now faces a severe cash crisis. Yet he comes along this afternoon not to offer any measures to remedy the situation but to announce a reckless and doctrinaire decision which can only make the situation worse.

In the light of our improved performance since 1976 there has been a case for some time for a relaxation in exchange control, but the right hon. and learned Gentleman is not only suspending all the rules governing the control of our exchanges; he is abolishing at a stroke the whole apparatus of control, so that if the balance of payments, or the position of our reserves, or the value of the pound, moves in such a way that it is necessary to restore controls it will be impossible for him to do so.

First, what does the Chancellor think will be the consequences of his decision? We were told by the Bank of England last month that the £500 million outflow the previous month was largely caused by the relaxation of exchange controls following the Budget. Can the Chancellor say what proportion of that sum was due to rich men buying property abroad and moving their wealth abroad? Secondly, what is the value of the applications that he has received for foreign exchange at the official rate since the relaxations in the Budget?

In the light of the answers to those questions will he say how much the financial institutions in Britain will invest abroad rather than in British industry, which is already suffering from a serious cash crisis? How much are the financial institutions likely to invest abroad rather than in Government securities so as to keep the money supply under control and finance the public sector borrowing requirement?

What does the Chancellor believe will be the effect of this decision on our exchange rate and consequently on the rate of inflation in Britain, and on interest rates? Finally, can he tell us no more about the reasons for his decision than that there will be a saving of £14½ million in public expenditure? Does not he recognise that to change in a moment an environment in which industry and finance have lived for 40 years risks as disastrous consequences as the decision of one of his predecessors to institute competition and credit decontrol some years ago, which were directly responsible for the fringe bank crisis and speculation in the property markets in 1973-74?

The right hon. and learned Gentleman must realise that this is one more reckless, precipitate and doctrinaire action, which the Government will regret no sooner than those who lose their jobs or go bankrupt as a result.

Sir G. Howe: I understand the right hon. Gentleman having difficulty in addressing himself to this argument. At one point he asserted his recognition of the strength of the case for some changes in our regime of exchange control. I welcome his limited support to that extent. However, at the commencement of his questions he emphasised the reckless, doctrinaire, unprincipled folly of making these changes. He must recognise that the changes that we are making are not undertaken in a moment; they are the third step in the programme of progressive dismantling of these controls which I announced at the time of the Budget. They have been undertaken stage by stage, not with a view to influencing the exchange rate but with a view to removing some of the restrictions that unjustifiably remain on investment decisions by our people.

The right hon. Gentleman suggested that these decisions would diminish the investment resources available in this country. He knows that that is not true. He knows from his own recollection of his days at the Treasury that the overwhelming body of evidence to the Wilson committee showed that there was no lack of resources available for capital investment in this country. The problem of one of the many inheritances from him is the lack of profitable investment opportunities. The idea of promoting additional investment overseas is that it will promote the expansion of the British markets. It is far better, in a period when oil adds strength to our resources and our currency, to acquire income-producing assets overseas than to shelter behind an apparatus of control.

The right hon. Gentleman began his questioning by suggesting, in an astonishing opening, that the inflation rate, the unemployment level, and the collapse—as he described it—of confidence in British industry were events for which the Government were responsible. He could not have more accurately described the inheritance that he passed on to us at the Treasury. During his period at the Treasury the pound was not protected from adverse consequences by the existence of the exchange control regime. It is not a regime of that kind that can produce economic strength—it is economic policies of a kind to which the right hon. Gentleman is not accustomed.

Mr. J. Enoch Powell : Is the Chancellor aware that I envy him the opportunity and the privilege of announcing a step that will strengthen the economy of this country and help to restore our national pride and confidence in our currency?

Sir G. Howe : I am grateful to the right hon. Gentleman for his support. I am not unaware of the historic importance of the decisions that I announced today. They mean a major break with the regime of control with which we have lived for almost 40 years. I am indeed grateful to the right hon. Gentleman for the recognition that he gave to that fact.

Mr. Fletcher-Cooke : Is my right hon. and learned Friend able to estimate the enormous increase in the earnings of the City of London as a result of being freed from the interminable barriers and paperwork that were required by the contols that he has so rightly abolished?

Sir G. Howe : I should not like to put an estimate upon that, but I have no doubt that my hon. and learned Friend is entirely right to draw attention to the extent to which these changes will add to the attractiveness and effectiveness of the City of London as the world's financial capital.

Mr. Richard Wainwright : Is the Chancellor aware that his announcement will be very welcome to all who opposed the attempts to insulate Britain from the rest of the world? Will he confirm that if one of the early effects of his measures is to reduce somewhat the sterling exchange rate, that will be good news for the millions of our people engaged in the exporting industries?

Sir G. Howe : I indicated in an earlier reply that this change is announced not with a view to influencing the exchange rate ; it is announced on its own merits. It is right to give this additional degree of freedom and to allow the pound to operate in the world unrestricted by restraints of that kind.

Mr. Rost : Will British nationals also be free to open bank accounts abroad if they so wish?

Sir G. Howe : That is one of the freedoms that will be restored under the changes that I announced.

Mr. Cryer : Does the Chancellor accept that one of the features of post-war Britain has been the signal lack of enterprise by private enterprise? Does not he accept that that is a signal for those enterprises to shovel money abroad and reduce the amount of investment for the British worker, and that the trade union movement will see this as a classic betrayal of the workers of this country by a Tory Government who are the lickspittles of the capitalist sector?

Sir G. Howe : I would not begin to follow the hon. Gentleman in his own emotional view of the world. My own judgment is that the enterprise of private enterprise has been the main factor in defending the economy of this country from the ravages of Socialism.

Mr. Emery : Will the Chancellor of the Exchequer accept not only our congratulations on making this move but that there will be major encouragement to the City that he has seen fit to do this not in a number of little bites, but has had the courage to sweep it away instantly in one full measure?

Sir G. Howe: I am grateful for my hon. Friend's support.

Mr. McWilliam: Will the right hon. and learned Gentleman please tell the House what he predicts will be the net effect on industrial investment of his decision this afternoon, and what will be the net capital outflow?

Sir G. Howe: It is not possible to make any net prediction of that kind, but those economies that have achieved greater strength and success than our own have been notable for the extent to which they have been expanding their overseas investment. Germany, Japan and the United States are good examples. The evidence of the inquiries that have been made suggests that a willingness on the part of our economy to invest overseas will be reflected in an enlargement of our market opportunities overseas, and the prospect of a continuing flow of income to this country that we would not otherwise have. I am quite certain that is right to allow those decisions to be taken that will contribute to the strength of our industrial economy and to the growth of jobs in this country, rather than the reverse.

Mr. Budgen: Will my right hon. and learned Friend agree that this move is most of all to be commended for the enhanced freedom that it gives to individual citizens, and for the further discipline that it will impose upon this Government and all Governments in maintaining the value of our currency?

I have one small and perhaps carping point to make. Does my right hon. and learned Friend agree that it is a practice of very dubious constitutional propriety to introduce even a small control, to take effect from today, when he is not to have, on his own account, the support of legislation or of Parliament until the spring of next year? Is that not a rather dubious slip into the principle of retrospective legislation?

Sir G. Howe: I appreciate, as always, my hon. Friend's concern about the point of principle to which he has just referred. I assure him that I have had it well in mind. We shall be continuing a necessary fiscal provision that has prevailed until now. By announcing it in the House today I am giving clear warning that that is our intention. There is nothing that I judge to be improper in so doing and in asking the House to enact it when the time comes.

Mr. Healey: Will the Chancellor at least attempt to answer my questions, which were repeated by one of my hon. Friends? The Chancellor must have made some estimate of the effect of this decision on the readiness of the financial institutions to buy Government securities and the readiness of the financial institutions to invest in British industry rather than abroad. Can he tell us what the consequences will be? He must have noticed that the only case put by his supporters on the Government Benches was based on a totally doctrinaire belief in the validity of market forces, which has been exploded time and again in our recent experience.

Sir G. Howe: It is clear that any change of this kind is likely to lead to some capital outflows across the exchanges out of this country, but it is just as likely to be matched by capital inflows in the opposite direction, without producing any substantial impact on the exchange markets. The right hon. Gentleman must understand that the prospects of promoting successful and effective investment in this country do not depend upon the preservation of a ring fence around our economy. They depend on the establishment within our country of conditions of co-operation by trade unions and their members, as well as anything else, which will make investment in Britain effective and successful. These changes do nothing to impede that. On the contrary, they give us the opportunity of acquiring income-producing investments abroad. There is total sense in that.

Mr. Robert Sheldon: Is the Chancellor aware that his statement today provides real cause for dismay? Is he further aware that he has been presiding over the collapse of British industry? His answer to this, rather than to intervene in the exchange rate, is to provide means of spending money overseas in acquiring capital assets. This decision will mark a turning point in the fortunes of this country, which I believe that he and many others will bitterly regret.

Sir G. Howe: The right hon. Gentleman appears to have overlooked the fact that all the representations made to me by and on behalf of British industry have been to the effect that I should announce precisely this change. It requires this change to be made as part of sensible economic management. It is not I who have been presiding over the collapse of British industry but the right hon. Gentleman and his colleagues in the last Government. There has indeed been a marked change of direction as a result of the change of Government. British industry recognises that we are taking the steps, which have been needed for too long, to begin restoring the conditions in which it can re-acquire prosperity.

Mr. Alexander : Will my right hon. and learned Friend indicate in some way how the £14½ million will be saved? Will he assure the House that an enormous element will be the release of civil servants to more productive and useful work?

Sir G. Howe : The figures that I have quoted for the saving are the figures that will be achieved. The staff at present employed on exchange control are in most cases staff of high skills and qualifications, for whom I have no doubt other opportunities will be forthcoming in areas of the economy where their services will be much needed and well used.

Mr. Cant : The Chancellor has given no reasons for undertaking this step, except in the most vague terms. Will he indicate what is likely to be the effect of these measures on the exchange rate of the pound? Does he anticipate, as all theorists suggest, that the exchange rate will now begin to decline? Is this acceptable? Is this what he is seeking? If this is what he is seeking, would it not have been much simpler to reduce the minimum lending rate, to stop funds coming into this country?

Sir G. Howe : As I have indicated, this change is not announced with a view to producing a given consequence in terms of the exchange rate of the pound. It is announced on its own merits. It would not be wise to accept the advice of the hon. Gentleman and to begin reducing interest rates as a means of influencing the exchange rate. The decision follows from our determination to establish and maintain effective monetary control as the foundation of conquering inflation.

That in itself is the foundation for a sensible outlook for the exchange rate.

Mr. Bruce-Gardyne : I warmly congratulate my right hon. and learned Friend for his wholly admirable statement today. Can he explain to us, in the light of the remarks of his predecessor this afternoon, why that predecessor was so keen to move in the same direction last year but was frustrated by the obscurantism and sheer illiteracy of the general council of the Trades Union Congress?

Sir G. Howe : I dare say that the right hon. Member for Leeds, East (Mr. Healey) would find it hard to answer that question. Far be it from me to try to penetrate the mysterious working of his mind.

Mr. Denzil Davies : As the Chancellor has said that the main determinant of confidence in the pound is monetary and fiscal policy, will he confirm that it is still the Government's policy to achieve a yearly reduction in the public sector borrowing requirement?

Sir G. Howe : We have announced our target for the public sector borrowing requirement for the present year and it is our intention to achieve that target.

Mr. Beaumont-Dark : May I thank the Chancellor of the Exchequer for a verbal reply to a written question that I have tabled for today and ask him his view on two things? First, manufacturing industry will welcome this relaxation. Secondly, when we had exchange control regulations the pound still dropped to 1·54 dollars during the Labour Party conference of that year. The pound will be kept firm by a realistic Government policy to ensure that this country can compete, can work, and can thrive. The pound will then be at a higher level than today, backed by resources and not by theory and dogma.

Sir G. Howe : I entirely endorse my hon. Friend's observations.

Mr. Healey : I think that the Chancellor misunderstood the question put by my right hon. Friend the Member for Llanelli (Mr. Davies). Several times since the Budget the Chancellor has said that it is his intention progressively to reduce, year by year, the public sector borrowing requirement and the monetary targets. If

[Mr. Healey.]
he is not prepared to reassert that determination today, it would constitute a very important change of policy, which the official Opposition would welcome. I hope that he will come clean on that.

Sir G. Howe: The right hon. Gentleman knows that, as I stated in my Budget speech, we are determined to secure a reduction in the burden of public borrowing and, as he said, a stage-by-stage reduction in the monetary targets. We shall be making announcements in due course.

Mr. Latham: Is my right hon. and learned Friend aware that the last people in the world from whom we need lectures on the subject of the exchange rate are former Treasury Ministers, under whom it reached its lowest level ever? Will he confirm that if we cannot defend our exchange rate by our own economic performance rather than by a blanket of controls there is something wrong with our production?

Sir G. Howe: Yes. My hon. Friend makes the point that I have already made in answer to the right hon. Member for Leeds, East (Mr. Healey). The existence of a regime of control of this kind failed altogether to protect our economy from the impact of the disastrous realities of the management of the economy by the right hon. Gentleman. It is not the regime or the controls that will be effective; it is the way in which we manage our economy and perform within it.

Mr. Douglas: The right hon. and learned Gentleman has referred to British industry. Will he confirm or deny that the TUC and/or the CBI agree with this decision? Does he agree that the reason for this change is the increase in revenues from North Sea oil and that it will be a poor inheritance for the people of this country to buy Howard Johnsons and have closed shipyards and steelworks, and a decline in manufacturing investment?

Sir G. Howe: The CBI has been urging us to make this change in policy. The underlying justification for this change includes, among other things, the proposition that when we are acquiring substantial revenues from North Sea oil—itself a capital asset—it makes sense for

us to use our resources to acquire income-producing capital assets in other parts of of the world. It is a long-term change, which makes total and complete economic sense, as well as the additional justification for sweeping away unnecessary controls.

Mr. Adley: Will my right hon. and learned Friend draw comfort from the fact that support this afternoon comes not only from this side of the House but from the Ulster Bench and the Liberal Bench? Does he agree that he should equate the gibes from the former Chancellor of the Exchequer and his colleagues about freedom and market economy with the kind of mentality that allowed the post-war Labour Government to keep sweets rationed rather than to allow market economy forces to get to work on those, too?

Sir G. Howe: I agree that the breadth, quality and nature of the support that I have received this afternoon for the decision that I have announced tends to confirm me in the view that it is a correct decision.

Several Hon. Members *rose*——

Mr. Speaker: Order. I shall call the five hon. Members who have been rising.

Mr. Leighton: We have heard from the Prime Minister this afternoon that Britain is now subject to what she calls the edicts of the Common Market, and the Chancellor has told us that he is now fulfilling a Treaty commitment for the free movement of capital. Does he agree that as capital has no nationality, no patriotism, but is solely attracted by the highest rate of profit, the most likely result of his move will be that the entrepreneurs, of whom we hear so much, will now shovel their capital on to the Continent, where they will get a higher rate of return and will accelerate the deindustrialisation of this country?

Sir G. Howe: The capacity of capital to move from one corner of a market to another and around the world market in search of opportunities for higher profit is one of its greatest justifications. Our economy has performed less well than it should have done because during the years of Socialist direction and over-taxation there was a lack of profitable and effective investment opportunities in this

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country. When we change those conditions, as this Government are doing by their policies, capital will find more fruitful opportunities for central investment in this country. Meantime, it makes good sense for capital to be employed in producing income from overseas and building up additional assets and opportunities for exports as a result of this measure.

Mr. Norman Atkinson: For those reasons, does not the Chancellor's statement represent a total and final abdication to the multinational companies? Is this not now the prelude to the sale of public sector assets to overseas interests?

Sir G. Howe: I do not think that the hon. Gentleman understands the essential requirements of how our economy can work. Our economy is attractive and will be the more attractive to multinational companies as well as to British investors—British entrepreneurs—the greater our success in creating conditions in which investment here can be profitable and successful. If the hon. Gentleman will join me in seeking to persuade his friends in the trade union movement of the crucial importance of recognising the legitimacy of profit seeking investment here, this country will be a great deal more prosperous than it was under the Labour Government.

Mr. Spearing: The Chancellor reminded the House that this move was fully in line with our obligations under the Treaty of Rome. Will he assure the House that it has nothing whatsoever to do with other monetary obligations of that Treaty under current discussion? Will he confirm that, as the Government's object is to give full freedom to the pound and let it find its own level in world markets, the Government have ruled out sterling from joining the EMS?

Sir G. Howe: No decision has been taken on the relationship between our currency and the exchange rate mechanism of the EMS. This decision has been taken entirely on its own merits.

Mr. Skinner: Will the Chancellor confirm that the Government's strategy hitherto has been to try to push investment away from the public sector to the private sector, presumably with a strong emphasis on small firms? Will not today's announcement, which is a continuation of the policy announced in July, mean that more money will, in the main, go into the multinationals abroad as opposed to the small firms that the Tory Party seems bent on supporting? Has the Chancellor not a duty to tell the House what effect this will have on the balance of payments, especially when we take into account that, within only four months of this Government being in office, the invisibles have become invisible?

Sir G. Howe: The hon. Gentleman must understand that this decision in no way impairs the capacity of small firms to expand their investment in this country. As I have several times said today, there is no lack of capital for investment in this country. The shortage has been lack of suitable and effective opportunities for that investment. The Government are committed to policies that will increase those opportunities for both small and large firms.

Mr. Dubs: Does the Chancellor agree that flows of capital into and out of this country are influenced by the question whether our rate of interest is higher or lower than that of other industrial countries? Will not the steps that he has announced today leave him particularly dependent upon the rate of interest as a weapon and therefore delay into the long and distant future any significant reduction in the high interest rates that are now crippling our economy?

Sir G. Howe: Rate of interest are not a significant determinant of flows of that kind. The underlying health of the ecenomy is far more significant in the long run. Interest rates are a necessary weapon in securing proper and effective monetary policy—control of the money supply—and they remain to be used and will be used for that purpose.

Mr. Hooley: Will there be any restriction on investment in or the acquisition of property in South Africa?

Sir G. Howe: There are no special provisions in relation to that matter in my announcement this afternoon.

POST OFFICE (REORGANISATION)

Mr. Speaker: Yesterday the hon. Member for Stirling, Falkirk and Grangemouth (Mr. Ewing) raised a point of order with me. I have looked very carefully into the matter that he raised and

[Mr. Speaker.]
I am entirely satisfied that it is not a matter for me.

BILLS PRESENTED

INDUSTRY

Mr. Secretary Joseph, supported by Mr. Peter Walker, Mr. Secretary Younger, Mr. Secretary Edwards, Mr. John Biffen, Mr. Adam Butler, Mr. Michael Marshall and Mr. David Mitchell, presented a Bill to make further provision in relation to the National Enterprise Board, the Scottish Development Agency, the Welsh Development Agency and the English Industrial Estates Corporation; to amend the Industry Act 1972 and the Industry Act 1975; to remove the requirement for a register of the financial interests of members of British Shipbuilders; and for connected purposes: And the same was read the First time; and ordered to be read a Second time tomorrow. [Bill 51.]

SHIPBUILDING

Mr. Secretary Joseph, supported by Mr. Secretary Pym, Mr. Secretary Prior, Mr. Secretary Younger, Mr. Secretary Atkins, Mr. Secretary Nott, Mr. John Biffen, Mr. Adam Butler and Mr. Michael Marshall presented a Bill to raise the limits imposed by section 11 of the Aircraft and Shipbuilding Industries Act 1977 in relation to the finances of British Shipbuilders and its wholly owned subsidiaries; and to extend the application of section 10 of the Industry Act 1972 to include the alteration of completed and partially constructed ships and mobile offshore installations: And the same was read the First time; and ordered to be read a Second time tomorrow. [Bill 52.]

EUROPEAN COMMUNITIES (GREEK ACCESSION)

Sir Ian Gilmour, supported by Mr. Douglas Hurd, Mr. Adam Butler and Mr. Cecil Parkinson, presented a Bill to extend the meaning in Acts, Measures and subordinate legislation of " the Treaties " and " the Community Treaties " in connection with the accession of the Hellenic Republic to the European Communities: And the same was read the First time; and ordered to be read a Second time tomorrow. [Bill 53.]

10 D 12

STATUTORY INSTRUMENTS, &c.

Mr. Speaker: By leave of the House, I shall put together the six questions on the motions relating to statutory instruments.

Hon. Members: Object.

Mr. Speaker: I believe that it is No. 5 to which hon. Gentlemen seek to object. Perhaps by leave of the House I may put the first four together, unless there is an objection.

The Question is, That the four instruments be referred to a Standing Committee on Statutory Instruments.

Hon. Members: Object.

Mr. Speaker: I shall put the instruments one by one.

Ordered, That the Legal Aid (Financial Conditions) (No. 2) Regulations 1979 be referred to a Standing Committee on Statutory Instruments, &c.—[*Mr. St. John-Stevas.*]

Ordered, That the Legal Advice and Assistance (Financial Conditions) (No. 3) Regulations 1979 be referred to a Standing Committee on Statutory Instruments, &c.—[*Mr. St. John-Stevas.*]

Ordered, That the Fruiting Plum Tree (Planting Grants) Scheme 1979 be referred to a Standing Committee on Statutory Instruments, &c.—[*Mr. St. John-Stevas.*]

Ordered, That the Plum Material and Clearance Grants Scheme 1979 be referred to a Standing Committee on Statutory Instruments, &c.—[*Mr. St. John-Stevas.*]

Motion made, and Question put, That the draft European Communities (Definition of Treaties) (International Wheat Agreement) Order 1979 be referred to a Standing Committee on Statutory Instruments, &c.—[*Mr. St. John-Stevas.*]

Not less than 20 Members having risen in their places and signified their objection thereto, Mr. SPEAKER *declared that the Noes had it, pursuant to Standing Order No. 73A (Standing Committee on Statutory Instruments, &c.).*

Ordered, That the Customs Duties (ECSC) (Quota and Other Reliefs) (Revocation) Order 1979 be referred to a Standing Committee on Statutory Instruments, &c.—[*Mr. St. John-Stevas.*]

BUSINESS OF THE HOUSE

Ordered, That, at this day's Sitting, Standing Order No. 3 shall apply to the Motion relating to State Aids for the Steel Industry with the substitution of One o'clock or three hours after it has been entered upon, whichever is the later, for the provisions in paragraph (*b*) of the Standing Order.—[*Mr. Le Marchant.*]

EXTRACT FROM HANSARD

DATE. 23|10|79

COL. 202 - 214

S4104

Reference 26

CODE 18 77

S E C R E T

UNTIL 4 P.M. ON 23 OCTOBER

CHANCELLOR OF THE EXCHEQUER

cc: PS/Financial Secretar
PS/Minister of State
PS/Minister of State
Sir Douglas Wass
Sir Kenneth Couzens
Mr. Barratt
Mr. Jordan Moss
Mr. Hodges
Mr Davies
Mr Ridley
PS C/E
PS/IR

PS/CHIEF SECRETARY

EXCHANGE CONTROL : STATEMENT

.... I attach a copy of the final version of the Chancellor's statement.

MAH

(M.A. HALL)
23rd October 1979

167/10

STATEMENT ON REMOVAL OF EXCHANGE CONTROLS

With permission, Mr. Speaker, I wish to make a statement about exchange control.

In my Budget Statement on 12th June I announced our intention progressively to dismantle these controls. I made a number of relaxations at that time; and again on 18th July, when I informed the House of the first major move towards liberalising outward portfolio investment.

I have now decided to remove all the remaining exchange control restrictions from midnight tonight, apart from those still needed, I hope not for long, in relation to Rhodesia.

With that single exception, 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 be wholly freed; and the requirement to deposit foreign currency securities with an Authorised Depositary is abolished. Foreign currency accounts can be held here or abroad. Passport marking for travel funds can now be abolished. The necessary Treasury Orders are being laid this afternoon.

The removal of controls 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. I would like to thank all those who have had the task of administering the controls - not only in the Treasury,

SECRET

UNTIL 4 P.M. ON 23RD OCTOBER

the Bank of England and Customs and Excise, but also those in the private sector, whose co-operation has enabled the system to work.

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.

From tomorrow, we shall be meeting in full our Community obligations on the freedom of capital movements.

Exchange controls have been with us in one form or another for just over forty years. They have now outlived their usefulness. The essential condition for maintaining confidence in our currency is a Government determined to maintain the right monetary and fiscal policies. This we shall do.

PARLIAMENTARY SECTION

cc PS/Chancellor of the Exchequer
PS/Financial Secretary
Sir Douglas Wass
Sir Kenneth Couzens
Mr Barratt
82/G — Mr Bridgeman
Mrs Hedley-Miller
54/G — Mr Middleton
Mr Gill
Mr Ilett
Mr McIntyre
Mr Ridley
Mr Cardona
Mr D A Dawkins (B/E)

PRIME MINISTER'S QUESTIONS, 25 OCTOBER
REMOVAL OF EXCHANGE CONTROLS

We were asked yesterday evening for "defensive" material on the Chancellor's announcement of 23 October removing all remaining exchange controls (except in relation to Rhodesia). I attach Notes for Supplementaries and a background note.

C H W HODGES
25 October 1979

"ND OF EXCHANGE CONTROLS

Notes for Supplementaries

1. Announcement was too sudden and sweeping

No. This was the third stage of a programme to dismantle controls announced on Budget day. Once again, we have implemented our declared policy.

2. Only possible reason doctrinaire

We were elected to give more freedom to individuals and companies. The controls have imposed costs and distortions on the economy. Removing them will also save administrative costs for the Government (£14½ million a year) and for the private sector.

3. Exchange Rate Effects

We have not removed controls in order to influence the exchange rate. The effects are very uncertain. So far, the rate is a little lower but the change has been modest compared with fluctuations over recent months. The main influences on the rate are the Government's fiscal and monetary policies and events in world markets, including the oil market.

4. Speculators will drive down the pound

Confidence in sterling depends not on exchange controls but on having the right economic policies, which we are determined to carry through.

5. Balance of Payments Effects

Some additional capital outflows are likely, particularly as portfolios are adjusted. But their size and timing are very uncertain. They should be offset over time by increased inflows, for example, by higher invisible earnings.

6. More capital and jobs will be exported

Investment at home does not depend on preventing money going abroad. There is no shortage of finance. The need is for profitable opportunities. Most

/evidence...

evidence suggests that direct investment overseas increases employment at home, if only by helping our exports.

7. Effects on Money Supply

These will depend on the size and timing of capital movements inward and outward as a result of the removal of controls. The effect on sterling £M3 could go either way but is likely to be fairly small.

8. Interest Rates

The impact on interest rates should also be small.

9. Effect on SSD Scheme ("Corset")

We shall take account of how the relaxation affects the corset in considering the roll forward of the scheme. Ending exchange controls in no way weakens our firm commitment to the monetary targets we have announced.

10. Effect on Gilts Market

There may be more investment overseas which might have gone into gilts. But this should be mainly a once-for-all effect and should not significantly affect our ability to meet the monetary target.

11. Effect on UK Equities

There may be more investment overseas but there should be no shortage of capital for United Kingdom companies with sound prospects. The overseas investment will benefit the current account by the increased flow of interest and dividends.

12. Benefits only for the rich (eg property abroad and gold bullion)

There is no case for continuing restrictions on personal freedom which have outlived their usefulness.

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13. Decision will help over EEC budget

It is good that we are now fully meeting our Treaty obligations on capital movements and our partners should welcome this. But we took this decision on its merits.

14. Decision will pave way with EMS

No decision on joining the EMS exchange rate regime has yet been taken.

15. Future of the Exchange Control Act?

The Act is still needed for Rhodesia and various technical reasons but its future is being reviewed. We have no intention of reimposing exchange controls.

16. Rhodesia?

The controls needed to maintain economic sanctions are being kept. If pressed: Various technical changes have had to be made to the rules on Rhodesia as a result of the removal of all other controls, but their general effect is to maintain the status quo. Positive Point: The Constitutional Conference has made good progress, and we hope we are approaching the time when we will be able to lift all sanctions against Rhodesia, but until agreement is reached the necessary measures must remain in place.

END OF EXCHANGE CONTROLS

Background Note

1. The Chancellor's announcement on 23 October marked the third step in the dismantling of controls. Earlier steps (12 June and 18 July) had paved the way, effectively freeing outward direct investment, increasing personal allowances, and starting to liberalise outward portfolio investment, mainly for shares in EEC currencies. Now all the remaining controls have been removed, except in relation to Rhodesia. The main controls removed with effect from 24 October were those on: buying and retaining foreign currency, in the UK or abroad; outward portfolio investment (the remainder); and the lending of sterling to non-residents. We are now meeting in full our EEC obligations on capital movements.

2. Since the announcement, the exchange rate has come down about 1 per cent both in effective terms and against the US dollar. A rise in US interest rates has probably been a factor. It is of course impossible to isolate the effect of the exchange control announcement. Both gilts and equity prices have also come down a bit, but the markets still still seem to be digesting the news.

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cc: Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir Douglas Wass
Sir Kenneth Couzens
Mr. Barratt
Mr. Hancock
Mr. Bridgeman
Mr. Middleton
Mr. P.G. Davies
Miss O'Mara
Mr. Allan
Mr. Halligan
Mr. McCrae
Mr. Cropper
Mr. Ridley

MR. UNWIN

THE EXCHANGE MARKET REACTION TO EXCHANGE CONTROL ABOLITION

The Chancellor has seen Mr. Gill's minute of 24th October. He has commented that the views reported and expressed in Thursday's Financial Times about the long run implications for e.g. the corset, monetary base etc. suggest that it would be a good idea for confidence for him to make a short reflective speech about these subjects fairly soon. The purpose would be to show that the Government has thought, and is continuing to think their way through these implications; and to hint, albeit carefully, at the Government's thoughts on future policy.

2. The Chancellor thought the speech to the American Bankers Association would be a good occasion, though it now looks as though it will clash with the publication of the White Paper.

MAH

(M.A. HALL)
25th October, 1979

EXC/34/04

CHANCELLOR

cc Financial Secretary
Sir Lawrence Airey
Mr Bridgeman
Mr Middleton

THE EFFECT OF ABOLITION OF EXCHANGE CONTROL - VIEWS OF MR IAN STEWART MP

I spoke yesterday to your PPS. He wished to stress a message which you will have, by now, heard on a number of occasions and will no doubt go on hearing. It is self-evident that, with the disappearance of the controls, problems of monetary control and management will be somewhat greater. This poses two difficulties and risks. On the one hand there may be opportunities here for Mr Healey and others to start making significant attacks on the Government, particularly if there is a lot of public fuss. On the other, markets themselves, though reasonably confident and stable for the moment considering the unexpected nature of the announcements, could well begin to become a bit shaken if they have prolonged doubts about Government policy.

2. The practical conclusion that Ian Stewart drew was that it woul be valuable if you could make a short speech at some point in the near future indicating your awareness of the problems of monetary control, and, perhaps, stressing that the authorities were thinking very hard about what changes if necessary are needed. Apart from anything else, people will be unimpressed if the corset continues any longer!

3. This message is, of course, very much in line with your minute of yesterday requesting a draft to this effect.

AR

ADAM RIDLEY
26th October 1979

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CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Sir Douglas Wass
Sir Lawrence Airey
Sir Fred Atkinson
Sir Kenneth Couzens
Mr Barratt
Mr Littler
Mr Bridgeman
Mr Dixon
Mr Middleton
Mr Butt
Mr P G Davies
Mr Gill
Mr Hodges
Mrs Lomax
Mr Riley
Mr Allan
Mr Ilett
Mr McIntyre
Mr Macrae
Miss O'Mara

Mr Ridley
Mr Cardona

Chief Cashier)
Mr Dawkins) B of E
Mr Sangster)

SPEECH TO THE SMALL BUSINESS BUREAU, WEDNESDAY 7 NOVEMBER

I attach a draft passage on exchange control and monetary policy for your speech on Wednesday to the Conference of the Small Business Bureau. A passage on the eligible liabilities figures will follow from HF as soon as possible. The proposal is that IDT should put out the complete text as a Press release under embargo on Wednesday afternoon. If you approve, this will replace the draft sent you by Mr Macrae on Friday. With the addition of a few courtesies, the draft, when completed by the commentary on the eligible liabilities figures, should be long enough.

2. The purpose of this press release would be:-

(i) To put on record a more fully argued justification for the decision to abolish exchange controls than any that has so far been made. This will be very useful for the record. For example, we should like to distribute it as guidance to our posts overseas.

(ii) To show that you considered the implications for sterling and the money supply carefully before the decision was taken.

(iii) To put tomorrow's eligible liabilities announcement in perspective in a context - namely (ii) above - which looks deliberate and considered and not a panic reaction to bad news.

3. Paragraph 5 of the draft is the first occasion on which we have suggested that Treasury Ministers should use in public the argument that the abolition of exchange controls was intended to improve competitiveness. We would not want any such statement to be misinterpreted as a desire to get the nominal rate down with all that implies for inflationary expectations. The attached draft, for this reason, combines the statement about competitiveness with a repetition of something you have said on a number of occasions, namely that it is not the Government's intention to secure any particular objective for the nominal rate. It also relates the prospective outflows on capital account to the increase in North Sea oil production still to come so as to avoid any implication that you want to get the rate down from its present level. (I am indebted to Mr Allan for this suggestion.)

4. The case for including paragraph 5 is that it is a powerful argument in support of the decision to abolish controls which adds depth to the arguments about distortion of choice, administrative costs and their having outlived their usefulness. It is a cogent answer to the TUC. It was in fact one of the principal reasons why many of us recommended you to get rid of controls. In the way it is deployed in the attached draft, I think its inclusion would help you to defend your decision without implying any weakening in your resolve to give priority to getting the rate of inflation down.

5. IDT would need the text you approve by 2.30 p.m. on Wednesday in order to be able to distribute copies in time to catch Thursday's papers.

D.H.

D J S HANCOCK
5 November 1979

DRAFT PASSAGE (FOR RELEASE TO THE PRESS) TO BE INCLUDED IN THE CHANCELLOR'S SPEECH TO THE SMALL BUSINESS BUREAU CONFERENCE ON WEDNESDAY 7 NOVEMBER

1. In the Budget Speech on 12 June I announced the Government's intention to dismantle exchange control progressively one step at a time. Apart from the very special case of Rhodesia, we have just completed the dismantling process earlier than expected, in three steps - in the Budget, on 18 July and on 23 October.

2. The abolition of controls is part of the Government's policy to enlarge freedom of choice, to reduce the role of the State and to permit markets to work as they should without distortion.

3. The decision has been widely welcomed, both at home and abroad, as an important step in the restoration of health to the British economy. But the TUC have said that the removal of exchange controls is contrary to the national interest because it boosts investment overseas at the expense of investment at home. In fact, I have not created any incentive for overseas investment. What I have done is to remove an artificial barrier discriminating against overseas investm that had the effect of preventing the price system from operating as it should. When it operates properly in the capital markets, the price system channels funds to the places where it is expected to earn the highest return.

4. It is clearly in the national interest that the country's savings should be invested so as to earn the highest return. The country benefits from overseas investment in the form of future receipt

to the current account. It benefits from domestic investment in the form of future goods and services domestically produced - provided of course that the domestic investments are profitable. The return on domestic investments has, in the past, been very disappointing and it is this, not a shortage of finance, that has been the cause of low investment in the UK. In time, as the Government's general economic policies take effect, as markets are freed, incentives restored and expectations become realistic in response to realistic Government policies, the return on domestic UK investment will increase and funds will flow there without artificial help. In the meantime, the UK economy would have gained no benefit from the continued existence of exchange controls which hampered the proper functioning of the capital markets and impeded the ability of British investors to exploit profitable opportunities.

5. At a time when North Sea oil is producing increasing inflows to the current account of the balance of payments, the continued existence of exchange controls would have been damaging, not helpful, to manufacturing industry in this country. By preventing the exchange rate from reflecting market forces, the controls, coupled with the increasing benefits of North Sea oil, would have been harmful to competitiveness. Now we have abolished controls, the improvement in the oil sector of our current account will tend to be offset by outflows on the capital account, rather than by a deterioration in the non-oil sector of our current account. Thus the balance of international trade by our manufacturing sector will no longer have to bear the full impact of the adjustment of our overall balance of payments to North Sea oil.

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6. Small businesses have a particular interest in direct investment overseas. In my June Budget, I allowed sterling to be used to finance such investments within very generous limits; and now I have completed the process by abolishing the requirement to obtain permission to make them. The great weight of the available evidence supports the Government's view that direct investment abroad encourages employment and output at home and does not substitute for it. A recent survey by the NEDC involving both sides of industry, for example, supported this conclusion by showing that overseas investment is in many cases necessary for a successful export performance. The old restrictions were particularly hard on small firms seeking outlets overseas because they lacked the resources possessed by larger firms to find ways round the formalities involved.

7. Exchange controls were justified in the past partly on the grounds that they protected the economy against speculative attack. Experience has shown that this was not a sufficient justification for the costs they imposed on the proper functioning of the economy. No exchange control regime can protect a currency against attack if the markets judge that the country's domestic policies are inappropriate. For example, our exchange controls did not prevent leading and lagging on current payments nor movements of non-resident holdings of sterling. In 1976 sterling plunged to an unprecedentedly low level despite the fact that the UK possessed at the time the most elaborate exchange control regime of any industrial country in the world.

8. The controls imposed substantial administrative costs on both the public and private sectors. About 750 staff in the Treasury and the Bank of England will now be released for other work. The

commercial banks, stockbroking firms and others who bore the brunt of the administrative burden are now free of these responsibilities. Individuals and firms will no longer have to contend with the rules. Everyone can now buy foreign currency without having his passport marked, and this is a benefit which will be appreciated by people at large and not only by those directly involved in business and finance.

9. In reaching our decision to abolish controls, the Government had to consider the possible effect on the exchange rate for sterling. We took into account the possibility that the exchange rate would be lower than it would otherwise have been over a period ahead as investors adjusted their portfolios. But this effect will, of course, be only one of many influences on sterling and I have already referred to another major one, namely the fact that rising North Sea oil production will bring an increasing benefit to the current account over the years ahead. I am therefore making no prediction about the future course of the exchange rate. It is true that the pound fell on the day I made my announcement; but that fall coincided with an unprecedented rise in US interest rates. We must expect the markets to reassess the position of sterling periodically in the light of all the changes in relevant conditions. In such reassessments, sterling's basic position will be determined by our domestic monetary and fiscal policies. I have repeatedly stressed and make no apology for stressing again today that the Government is firmly committed to policies which will be favourable to the strength of our exchange rate.

10. The Government also considered very carefully the implications of the abolition of exchange control for domestic monetary policy, and we were, of course, particularly concerned with how it would affect

our ability to meet our monetary targets. Some City commentators have argued that abolition will make our task more difficult, and there has been a considerable amount of Press comment along these lines. But these arguments miss one basic point, and that is that the fundamental elements in achieving monetary control are keeping down the level of public sector borrowing and ensuring that interest rates are at the right level. There is no avoiding this, with or without exchange controls. The Supplementary Special Deposit scheme (the "corset"), which these commentators are saying has now outlived its usefulness, has never been intended as a substitute for appropriate action on the PSBR and interest rates, but rather as a complement. It certainly cannot help if these fundamentals are wrong. The Government's commitment to getting the fundamentals of monetary control right is in no way affected by abolition, and its ability to do so is unimpaired.

11. The effects of abolition on domestic monetary conditions have also been somewhat overplayed. We can obviously expect a complex movement of funds both across the exchanges and within the domestic financial system and these will clearly have domestic monetary implications. To the extent that there is an outflow of capital from the UK this will put downward pressure on the money supply and so on the level of domestic interest rates required to ensure that our monetary target is met. But there will be some offsetting influences. For instance, there may be some increase in bank borrowing to finance repayment of foreign currency debt, and this will add to Domestic Credit Expansion and put upward pressure on the money

supply and interest rates. However, the net effects of these factors over a period is likely on balance to be small, and indeed they could go either way.

12. [Passage on eligible liabilities figures to follow.]

CONFIDENTIAL

PRINCIPAL PRIVATE SECRETARY

EF(2)CS
13 NOV 1979

cc Chief Secretary
Financial Secretary
Sir Douglas Wass
Sir Lawrence Airey
Sir Fred Atkinson
Sir Kenneth Couzens
Mr Barratt
Mr Littler
Mr Bridgeman
Mr Dixon
Mr Middleton
Mr Butt
Mr P G Davies
Mr Gill
Mr Hodges
Mrs Lomax
Mr Riley
Mr Allan
Mr Ilett
Mr McIntyre
Mr Macrae
Miss O'Mara
Mr Ridley
Mr Cardona
Mr Cropper
Chief Cashier)
Mr Dawkins) B of E
Mr Sangster)

SPEECH TO THE SMALL BUSINESS BUREAU, WEDNESDAY 7 NOVEMBER

I refer to my minute of yesterday's date. I understand that the Chancellor has decided that the small business bureau would not be able to take more than about 5 minutes of such material; but that he will authorise a Treasury Press Notice of about twice the length of what he actually said.

2. Accordingly, I am submitting with this minute two drafts:-

(i) A draft passage for inclusion in the Chancellor's speech. Mr Macrae will let you have separately a full draft for a 20 minute speech which combines this passage with other material which the Chancellor has already discussed with Mr Cropper.

(ii) A draft Treasury Press Notice.

3. The reference to the eligible liability figures appears in the draft Press Notice and not in the speech (on the grounds that it is too technical for the small business bureau). HF may wish to suggest a change in the wording when they have seen tomorrow morning's newspapers.

4. IDT must receive the final text of the press release by 2.30 p.m. tomorrow.

D.H.

D J S HANCOCK
6 November 1979

DRAFT PASSAGE FOR INCLUSION IN SPEECH.

1. In the Budget Speech on 12 June I announced the Government's intention to dismantle exchange control progressively one step at a time. Apart from the very special case of Rhodesia, we have just completed the dismantling process earlier than expected, in three steps - in the Budget, on 18 July and on 23 October.

2. The abolition of controls is part of the Government's policy to enlarge freedom of choice, to reduce the role of the State and to permit markets to work as they should without distortion.

3. The decision has been widely welcomed, both at home and abroad, as an important step in the restoration of health to the British economy. But the TUC have said that the removal of exchange controls is contrary to the national interest because it boosts investment overseas at the expense of investment at home. In fact, I have not created any incentive for overseas investment. What I have done is to remove an artificial barrier discriminating against overseas investment that had the effect of preventing the price system from operating as it should.

4. Small businesses have a particular interest in direct investment overseas. In my June Budget, I allowed sterling to be used to finance such investments within very generous limits; and now I have completed the process by abolishing the requirement to obtain permission to make them. The great weight of the available evidence supports the Government's view that direct investment abroad encourages employment and output at home and does not substitute for it. A recent survey

4-8

by the NEDC involving both sides of industry, for example, supported this conclusion by showing that overseas investment is in many cases necessary for a successful export performance. The old restrictions were particularly hard on small firms seeking outlets overseas because they lacked the resources possessed by larger firms to find ways of achiving what they needed to do consistently with the rules.

5. The controls imposed substantial administrative costs on both the public and private sectors. About 750 staff in the Treasury and the Bank of England will now be released for other work. The commercial banks, stockbroking firms and others who bore the brunt of the administrative burden are now free of these responsibilities. Individuals and firms will no longer have to contend with the rules. Everyone can now buy foreign currency without having his passport marked, and this is a benefit which will be appreciated by people at large and not only by those directly involved in business and finance.

6. In reaching our decision to abolish controls, the Government had to consider the possible effect on the exchange rate for sterling. We took into account the possibility that the exchange rate would be lower than it would otherwise have been over a period ahead as investors adjusted their portfolios. But this effect will, of course, be only one of many influences on sterling. Among the other influences is the fact that rising North Sea oil production will bring an increasing benefit to the current account over the years ahead. I am therefore making no prediction about the future course of the exchange rate.

7. The Government also considered very carefully the implications of the abolition of exchange control for domestic monetary policy, and

We are, of course, particularly concerned with how it would affect our ability to meet our monetary targets. Some City commentators have argued that abolition will make our task more difficult. But these arguments miss one basic point, and that is that the fundamental elements in achieving monetary control are keeping down the level of public sector borrowing and ensuring that interest rates are at the right level. There is no avoiding this, with or witho exchange controls.

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DRAFT TREASURY PRESS NOTICE

1. In the Budget Speech on 12 June I announced the Government's intention to dismantle exchange control progressively one step at a time. Apart from the very special case of Rhodesia, we have just completed the dismantling process earlier than expected, in three steps - in the Budget, on 18 July and on 23 October.

2. The abolition of controls is part of the Government's policy to enlarge freedom of choice, to reduce the role of the State and to permit markets to work as they should without distortion.

3. The decision has been widely welcomed, both at home and abroad, as an important step in the restoration of health to the British economy. But the TUC have said that the removal of exchange controls is contrary to the national interest because it boosts investment overseas at the expense of investment at home. In fact, I have not created any incentive for overseas investment. What I have done is to remove an artificial barrier discriminating against overseas investment that had the effect of preventing the price system from operating as it should. When it operates properly in the capital markets, the price system channels funds to the places where it is expected to earn the highest return, whether at home or overseas.

4. The return on investment at home has, in the past, been very disappointing and it is this, not a shortage of finance, that has been the cause of low investment in the UK. In time, as the Government's general economic policies take effect, as markets are freed, incentives restored and expectations become realistic in response to realistic

Government policies, the return on domestic UK investment will incre
and funds will flow there without artificial help. In the meantime, the UK economy would have gained no benefit from the continued existence of exchange controls which hampered the proper functioning of the capital markets and impeded the ability of British investors to exploit profitable opportunities.

5. Small businesses have a particular interest in direct investme overseas. In my June Budget, I allowed sterling to be used to financ such investments within very generous limits; and now I have completed the process by abolishing the requirement to obtain permiss to make them. The great weight of the available evidence supports th Government's view that direct investment abroad encourages employment and output at home and does not substitute for it. A recent survey by the NEDC involving both sides of industry, for example, supported this conclusion by showing that overseas investment is in many cases necessary for a successful export performance. The old restrictions were particularly hard on small firms seeking outlets overseas because they lacked the resources possessed by larger firms to find ways of achieving what they needed to do consistently with the rules.

6. The controls imposed substantial administrative costs on both the public and private sectors. About 750 staff in the Treasury and the Bank of England will now be released for other work. The commercial banks, stockbroking firms and others who bore the brunt of the administrative burden are now free of these responsibilities. Individuals and firms will no longer have to contend with the rules. Everyone can now buy foreign currency without having his passport marked, and this is a benefit which will be appreciated by people at large and not only by those directly involved in business and finance.

7. In reaching our decision to abolish controls, the Government had to consider the possible effect on the exchange rate for sterling. We took into account the possibility that the exchange rate would be lower than it would otherwise have been over a period ahead as investors adjusted their portfolios. But this effect will, of course, be only one of many influences on sterling. Among the other influences is the fact that rising North Sea oil production will bring an increasing benefit to the current account over the years ahead. I am therefore making no prediction about the future course of the exchange rate. It is true that the pound has fallen since I made my announcement; but that fall has coincided with an unprecedented rise in US interest rates. We must expect the markets to reassess the position of sterling periodicall in the light of all the changes in relevant conditions. In such reassessments, sterling's basic position will be determined by our domestic monetary and fiscal policies. The Government is firmly committed to policies which will be favourable to the strength of our exchange rate.

8. The Government also considered very carefully the implications of the abolition of exchange control for domestic monetary policy, and we were, of course, particularly concerned with how it would affect our ability to meet our monetary targets. Some City commentators have argued that abolition will make our task more difficult. But these arguments miss one basic point, and that is that the fundamental elements in achieving monetary control are keeping down the level of public sector borrowing and ensuring that interest rates are at the right level. There is no avoiding this, with or without exchange controls. The Supplementary Special Deposit scheme (the "corset"),

which these commentators are saying has now outlived its usefulness, has never been intended as a substitute for appropriate action on the PSBR and interest rates, but rather as a complement. It certainly cannot help if these fundamentals are wrong. The Government's commitment to getting the fundamentals of monetary control right is in no way affected by abolition, and its ability to do so is not changed significantly.

9. Yesterday's figures for eligible liabilities seem to suggest that it may be taking us longer to bring the rate of growth of the money supply down from the levels which we inherited than many had hoped at the time of the Budget. This is not entirely unexpected: the Budget measures reducing the PSBR - notably the increase in VAT and disposals - will affect government receipts in the second half of the year. On the other hand, those increasing the PSBR took effect earlier, and the income tax rebates have a large once-for-all effect. The lower PSBR is of itself likely to tighten monetary conditions from next month onwards.

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cc PS/Chief Secretary
PS/Financial Secretary
Sir Douglas Wass
Sir Lawrence Airey
Sir Fred Atkinson
Sir Kenneth Couzens
Mr Barratt
Mr Littler
Mr Bridgeman
Mr Dixon
Mr Middleton
Mr Butt
Mr P G Davies
Mr Gill
Mr Hodges
Mrs Lomax
Mr Riley
Mr Allan
Mr Ilett
Mr McIntyre
Mr Macrae
Miss O'Mara

Mr Ridley
Mr Cardona

Chief Cashier)
Mr Dawkins) B of E
Mr Sangster)

CHANCELLOR'S SPEECH ON EXCHANGE CONTROL

As requested, I am submitting with this minute a draft passage on exchange control for inclusion in the Chancellor's speech to a Conservative Party body in his constituency tomorrow, 10 November. The suggestion was that it should be put out by the Party Central Office.

2. I have drafted this as a self-contained passage. I understand that the Chancellor is considering separately the possibility of saying something about the domestic markets as well.

3. It seems to me that, as it is now nearly three weeks since the announcement, the [illegible] way of dealing with exchange control is in the form of a reply [illegible]. The Chancellor will [illegible]

[illegible]. Paragraph 5 incorporates the suggestion about the relative return on private and public sector holdings of overseas assets in Sir Douglas Wass's recent minute (not copied to all).

D.H.

D J S HANCOCK
9 November 1979

[illegible]
[illegible] the Bank [illegible] to
abolish exchange controls [illegible] on 23 October.

2. It has been said that we are encouraging overseas investment and discouraging investment at home. This is untrue. We have removed an artificial distortion in the capital markets that discriminated against overseas investment. Funds can now flow to where the return is expected to be greatest whether at home or abroad. Investment in the UK has been restrained by a lack of profitable opportunities, not by a lack of finance. The Government's economic policies are designed to increase the profitability of domestic investment. Unprofitable investment is no use to anyone.

3. It has been suggested that we have removed the nation's defences against speculative flows. This is an illusion. The exchange control regime did not protect the economy from the consequences of unsound economic policies as the events of 1976 showed. In the modern world, with its rapid communications and the increased sophistication of the business community, no conceivable exchange control regime can prevent the movement of funds out of an unsound economy. The only effective defence against speculative flows is to maintain confidence.

4. [illegible]

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[illegible] with the [illegible] of [illegible] in the [illegible] interest simply because the Government [illegible] it and regardless of the evidence of its actual effects.

5. The competitiveness of British industry should over time benefit from the relaxation of exchange control. The manufacturing sector of our economy will no longer have to take the full force of the adjustment of our balance of payments to increasing North Sea oil production. I have been urged to increase competitiveness by manipulating sterling lower on the foreign exchange market. This would be no answer to the problem. If we intervened in that way we should expand the money supply and that would conflict with other objectives. Moreover, it is surely preferable to allow the private sector greater scope to invest in overseas [illegible] and real assets, with the prospect of capital growth, rather than to increase our already high reserves.

6. The nation will benefit from the abolition of exchange controls in many ways. Firms competing to establish their position in export markets will no longer have to contend with the regulations. The evidence of a number of surveys confirms the Government's view that overseas investment is a necessary part of a successful export performance and not a substitute for it. Administrative staff, both in the Bank of England and in the private sector, will be released [illegible]

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[illegible]

to decline.

7. There is nothing doctrinaire about a decision which gives the country such advantages.

[illegible]
Reaction
"Risky leap"

OPINION

Abolition of exchange controls a risky leap into uncertainty

HEN Nigel Lawson, the Financial cretary to the Treasury, was asked on the dio the other day whether he agreed that e abolition of exchange controls was a ingerous gamble, he replied: "No, but it a leap in the dark."

The fact is that no one could know how e economy would respond to the sudden olition of a major feature in its environ- ent over the last 40 years. The immediate rdict of the markets was an emphatic umbs down. Gilts wilted, and the equity arket has fallen to the lowest level for arly three years. Sterling's recent decline celerated, in spite of intervention by the ink of England, and as a result the retail ice index will be two per cent higher than would otherwise have been next year.

The explanation given in both the omestic and foreign markets is that oney will flow out of Britain instead of to gilts and equities, and the exchange te will continue under pressure.

Ministers may not be too unhappy at the ll of sterling so far, and they can argue at studies carried out in recent years both the Department of Trade and the NEDC ggest that little investment abroad is at e expense of potential investment in Bri- in. But these studies were carried out with e whole pa[illegible]ply of exchange controls in ace; they [illegible]not throw light on what ay happe[illegible] when exchange controls are oli[illegible]d altogether at a stroke.

Th[illegible] is why I myself as Chancellor eferred to move in this area with glacial ajesty particularly since the clamour for removing exchange controls was loudest among those who had pushed the previous Conservative Government into the disastrous banking policy of competition and credit control.

I recall that the Dresdner Bank, in its seminal paper on the reasons for the superior performance of Geman industry, emphasised the benefits derived from the fact that until a few years ago very little German money was invested abroad.

No one is suggesting that domestic investment in Britain will now cease altogether. But the markets are surely right in believing that the abolition of exchange controls will lead individuals who might otherwise have invested at the margin in Britain to prefer investment in countries where inflation is lower or growth is higher.

This is even more likely to be true of the financial insitutions, which in particular may want to increase the proportion of their portfolios which they hold abroad — at present 5 or 6 per cent — at the expense of the 50 per cent they hold in gilts. So it will be more difficult for the Government to finance its borrowing requirement.

Moreover, there is now total freedom for the banks to avoid domestic monetary

DENIS HEALEY

controls by lending through their subsidiaries abroad — and no one yet seems to have considered what to do about it. Whatever fiddling with monetary definitions now takes place, the result is likely to be higher interest rates in Britain than would otherwise have been necessary, and an attempt to curb lending in Euro-currencies which could be disastrous both for the non-oil developing countries which have no other means of financing their deficits, and for some at least of the private banks which have to continue lending to serve their existing loans if they are to avoid the default of their clients.

A further risk to the banking system arises from the new freedom for specula- tion in commodity futures, which is already building up in many countries like a gigan- tic South Sea Bubble.

The only certain beneficiaries of the abolition of exchange controls are those who use it to speculate in foreign property and to escape taxation. The Capital Transfer Tax risks becoming as avoidable for the wealthy as the Estate Duty it replaced. Indeed tax evasion is now much easier since the Inland Revenue will find it difficult to detect evasion through conspicuous expenditure in Britain and people will be able to move money into countries which are not obliged to exchange information with Britain.

I do not know any more than does the Chancellor of the Exchequer the magnitude of the disadvantages which may follow from these implications of his action. It is indeed a leap in the dark.

If the scale is substantial, a more general risk could follow. With inflation in Britain now certain to rise above the level predicted by the Government in June, and the fall in gross domestic product likely to be greater, we cannot absolutely rely on further in- creases in the price of oil or cuts in its out- put to offset the downward pressure on sterling — though in my view at some point they are likely to do so.

It is all too easy to envisage cir- cumstances in which the outflow of bor- rowed money from our reserves could become a major threat to our viability as part of the international system.

In that case it could become necessary to re-establish exchange control overnight. But if the Government has dismantled the whole of the machinery as it boasts of hav- ing done, this might be impossible to do in time. And if it were even thought to be im- possible, that might produce the very situa- tion in which it was necessary.

The legal framework for exchange con- trol does however remain. One can only hope that someone less infected with the foolhardy dogmatism of Treasury Ministers has buried somewhere the weapons needed to enforce that law.

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cc: PS/Chief Secretary
PS/Financial Secretary
Sir Douglas Wass
Sir Lawrence Airey
Sir Fred Atkinson
Sir Kenneth Couzens
Mr. Barratt
Mr. Littler
Mr. Bridgeman
Mr. Dixon
Mr. Middleton
Mr. Butt
Mr. P.G. Davies
Mr. Gill
Mr. Hodges
Mrs. Lomax
Mr. Riley
Mr. Allan
Mr. Ilett
Mr. McIntyre
Mr. Macrae
Miss O'Mara
Mr. Ridley
Mr. Cardona

EF2CS

P. Hodges
pa
DH.
23/11

MR. HANCOCK

CHANCELLOR'S SPEECH ON EXCHANGE CONTROL

I fear your efforts to provide the Chancellor with some speaking notes on exchange control have again proved still-born.

2. There was a general feeling that this was not a suitable occasion for talking about the domestic markets, and consequently the Chancellor decided to drop the whole idea of an on the record speech altogether.

3. He has asked me to thank you particularly for producing, at very short notice, yet another passage which he is not immediately going to use. But there are plenty of other opportunities coming up and it may yet reach its intended audience.

(A.M.W. BATTISHILL)
9th November, 1979

22/11

Reference Hous of Commons
9/11/79 12
WA 274

NATIONAL FINANCE

Exchange Controls

15. **Mr. Cryer** asked the Chancellor of the Exchequer what representations he has received from the Trades Union Congress regarding the abolition of exchange controls.

Sir Geoffrey Howe: None.

37. **Mr. Gwilym Roberts** asked the Chancellor of the Exchequer what representations he has received about the abolition of exchange controls; and if he will make a statement.

Sir Geoffrey Howe: The representations I have received have generally welcomed the abolition of exchange controls and have recognised the significance of this historic step.

EF(2)CS

14 NOV 1979

FINANCIAL SECRETARY TO THE TREASURY

EF2CS x file

MR DAWKINS (BANK OF ENGLAND)

cc Principal Private Secretary
PS/Chief Secretary
Sir D Wass
Sir L Airey
Sir F Atkinson
Sir K Couzens
Mr Barratt
Mr Littler
Mr Bridgeman
Mr Dixon
Mr Middleton
Mr Unwin
Mr Butt
Mr P G Davies
Mr Gill
Mr Hodges 14/xi
Mrs Lomax
Mr Riley
Mr Allan
Mr Ilett
Mr McIntyre
Miss O'Mara

Mr Ridley
Mr Cardona

Chief Cashier) B/E
Mr Sangster)

ABOLITION OF EXCHANGE CONTROLS

Now that the dust has settled following our announcement on 23 October I feel that I owe you a word of thanks for all your help and advice. I well realise that it cannot have been an easy task for one in your position; indeed that fact greatly adds to my appreciation of your efforts.

NL.

NIGEL LAWSON
13 November 1979

Mr Hodges

SECRET

CHANCELLOR

cc Chief Secretary
Financial Secretary
Sir D Wass
Sir L Airey
Sir F Atkinson
Sir K Couzens
Mr Barratt
Mr Littler
Mr Bridgeman
Mr Hancock
Mr Middleton
Mr Unwin
Mr P G Davies
Mr Bottrill
Mr Gill
Mrs Gilmore
Mr Hodges
Mrs Lomax
Mr Folger
Mr Williams
Mr Macrae
Mr Ridley
Mr Cardona
Mr Cropper

Mr Fforde)
Chief Cashier) Bank
Mr Goodhart)

EF(2)CS
27 DEC 1979

4.30 today

DH 15/11

SPEECH TO THE INSTITUTE OF BANKERS, FRIDAY 16 NOVEMBER

I attach a draft speech which concentrates on monetary policy but contains also a section prepared by Mr Hancock on exchange controls. The material may not be entirely consistent with the latest version of tomorrow's statement, and has not yet been checked in detail with the Bank. Some changes may be necessary on both accounts. Topping and tailing will, of course, also be necessary.

2. I also attach a section by Mr Brendon Sewill on the method of payment of wages which he has suggested might be included in the speech. It does not fit easily into the speech as currently drafted, and the Bank have not yet seen it, but you may wish for it to be woven in.

pp C J RILEY
~~15~~ 14 November 1979

SECRET

21/2/11

14.11.79

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DRAFT SPEECH TO INSTITUTE OF BANKERS, FRIDAY 16 NOVEMBER

1. Yesterday in the House of Commons I announced the Government's plans for rolling forward the monetary target and a package of measures designed to ensure that the target is met. I also discussed techniques of monetary control, and I would like to talk tonight about some of these issues in greater detail.

2. Control of the money supply is, of course, absolutely central to our economic strategy. It is now generally accepted, not only in this country but also throughout the industrialised world, that reducing inflation is the key to sustained economic growth. It is also recognised that excessive monetary growth is inconsistent with low inflation. Even our predecessors eventually came to realise this. But they put the cart before the horse; they continued to rely heavily on incomes policies, in one guise or another, in spite of the demonstrable failure of such policies over a long period of years. These years of failure show quite clearly that the Government's policy of relying mainly on monetary means of controlling inflation is right. We are committed to take whatever measures are necessary, whether monetary or fiscal, to achieve monetary objectives.

3. But tight monetary control is not a painless cure. As the Prime Minister made quite clear in her speech at the Lord Mayor's Banquet on Monday the path to lower inflation may well be a ~~strong~~ stony one. Inflationary

/attitudes

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attitudes and behaviour are deeply entrenched in our economy, and inevitably it will take time for these to be corrected. A tight monetary policy will therefore almost certainly involve some loss of output in the transitional period before inflation adjusts to lower monetary growth. This is so whether monetary control is achieved by fiscal means - cutting the PSBR - or by having high interest rates. But it is essentially a temporary phenomenon, and furthermore the extent of the temporary loss of output is something which those in industry have within their power to determine.

4. Put simply, the quicker that unions and management accept that the Government will not shrink from tight monetary control, and that inflation <u>will</u> come down if they behave responsibly, the less will be the temporary loss of output and jobs. If inflationary expectations do not adjust quickly and high wage settlements persist, this will inevitably mean a loss of jobs as the Government has either to tighten fiscal policy or raise interest rates in order to prevent monetary growth exceeding the target. There is no escape from this, and it is quite clearly in everybody's interests to recognise it.

5. Influencing inflationary expectations is thus a critical part of the Government's strategy, and in this respect the commitment which I made in my Budget Speech to a progressive reduction in the rate of monetary growth has an important role to play. My decision not

/to

to allow for "base drift" when rolling forward the monetary target should also convince both sides of industry that we will not surreptitiously allow a relaxation in our monetary stance. And the other measures which I took yesterday show how much importance I attach to ensuring that the targets are met and hence that our whole strategy carries conviction. Only then can we rely on the emergence of those favourable expectational factors which will allow us to beat inflation with a minimum cost to output and jobs.

6. But I would like to add a warning here about the ability of the authorities to control monetary growth in the very short run. The events of the last few months in particular have shown that it is not a practical possibility to achieve control on a month by month basis. In spite of the rise in MLR in the Budget, monetary growth has been well above the top end of the target range. In practice it is not feasible to control the money supply over periods of much less than about 6 months. It is important that those who operate in financial markets realise this, because if they expect more than is in practice achievable this inevitably makes the authorities' task harder. It is unlikely that deviations from a target path for the money supply which are corrected over 6 months to a year will significantly affect either output or prices. But the Government is well

/aware

aware that it is vital that such corrections are made so that a temporary deviation does not become a trend. Only by ensuring the complete credibility of the target can we hope to have the favourable impact on inflationary expectations which is so important.

7. Thus the crux of the Government's policy for controlling inflation is to provide an appropriate financial framework and to try to ensure that inflationary expectations respond as quickly as possible to the rate of inflation consistent with that framework. Our policy is not to interfere in the workings of the labour market so that the distortions associated with incomes policies are avoided.

8. It was in similar spirit that I announced on 23 October the completion of the process of abolishing exchange controls which I foreshadowed in my Budget Speech. The decision has been widely welcomed, both at home and abroad, as an important step in the restoration of health to the British economy. But the TUC have said that the removal of exchange controls is contrary to the national interest because it boosts investment overseas at the expense of investment at home. In fact, I have not created any incentive for overseas investment. What I have done is to remove an artificial barrier discriminating against overseas

/investment

investment that had the effect of preventing the price system from operating as it should.

9. In my June Budget, I allowed sterling to be used to finance direct investment overseas within very generous limits; and now I have completed the process by abolishing the requirement to obtain permission to make such investments. The great weight of the available evidence supports the Government's view that direct investment abroad encourages employment and output at home and does not substitute for it. A recent survey by the NEDC involving both sides of industry, for example, supported this conclusion by showing that overseas investment is in many cases necessary for a successful export performance. The old restrictions were particularly hard on small firms seeking outlets overseas because they lacked the resources possessed by larger firms to find ways of achieving what they needed to do consistently with the rules.

10. The controls imposed substantial administrative costs on both the public and private sectors. About 750 staff in the Treasury and the Bank of England will now be released for other work. The commercial banks, stockbroking firms and others who bore the brunt of the administrative burden are now free of these responsibilities. Individuals and firms will no longer have to contend with the rules. Everyone can now buy foreign currency without having his passport marked, and

/not

not only by those directly involved in business and finance.

11. In reaching our decision to abolish controls, the Government had to consider the possible effect on the exchange rate for sterling. We took into account the possibility that the exchange rate would be lower than it would otherwise have been over a period ahead as investors adjusted their portfolios. But this effect, will, of course, be only one of many influences on sterling. Among the other influences is the fact that rising North Sea oil production will bring an increasing benefit to the current account over the years ahead. I am therefore making no prediction about the future course of the exchange rate.

12. The Government also considered very carefully the implications of the abolition of exchange control for domestic monetary policy, and we were, of course, particularly concerned with how it would affect our ability to meet our monetary targets. Some City commentators have argued that abolition will make our task more difficult. But these arguments miss one basic point, and that is that the fundamental elements in achieving monetary control are keeping down the level of public sector borrowing and ensuring that interest rates are at the right level. There is no avoiding this, with or without exchange controls.

/13.

13. But the abolition of controls will certainly affect the environment in which monetary control operates and the usefulness of certain forms of control will clearly be affected. In my statement yesterday I made it plain that the Supplementary Special Deposits scheme - the corset - is nearing the end of its useful life, and exchange control/. But it is not the only one. This year already there has been increasing evidence that certain transactions which might normally have been undertaken by the banks have been pushed outside the banking system as pressure under the corset increased. To the extent that this has occurred sterling M3, our target variable, has tended to understate underlying monetary growth. And the abolition of exchange controls adds further to the possibilities for evading the control without affecting underlying monetary conditions by switching transactions outside the domestic banking sector.

/abolition is one factor which leads me to that conclusion

14. The corset has only been used as a complement to the main weapons of monetary control - fiscal policy and interest rates - and the fact that its usefulness has diminished does not significantly affect our ability to get these fundamentals right. But I have decided that it would be unwise abruptly to abolish any control, even if it has only a limited effect, at a time when particularly strenuous efforts are needed to get monetary growth under control. As I said in my statement, the Treasury and the Bank are to start consultations on possible

/alternative

alternative forms of control, and in particular various types of monetary base control which have been suggested, and I believe it would be right to retain the corset until those consultations are complete.

15. The second reason for not ending the corset immediately is that once the control is removed most of the transactions pushed outside the banking system which I mentioned earlier will once again be taken onto their books and this will inflate the recorded money supply. The Governor and I believe that it is important that this process of "reintermediation" should not be allowed to occur so abruptly that there is a substantial surge in recorded monetary growth which would be quite misleading as an indicator of underlying monetary conditions.

16. It is for these two reasons, therefore, that I decided on an extension of the scheme for a further six months. But the permitted rate of increase of interest bearing eligible liabilities of 1% per month is some way above the rate of growth of sterling M3 which must be achieved in the next twelve months if our target is to be met. The relationship between the growth in sterling M3 and IBELs is extremely complex, but it is my hope that the growth of bank lending will moderate sufficiently to allow some unwiding of existing distortions. I must stress, however, that the extension is a temporary measure pending abolition of the scheme.

/17.

17. The extension of the 7-11% target which I announced yesterday means that monetary growth will have to be quite a bit lower over the next twelve months than it has been in the last twelve. I could have set an easier target by allowing "base drift" and starting the low target from October for example, but I do not believe this would have carried conviction and we would almost certainly have forfeited the chance of any beneficial effect on inflationary expectations.

18. However, although a significant deceleration will be necessary I do not doubt that the target can be achieved. If bank lending were to continue to increase over the next year at anything like the same rate as in the last year this would imply a quite unprecedented cumulative increase in the amount of loans outstanding. I do not believe that the current rate of increase will go on indefinitely and I am confident that the rate will fall off in due course, particularly in view of the high rates of interest which borrowers must now pay. I have also taken steps to ensure that the PSBR will be about £8½ billion this year which means a substantial slowing down from now on. And in my next Budget I will take whatever steps are necessary to ensure that the PSBR next year is consistent with meeting the target at an acceptable level of interest rates.

19. The measures I announced yesterday, and in particular the rise in MLR, will undoubtedly hurt some sections of the economy in the short run. But the Government cannot evade its responsibilities. We are determined not to relax our monetary stance and we aim to convince people that this is so. Inflation <u>will</u> come down, and if this is accepted and acted upon in both financial and labour markets the sooner we can return to a high employment, low interest rate economy.

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November 8, 1979

P. Cropper Esq.,
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Dear Peter

Here is another possible contribution for the Chancellor's speech to the Chester Institute of Bankers next Friday. As you will see, it is on the subject of the payment of wages, which is one of Geoffrey's pet hobbyhorses. Quite a lot of activity is taking place on this subject within the banks at present. At some stage one might like Geoffrey to make a major speech which would be designed to catch the headlines, but at this stage we feel that is not necessary (and indeed there might be some disadvantages in making the issue too political). It would, however, be very useful to have a short piece on the lines of the attached draft on the record so that we could quote it in negotiations, particularly, for example, with public sector corporations.

Yours

Brendon

Brendon Sewill

DRAFT note for speech by Sir Geoffrey Howe to the Chester Branch of the Institute of Bankers, Friday November 16

One aspect of high street banking in which I take a strong personal interest is the method of payment of wages. In this country four manual workers out of five are still paid weekly in cash. I would like to see a far higher proportion paid monthly and paid through bank accounts.

Such a move is long overdue. It would greatly help to reduce robbery with violence. It would improve productivity by cutting payroll costs. It should provide benefit both for employees and employers. It would, I believe, help to strengthen family budgetting and to create more responsible attitudes.

I know the move towards monthly pay through bank accounts is accelerating, but there is still far to go. In France, largely as a result of trade union pressure, they have moved to a situation where almost all workers are paid monthly and three quarters of them through bank accounts. In other countries the proportions are almost as high.

This is very much a matter for employers and employees to work out together, but I would like to express the hope that serious consideration will be given to this matter throughout both the public and private sectors of the economy.

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CHANCELLOR

cc Chief Secretary
Financial Secretary
Sir Douglas Wass
Mr Littler
Mr Butler
Mr Hancock
Mr Unwin
Mr Ridley

STATEMENT BRIEFING: MR BARNETT ON PUBLIC SPENDING
LORD LEVER ON EXCHANGE CONTROL 7/11/79
MR HEALEY ON DEMAND MANAGEMENT AND INCOMES POLICY

You asked for material on recent statements by members of the Opposition, for use in the House this afternoon. This is attached.

M T Folger

M T FOLGER
15 November 1979

(1) Mr Ylett

(2) Mr Cull

(3) Mr Hodges (or) 19/xi

Mr Mcintyre
Mr Russell
EF2CS - PA with papers X

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MR BARNETT ON PUBLIC SPENDING

The key quotes from Mr Barnett's famous article in the Guardian on 25 September are:

> "... there are no miracles left. We have to face the unpalatable fact that with, at best, low rates of economic growth, and at worst, nil or even negative growth, public expenditure cuts will be necessary."

> "... if borrowing and taxation reach a point beyond which it is not feasible to go, then it will be necessary to restrict (cut) public expenditure."

LORD LEVER ON EXCHANGE CONTROL

In the Guardian on 12 November Lord Lever said, inter alia:

> "Those who are genuinely in search of improved investment in our private sector would do well to focus on ["the dismal and declining rate of return on existing capital investment"] instead of frothing irrelevantly on the need to retain the last marginal relics of exchange control."

In the Lords on 7 November he said, inter alia:

> "However, for all the reasons that I have given, I can, as a member of the Labour Party and of the former Government, welcome the end of this exchange control which has served no useful purpose, and the abolition of which could be a considerable encouragement to a great trading, insurance and banking nation like our own."

The full text of the Lords speech is attached. It should be noted that Lord Lever urged the government to look into the effect of abolition of controls on the banking system (by inference, the effect on control of the monetary aggregates). There is separate briefing on that point.

MR HEALEY ON DEMAND MANAGEMENT AND INCOMES POLICY

The key words from the transcript of Mr Healey's "World at One" interview on 12 November were:

> "... [the Chancellor] has got to be prepared to make good the shortfall in demand by more government spending or more tax cuts and I think he's got to have some sort of policy for incomes."

Speaking notes to counter Mr Healey's suggestions were sent forward under Mr Folger's minute of 15 November.

MONETARY POLICY

The Chancellor of the Exchequer (Sir Geoffrey Howe): With the permission of the House, Mr. Speaker, I should like to make a statement on monetary policy.

The figures for October, just published, show that sterling M3 grew by 2 per cent. in that banking month. The growth since mid-June, the beginning of the target period, has been equivalent to just over 14 per cent. a year. Although the figure for banking in October was erratically high, it is clear that the underlying growth of sterling M3 is still significantly above the target of 7 per cent. to 11 per cent. There have been two principal causes of this excess: a higher than expected public sector borrowing requirement in the first half of the year, and the persistently high level of bank lending.

Because of the timing of the Budget measures—in particular receipts from VAT and reductions in public spending—the PSBR was always expected to be higher in the first half of the year than in the second. In the event, the PSBR in the first half year has been further increased by strikes and other industrial action which have delayed the collection of value added tax and telephone bills. At the peak, arrears on telephone bills are expected to reach £1 billion. A large part of these arrears will be made good in the second half-year. Even so, the best estimate which could now be made of the PSBR for the year as a whole, if no action is taken, is that it would be about £9 billion compared with the £8·3 billion Budget estimate.

The monthly growth of bank lending has average about £700 million over the last quarter. Although the timing is difficult to predict, its growth can be expected to fall in due course. Nevertheless, it is necessary to take action now to bring the growth of the money supply within the target range. The Bank of England accordingly announced this morning, with my approval that minimum lending rate would be increased to 17 per cent. This goes beyond the rise in market interest rates at home and demonstrates the Government's determination to act with the firmness foreshadowed by my right hon. Friend the Prime Minister earlier this week.

The House will realise that interest rates overseas have risen sharply as other countries have moved to fight inflation by limiting monetary growth. In the United States, for example, prime rates have risen from 11½ per cent. to 15½ per cent. since the summer.

In addition to sales of gilts, we intend to secure further funding of the PSBR through national savings. The limit on holdings of the index-linked national savings certificates retirement issue will be increased next month from £700 to £1,200. A new ordinary national savings certificate will be introduced early next year. The interest rate on the National Savings Bank investment account will be raised to 15 per cent. from 1 January next.

Although much of the increase in the estimate of this year's PSBR is due to the timing of receipts, further action is required to bring the PSBR down. In the light of this, we shall require oil companies to make a payment on account of petroleum revenue tax at the time when they make their returns. This will have the effect from now on of advancing the due date for collection by two months, thus bringing the arrangements for PRT into line with those for collecting royalties. This will ensure that PRT reaches the Exchequer with the minimum of delay at a time when oil prices are rising.

The Bill to achieve this will be introduced shortly. It will reduce this year's PSBR by £700 million and thus bring the estimated level back to the original Budget figure of £8·3 billion. It will also yield an extra £300 million next year, in addition to £400 million or so from the deferred payment of telephone bills.

I set in hand some months ago a review of methods of controlling the growth of the money supply. The main instruments must continue to be our public expenditure and tax policies, which together determine both the size and the composition of the PSBR, and interest rate policies. Recently, the supplementary special deposits scheme, or corset, has also played a part in monetary control. I am well aware of the limitations of this scheme and do not believe that it has a permanent role to play. Nevertheless, the Governor and I have agreed that it is right that it should continue for a further six months. The Bank announced the arrangements this morning.

the White Paper published this week, may we assume that the rules themselves will be made immediately after the debate on the White Paper?

Mr. St. John-Stevas: The two are clearly connected. It is important to have the debate on the White Paper first, followed by the publication of the rules.

Mr. Kilroy-Silk: Will the Leader of the House say when we can expect the promised statement on the Government's policy on jury vetting? Will he also say when there will be an opportunity to debate the reports of the May Committee and of the Expenditure Committee on the prison system?

Mr. St. John-Stevas: I will consider what the hon. Gentleman said with regard to the two reports that have been published. With regard to jury vetting, my right hon. and learned Friend the Attorney-General told the House earlier this week that consideration of the matter is continuing within his Department.

Mr. Skinner: Now that the Government are engaged in a series of U-turns, can the Leader of the House arrange for Ministers in the Department of Trade to make a statement on the number of quangos that are now being brought forward for the Government? Perhaps the two Ministers can give the names of the chairman and other representatives of this quango—the Commission for Pilots—so that the House may be fully informed what the Government are doing in this direction.

Mr. St. John-Stevas: The Government have set an impressive example by the number of quangos that they have abolished. As for making a series of U-turns I point out to the hon. Gentleman that if one went through that manoeuvre one would end up in the position where one started.

Mrs. Reneé Short: Last week I reminded the right hon. Gentleman about the need to debate the report of the Royal Commission on the National Health Service. He made certain promises. Will he look at the replies given by his right hon. Friend the Home Secretary about the need to debate the May report and add that report to the list that should be debated in the House before Christmas?

Mr. St. John-Stevas: I shall certainly bear that in mind. The difficulty is that there are a number of important reports all of which have claims to be debated in the House. They will have to be taken in some order of priority.

In the future, other techniques, including one of the variants of monetary base control, could play a useful role, without the disadvantages of the SSD scheme. The Bank and Treasury will therefore shortly issue a discussion paper for consultation. I must, however, stress that no such scheme can avoid the need for the right fiscal and interest rate policies. Indeed, one of the possible advantages would be to improve the response of interest rates to monetary conditions.

Finally, I am extending the period covered by the present target range for sterling M3 of 7 per cent. to 11 per cent. per annum. That target at present applies to the 10 months from mid-June 1979 to mid-April 1980. It will now cover the 16 months from mid-June to mid-October 1980. The effect will be to avoid building into the target for the new period the excess growth of the money supply in the recent past, while allowing a reasonable period in which to offset that excess.

Britain's future depends, above all, on mastering inflation. That can only be done, as the right hon. Member for Leeds, East (Mr. Healey) well knows, if we bring the money supply under firm control, progressively reduce the rate of monetary growth over the years and pursue the most rigorous restraint on public spending. The supposed alternatives to these policies are a delusion. None of those alternatives would be responsible and none would be sustainable. The action that I have taken today underlines the Government's total and continuing commitment to getting inflation down.

Mr. Healey: Is the right hon. and learned Gentleman aware that the measures that he has just announced will mean that millions of our fellow citizens will face the unhappiest Christmas on record? Is he aware that a Government who rely exclusively on monetary policy have proved totally incompetent even at that and that, as a result, the British people now face the highest interest rates and mortgage rates in our history and the possibility of a further rise in mortgage rates in the new year? The House will want a full-scale debate in Government time on these matters.

I hope that the right hon. and learned Gentleman can assure us that he will shortly be publishing the mid-year forecast, that it will include an estimate of the PSBR in the coming year and will make clear that, thanks to the fall in output engineered by the Government, public expenditure as a percentage of gross domestic product, even after the cuts, will still be higher next year than this year, contrary to what the Prime Minister told us it should be on Tuesday.

Government policies will push the inflation rate up to 20 per cent. or higher in the new year. Is the right hon. and learned Gentleman satisfied that a minimum lending rate of 17 per cent. will achieve his objective on the money supply, since it is bound to be a negative interest rate when inflation rises to that level?

The abolition of exchange control has opened a gaping loophole in the Government's control of monetary policy. Will the right hon. and learned Gentleman explain how, weeks after he announced the abolition of exchange control, he and the Bank of England have still failed to agree on how to plug that loophole? Why is he keeping the corset still in place when it is well known throughout the financial community that its worth is absolutely useless now that he has abolished exchange control?

Why has the right hon. and learned Gentleman taken no action in this mini-Budget on credit cards and Access cards, as private borrowing is the main cause of the monetary problems now facing him?

How does he propose to protect millions of householders, particularly small families, against a further increase in mortgage rates in January?

How does he propose to help the thousands of small businesses that now face bankruptcy as a result of this blow to their financial viability?

Has the right hon. and learned Gentleman yet made an estimate of the further increase in unemployment that will follow this tightening of the cash position of British companies?

Finally, for how long will Conservative Members allow the nation's economic prospects to be ruined by a bunch of bungling doctrinaires?

Sir G. Howe: I do not intend to compete with the right hon. Gentleman in discussing the quality of the Christmases over which he presided when he was at the Treasury. I shall take in order the serious questions put by the right hon. Gentleman.

[Sir G. Howe.]

First, we shall certainly be publishing the forecast for next year at the appropriate time as required by the Industry Act. When we consider the right hon. Gentleman's suggestion that the Government have engineered or presided over a fall in output, we begin to see the quality of his comments. It is high time that he realised, as the country realises, that declines of that kind are the consequences of the condition of the economy over which he presided when he was at the Treasury. The right hon. Gentleman also understands the extent to which continuing shortcomings in our industrial performance are caused by recurrent irresponsible industrial strike action instead of a willingness to improve productivity.

If, as the right hon. Gentleman suggested, public expenditure next year were to be a larger proportion of our gross domestic product, I hope that he would join us in the continuing and necessary task of reducing that burden of public expenditure, which is what we are determined to do.

The right hon. Gentleman knows that these problems are nothing to do with the modest expansion of credit attributable to the use of credit cards but concern the continuing size and burden of public spending. That is why it is important that it be reduced.

The right hon. Gentleman suggested that exchange control may or may not have had something to do with these matters. The monetary figures underlining the decisions that I have announced today accrued before the decision to modify exchange control was announced. As regards exchange control, I am delighted to stand on the judgment given by the former Member for Manchester, Central, now Lord Lever, who, in his maiden speech in another place, said that, speaking as a member of the Labour Party and of the former Government, he welcomed the end of this exchange control which had served no useful purpose and the abolition of which could be a considerable encouragement to a great trading, insurance and banking nation like ours.

Finally, protests by the right hon. Gentleman about the Government's determination to take the necessary decisions to assert and carry through effective control of monetary policy come ill from him. I remind him of what he said to the House just over 12 months ago:

"If the Government were to . . . fail to take timely action when necessary and lose control of the money supply, the sufferings of the whole of the British people . . . would be infinitely more serious than suffering brought about by increases in mortgage rates".—[*Official Report*, 9 November 1978; Vol. 957, c. 1233.]

Mr. Healey: Would the right hon. and learned Gentleman answer two of the questions that I put to him? First, will the mid-term forecast be published next Tuesday, as the press has been led by the Treasury to expect, and will it include a forecast of the PSBR next year? Secondly, the Government proved incompetent at controlling the money supply even before the abolition of exchange control. The point that I put to the right hon. and learned Gentleman was that the abolition of exchange control would make the problem still more difficult. What does he propose to do about it?

Sir G. Howe: I propose to take the necessary action that I have announced to ensure continuing and effective control of the money supply. There has been a developing case over a number of years for examination of the methods of control of the money supply. That is why I set in hand the inquiry to which I referred in my statement. But it would be unwise to proceed at a faster pace than we are going in that respect.

The statement under the Industry Act will be published in due course.

Mr. Healey: Will it include the forecast of the PSBR?

Sir G. Howe: The right hon. Gentleman will find out in due course when the statement is published.

Mr. Maurice Macmillan: First, to what extent is control of the money supply made harder by the fact that there is no restriction on acceptances and the degree to which clearing banks, by accepting paper, can, in effect, lend without doing so directly? Secondly, am I right in thinking that there is about £1·7 billion of acceptances outside the banking sector which is perhaps increasing the money supply by about 2 per cent.?

Thirdly, would it not be right to assume that the extent to which people could borrow from abroad, because of the lack of exchange control, is less effective than the right hon. Member for Leeds, East (Mr. Healey) would think, because the foreign banks have to find sterling somewhere, and that probably means obtaining it from British banking institutions?

Sir G. Howe: I am grateful for my right hon. Friend's comments in the second part of his question.

Acceptances are taken into account in the measurement of the money supply at the present time. If we were to seek to act directly to control them, the result would be a further variation and distortion in the system. Therefore, there would be no purpose in acting separately on that account. That is one of the factors that must be taken into account in this country, as in others, in continuing to develop the techniques by which we measure and control the money supply.

Mr. David Steel: Does the Chancellor recognise that the principal criticism levelled at his economic policy is that he is relying wholly and exclusively on control of the money supply as the weapon for controlling inflation? Has he not yet reflected on the folly of abandoning any attempt to introduce a policy on increases in prices and incomes? Since he is anxious to create an incentive economy, how does he expect business men to respond to an improvement in their personal tax returns when they must now go to the market to raise money for their businesses at rate of around 20 per cent.?

Mr. Skinner: The right hon. Member for Roxburgh, Selkirk and Peebles (Mr. Steel) tells a different story every week.

Sir G. Howe: In response to the last point made by the right hon. Member for Roxburgh, Selkirk and Peebles (Mr. Steel), action of this kind is necessary in order to establish, in the long term interests of business, effective control of inflation. Businesses would find it much more difficult if this kind of action were not taken in time. It is remarkable that the need for firm and early action of this kind is widely supported by those in small and large businesses. Business men recognise the Government's determination to bring inflation under control. The right hon. Gentleman persists in repeating the canard that we are relying solely on monetary policy to defeat inflation. That is not so. As a crucial part of supporting monetary policy, we are implementing fiscal policy and policies to control and reduce the rate of public expenditure.

We recognise, and continue to assert, the necessity for those responsible for pay bargaining to conduct their affairs in a way that is consistent with the growth in the money supply. We do not believe that it is right, in the light of the experience of successive Governments, to intervene for direct regulation of income growth and bargaining. Experience has shown that that sows the seeds of its own destruction. It is therefore necessary for those involved in pay bargaining to understand the imperatives that follow from the implementation of an effective policy for the control of money supply. Both sides of industry have a high responsibility for ensuring that their pay bargains recognise the actual resources, increased performance and productivity in the firms in which they are employed. They ignore that lesson at their peril.

Mr. Donald Stewart: Is the right hon. and learned Gentleman aware that his announcement will stoke inflation, which will now go like a forest fire? What will happen to the desirable policy, advocated by the Prime Minister, of encouraging more home buyers? Will the Government now assist them to pay the mortgages that they can no longer afford?

Sir G. Howe: Home buyers, like other members of the community, would not profit by a failure to control the rate of growth in money supply. The effective remedy, in that respect as in every other, is to bring money supply growth under control. No service whatsoever is done to the British people by ignoring that lesson.

Mr. Cockeram: Will the Chancellor of the Exchequer accept that it was a mistake to stabilise the level of Government expenditure in his recent White Paper, which took last year's level—established by a Socialist Government—as its starting point? Does he agree that cuts will have to be made? Will he make a start with the rate support grant by not maintaining it at the previous Socialist level of 61 per cent.? Does he agree that otherwise it will be seen that "the party" is continuing?

Sir G. Howe: I am grateful to my hon. Friend for underlining the continuing need

[Sir G. Howe.]

to scrutinise the rate, the pattern and the size of public expenditure. The imperative need to carry that task through the years ahead will be with us throughout that time. My hon. Friend must await the announcement on the rate support grant by my right hon. Friend the Secretary of State for the Environment.

My right hon. Friend will certainly need to take into account the fact that the rate support grant will be setting down the limits within which total local authority expenditure—including local authority pay bargaining—will have to be undertaken. Those responsible for those matters will have to accept the same need for restraint as others who are trying to live with a sensible monetary policy.

Mr. Joel Barnett: In the Budget, the Chancellor spoke of the need for a new beginning and said that he would achieve his monetary targets without curbing the private sector. What is he doing now?

Sir G. Howe: We are continuing to achieve those monetary targets as swiftly and effectively as possible. Of course, it will be more and more easy to achieve those targets with less discomfort to the private sector if we maintain the battle against excessive public spending. I am grateful for the candour with which the right hon. Gentleman said, not long ago, that if borrowing and taxation reached a point beyond which it was not feasible to go it would be necessary to restrict public expenditure. I hope that he continues to hold that view. We look forward to the courageous and candid support of the right hon. Gentleman for many years.

Mr. Neubert: Does my right hon. and learned Friend agree that not the least important feature of our present problems is the expansion of public lending unleased last year by his predecessor, at a time when it was thought that the general election would be held in the autumn?

Sir G. Howe: My hon. Friend is entirely right. One of the first things to which we had to address ourselves on coming into office was the containment and reduction of the massively expanded public expenditure plans on which the previous Chancellor and his friends had so irresponsibly embarked before the general election.

Mr. Skinner: Is the Chancellor of the Exchequer aware that when his side-kick reported on the cuts in public expenditure a few days ago he announced that approximately 300,000 more people would be thrown out of work as a result of that policy? Will the Chancellor specifically answer the questions put to him by my right hon. Friend the Member for Leeds, East (Mr. Healey)? Will he come clean and tell the House how many more people will be ruined and put on the pile of human misery known as the dole queue as a result of that statement?

Sir G. Howe: I am grateful to the hon. Member for affording me the opportunity of correcting his misunderstanding about my right hon. Friend's statement. My right hon. Friend did not tell the House that there would be an increase of 300,000 in unemployment as a result of the measures that he announced to the House.

Mr. Skinner: Twisting again.

Sir G. Howe: Will the hon. Gentleman be patient enough to listen to my reply? What my right hon. Friend said was that one of the working assumptions underlying the White Paper was that unemployment would be higher to the extent of 300,000 next year. That is not in consequence of the White Paper. It is nevertheless a fact to which the House must reconcile itself, that unless we are able, by all our policies, to secure better performances in our industrial and manufacturing sectors it will be very difficult to avoid an increase in unemployment of that order. The Government's policies, including fiscal policies and our determination to control public expenditure, are designed to make our economy the better able to fight rising unemployment.

Mr. Healey: May I press the right hon. and learned Gentleman on this matter? Even if one accepts that what his right hon. Friend meant was something different from what he said, the fact is that as a result of all Government policies—according to the right hon. and learned Gentleman—unemployment will rise by 300,000 next year. By how much further will that figure rise as a result of the collapses in private industry following the measures that he has announced this afternoon?

Sir G. Howe: I am astonished that the right hon. Gentleman should seek to perpetuate that falsehood about my right hon. Friend's statement. [HON. MEMBERS: " Answer the question."] I am endeavouring to answer the question and will do so if Opposition Members will do me the courtesy of listening to what I am saying.

The right hon. Gentleman, who was Chancellor of the Exchequer not long ago, knows perfectly well that at the time when he published his public expenditure White Papers they contained a working assumption about the likely level of unemployment in the year ahead. The figure about which my right hon. Friend was asked when he made his statement was precisely that assumed figure. He told the House that the working assumption was for an increase of 300,000. What he did not say, and what was not implicit in his statement, was that that figure was a consequence of Government policies. That working assumption remains exactly the same.

The right hon. Gentleman and his hon. Friends must understand that the prospect of unemployment in the year ahead and thereafter depends on the willingness and capacity of the people to turn away from irresponsible industrial action and to work together to improve productivity and the performance of our economy. They must recognise that we are long past the point when people should believe that each and every thing that happens in our economy can be influenced by direct Government action.

We are creating conditions under which it will be easier for the British people to improve their economic performance. On that we must concentrate in the years ahead.

Mr. Lawrence: Is my right hon. and learned Friend able to quantify the exact effect of the disastrous engineering strike upon the economy?

Sir G. Howe: The engineering strike was one of a number of strikes that had a substantial impact upon the performance of industry. It added substantially to the growth of bank lending in order to protect firms which had to resist such industrial action. Each action of that kind contributes directly to the dangers that our people face. We must understand that reponsible industrial conduct has as much a part to play in improving our economic performance as anything that is said in the House.

Mr. Robert Sheldon: Is the Chancellor of the Exchequer aware of his addiction to untested theory? What does he intend to do if this experiment fails? What will he do if inflation continues to rise, if unemployment rises even higher than the estimate, and bankruptcies rise still further to horrifying levels? What contingency plans do the Government have in the event of failure?

Sir G. Howe: The policies that we are pursuing are consistent and coherent. They will be sustained. They are policies for the control of the rate of growth in the money supply, the control of public expenditure, the restoration of incentives, and the restoration of balance in our industrial society. We have been in office for six months and the Opposition have been on the Opposition Benches for the same time. They have proferred no alternative policy.

Mr. Latham: Can my right hon. Friend confirm that today's announcement will have its effect on the future output of the economy? Does he accept that as a result the figures for cash limits in part II of the public expenditure White Paper will have to be revised? Will he confirm that whatever else we need we need no lectures on the economy from the man under whom inflation rose to 25·6 per cent.?

Sir G. Howe: I agree with my hon. Friend's last point. He will have to wait until the cash limit figures and the remainder of public expenditure plans are published, in due course.

Mr. Arthur Lewis: Have the same Treasury nuts advised the Chancellor as advised my right hon. Friends? I meant to say " knights ", but a slip of the tongue often speaks the truth. Have those nuts or knights given the Chancellor of the Exchequer any idea what will happen if his proposals are successful, or if they are not? Can the Chancellor say whether unemployment figures will go up or down, and whether the rate of inflation will go up or down?

Sir G. Howe: The hon. Member must understand that a large part of the answer to both those questions depends upon how

[Sir G. Howe.]

far those who are responsible for management and trade union negotiations understand the facts of economic life. A crucial part of Government responsibility is to maintain control of the money that is available. Equally, a crucial part of the role of those involved in industry is to avoid strike action, to avoid industrial disruption and to achieve pay settlements that are consistent with the growth of productivity and the maintenance of employment. If people bargain in a pattern that is consistent with the policies that I have laid down the future for both employment and inflation will be more hopeful.

Mr. Bruce-Gardyne: May I congratulate my right hon. and learned Friend on a wise and courageous statement? Does he agree that his task of financing this year's PSBR in a non-inflationary manner might be facilitated if he restated publicly and as quickly as possible his intention to achieve a lower target figure for PSBR in money terms next year? Will the Chancellor also tell the House what the achievement at the top end of the sterling M3 money supply target for the next 12 months will mean in terms of sterling M3 growth over the whole of the current 16 months?

Mr. Skinner: The Chancellor should not forget that his hon. Friend is after his job.

Sir G. Howe: I shall take up the last question of detail afterwards. I am responding for the third time in almost the same number of weeks to my hon. Friend's question about the PSBR next year. We take account of the point that he makes. Our plans will be announced in due course.

Mr. Speaker: I propose to call four more hon. Members from either side. Mr. John Hunt.

I apologise to the House. I think that I have lost the balance, but I shall make up for it later.

Mr. John Hunt: Does my right hon. and learned Friend agree that credit cards represent an open invitation to overspend? Did he see an advertisement last night in a London evening newspaper by a leading multiple store offering an instant £240 on the basis of repayments of £10 a month? Is that not a major factor in the growth of money supply? Should not something be done to curb it?

Sir G. Howe: That is a matter about which my colleagues and I have been concerned, and we have made a number of inquiries about it. Personal lending, including credit cards and similar devices, is less than one-sixth of total bank lending—a small proportion. The contribution made by credit cards as part of that proportion is even smaller.

Experience with previous patterns of direct control suggest that if one controls this or that type of credit new and more sophisticated types of credit are created. We must remember that credit card lending, like any other, is subject to the consequences of a higher lending rate. It becomes more expensive and borrowing on a credit card is already an expensive way of borrowing. I shall bear in mind the anxiety that has been expressed. However, I should not like the House to believe that we are likely to discover a special method of dealing with that form of credit.

Mr. Dalyell: Does the Chancellor think that it is wise to have dismantled exchange rate controls? Even at this eleventh hour and fifty-ninth minute, is it too late to preserve the mechanism which he may need?

Sir G. Howe: I have no reason to question the wisdom of the policy change referred to by the hon. Member. I take comfort from the glowing tribute by Lord Lever and from the fact that most people regard the abolition of exchange control as a significant contribution to the capacity of the country to use its resources more effectively. I have no reason to change that view.

Mr. Jay: Is it not clear that in all the circumstances the abandonment of exchange controls was a reckless and disastrous blunder?

Sir G. Howe: From the right hon. Gentleman's long tradition of believing that the gentlemen in Whitehall know best, he would believe the abolition of any control to be a reckless and disastrous blunder. The abolition of exchange control represents a sensible change in policy which brings us into line with many other countries. It lays the foundation for the more effective use of the nation's resources.

Mr. Robert Taylor : Does my right hon. and learned Friend agree that much of the increase in private sector borrowing is used to finance stock increases to avoid corporation tax? How long is he prepared to allow that to continue?

Sir G. Howe : That is an issue of legitimate importance. It is one of the factors underlying the decision announced in my Budget Statement to undertake a review of the entire pattern of corporation tax. That review is continuing.

Mr. Anderson : Will the Chancellor of the Exchequer dare to contrast the near ecstasy with which his first Budget was greeted by his hon. Friends with the current gloom and the fast-emptying Tory Benches? Is this the incentive that he promised private industry? What is the working assumption for industrial investment in the next year as a result of this package?

Sir G. Howe : I am quite certain that failure to introduce such measures would have gravely worsened working assumptions for industrial relations and other aspects of the economy. Such action is and was essential to restore the monetary balance. It is only under a Government who have the courage to take such action that we can look forward to restoring this country to prosperity.

Mr. Kenneth Lewis : Is my right hon. and learned Friend aware that what he has announced today will undoubtedly have a tremendous effect on the private sector? Is he satisfied that in the public sector, through the measure that he has announced or through any other measures, he can hold back what many believe will be wage and salary rises that are far too high?

Sir G. Howe : My hon. Friend is entirely right to draw attention to the continuing danger of pay claims that are excessive by any standards in the public as well as the private sector. The measures that I have taken are necessary to control the total resources of money available to meet those claims. Those who are conducting pay bargaining must recognise that if they press their claims too far they increase the chances of unemployment increasing, and destroy the chance of advancing prosperity.

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Mr. Campbell-Savours : Would not the right hon. and learned Gentleman accept that there is a lesson in his statement for both Front Benches in this House, namely, that traditional solutions will not resolve these traditional problems and that if the objective is to be growth it would be well if the Government were to accept the need for a change, in terms of a transformation in the relationship between capital and labour, because that is at the root of the problem.

Sir G. Howe : I am sure there is lesson not just for both Front Benches but for Front and Back Benches on both sides of the House, namely, that it is not sufficient for a Government to take the steps which this Government are taking—the action that they can take—to control the central features of the economy ; but that it is important, as the hon. Gentleman puts it, for relationships between capital and labour to be transformed in the direction of common sense. If those who are conducting negotiations between capital and labour recognise the extent to which they can destroy their jobs, their firms and their futures by irresponsible action, and instead behave in a sensible fashion, devoted to raising productivity and improving job security, a great transformation would indeed follow. If the hon. Gentleman would join us on the Government side of the House in preaching the cause of industrial responsibility, no one would be happier than I.

Mr. John H. Osborn : The right hon. Gentleman the Shadow Chancellor raised the question of public expenditure as a percentage of the gross national product. Is my right hon. and learned Friend aware that trade unions and Socialist councils from South Yorkshire are coming to the House next week to urge a further increase in public expenditure? Would he comment on that, and would he explain the extent to which this dilemma is due to the failure of an incomes policy last winter?

Sir G. Howe : My hon. Friend is right to remind the House of the extent to which many of the problems that we have inherited are the result of the failures of the last Government in the winter of discontent through which we then lived. He is also right to remind us that the

[Sir G. Howe.]

question that we should be constantly addressing to hon. Members on the Labour Benches is whether they are criticising us today for taking action to reduce public borrowing or public spending, or, on the other hand, for not spending enough. The dichotomy in policy on the part of the Labour Party has to be resolved. I hope very much that Labour Members opposite will support us, as we need their support, in continuing to reduce public expenditure so as to restore the health of the economy.

Mr. Meacher: Given that the main cause of an extension of the money supply is now the soaring amount of bank lending to the private sector, will the Chancellor accept that the supplementary special deposit scheme is now totally inadequate to remedy this? If that is so, why has he maintained it? Or, if he still thinks it is relevant, why has he not blocked such patent evasion measures as the issue of acceptances?

Sir G. Howe: For the reason I have explained to my hon. Friend, that action to block one variation of that kind is all too likely to lead to the development of some variation beyond it, making it more difficult to measure and identify what is taking place. As I said in my statement, I recognise that the supplementary special deposit scheme has many shortcomings about it, but it would be foolish to sweep it away without having further thought about what supplementary system ought to take its place. That is why studies are continuing on a monetary-based control.

The hon. Gentleman would be unwise to conclude that our problems spring mainly or wholly from expanding bank lending to the private sector. He should bear in mind the extent to which public borrowing has, as I said in my statement, been substantially and unpredictably increased to the tune of no less than £1,000 million, as a direct result of irresponsibility by no more than 80 people.

SIR ANTHONY BLUNT

Mr. Skinner: On a point of order, Mr. Speaker. I want to raise a matter on the revelations affecting Sir Anthony Blunt, and a statement that has been provided in the form of a written answer today by the right hon. Lady the Prime Minister. Sir Anthony Blunt is known to have confessed to having been involved in the Burgess-Maclean-Philby and others affair. I want to ask you, Mr. Speaker, whether you consider that this matter of security is so important that it should be the subject of a statement from the Dispatch Box so that it can be properly examined and probed by Members of the House of Commons? Is it not worth noting that it contrasts sharply with the relentless pursuit of the journalists involved in the ABC case, and Mr. Philip Agee?

Does it not warrant a statement now from the Box and also a full debate on the matter in the course of next week?

Mr. Speaker: Order. I know that the hon. Gentleman is interested in the same question. I allowed him to make his full point of order in the knowledge that I am not responsible for national security. That responsibility does not lie with the occupant of this Chair. Therefore, there can be no point of order about that.

Mr. Skinner: On a different aspect of the point of order—[*Interruption*].

Mr. Speaker: There can be no point of order about national security, because I am not responsible for it.

Mr. Christopher Price: I want to raise a point of order about the issuing of writte nanswers in this House. It is a convention in the House that, when a question is down for written answer, the normal time for the issuing of that answer is 3.30 pm. One of the reasons for that is that hon. Members should be able to raise during business questions matters which are the subject of written answers. On this occasion, Mr. Speaker, the answer to a written question formed the subject of a very important issue which has been reported in all the newspapers today, and on which I wished to address a question to the Leader of the House asking for an urgent debate next week on this issue. This answer was delayed until the end of business questions, which deprived hon. Members of their proper and rightful privilege of questioning the Leader of the House on this issue, when the whole country is wanting to know when we are to debate the double standards about the Official Secrets Act which this Government are attempting to introduce in another place, thereby making matters very much worse.

Reference House of Commons 15/11/1982

1

CODE 18 77

EXC/94/94 (3)

B56/22

CABINET OFFICE

Central Statistical Office

Great George Street, London SWIP 3AQ Telephone 01-233 7371

MR WELLS, CSO
MR DWORKIN, DIT
MR DRAKE, B/E
MR ALLAN, HMT -

cc Mr Mutch, B/E
Mr Richardson, DIT
Mr Walker, DIT
Mr Cresswell, CS

LIFTING OF EXCHANGE CONTROLS AND THE BALANCE OF PAYMENTS ACCOUNTS

The attached is a draft of the submission to be put to the Chancellor and the Secretary of State for Trade as agreed at the meeting on 13 November.

I should be grateful if comments could be made by telephone to me (ext 7371) or to John Cresswell (ext 8371) as soon as possible.

David Wroe

D C L WROE

16 November 1979

ENC

DRAFT MINUTE FROM A J BOREHAM TO THE PRINCIPAL PRIVATE SECRETARY TO THE CHANCELLOR

LIFTING OF EXCHANGE CONTROLS AND THE BALANCE OF PAYMENTS ACCOUNTS

Reference to earlier paper -

1. The balance of payments accounts have in the past rested heavily on exchange control sources. The Chancellor will wish to know of the steps being taken to fill the gaps following the lifting of controls, and to consider in particular the need to collect additional information from companies.

Need for balance of payments accounts

2. Reliable balance of payments accounts are required because:

a. The balance on current account is widely regarded as an important indicator of our performance in international markets.

b. The accounts provide information about pressures on the exchange rate and help to identify future pressures.

c. The accounts will be needed to assess the impact of the removal of exchange controls.

d. The information required for the accounts is needed to complete the accounts for the economy as a whole.

e. They are needed in the context of our membership of international organisations. A balance of payments test is one of the criteria for activating the EEC's corrective mechanism, and the IMF's Article of Agreement places an obligation on member countries to supply balance of payments information desired by the Fund in "as detailed and accurate manner as is practicable".

Information needed

3. Information available as a by-product of exchange controls was used extensively in compiling the accounts (for example, in keeping up-to-date the register for the direct investment inquiry) and the following important series were based entirely on exchange control sources:

Current account

a. Imports on certain services (£400 million in 1978)

b. Private transfers overseas (£800 million in 1978)

Capital account

c. Portfolio investment in foreign currency securities (£450 million net in 1978)

d. Borrowing from non-residents to finance investment overseas etc (£600 million net in 1978).

Because of the amounts involved and the possibility that these could change substantially following the removal of exchange controls, it is clearly important to develop alternative sources for the series a.-d.. It is also necessary to find some means of covering deposits overseas, as these are likely to become more common in the absence of exchange controls.

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Possible sources

4. Discussions are already in progress between the Bank of England, the British Bankers' Association and the Stock Exchange to establish suitable reporting procedures covering private transfers abroad and portfolio investment overseas, which in the case of the latter would be used in conjunction with information already collected from financial institutions on their overseas investments. The possible use in the UK balance of payments accounts of information collected from other countries by the Bank for International Settlements is also being examined.

5. Inquiries addressed to companies are the only possible source of information on imports of certain services and borrowing from non-residents (a. and d. above respectively), and on deposits abroad. A question on imports of services would fit fairly conveniently in one of the existing questionnaires in the Department of Trade's Overseas Transactions Inquiry, and the opportunity could also be taken to collect information on exports of services which at present are not covered at all completely. A new return, but still part of the Overseas Transactions Inquiry, would be necessary for overseas borrowing and deposits, and associated interest payments.

Timing of requests to companies

6. Particularly as the removal of exchange controls has relieved industry of a considerable burden of form-filling, it is thought that the necessary consultations with industry could be completed in time for the new questions to be incorporated in the 1979 Overseas Transactions Inquiry, for which returns will be sent out in April or May of next year. Officials of the Department of Trade are seeking the approval of the Secretary of State to collect this additional

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information. The results of the 1979 inquiries will become available late in 1980, or early in 1981. To estimate the value of imported services until them it will be possible to do little more than project the figures. For companies' borrowing and lending overseas it may be possible to obtain some very rough estimates from the existing quarterly inquiry into companies' sources and uses of funds, and the Department of Trade are examining this possibility in more detail.

7. With results for 1979 from the Overseas Transactions Inquiry it would be easier to assess whether an additional quarterly return on overseas borrowing and deposits is necessary, and whether sufficiently high response can be achieved without the use of compulsory powers.

Conclusions

8. The Chancellor is asked to approve the steps being taken to maintain the coverage of the balance of payments accounts in the absence of exchange controls, and to support the proposal to collect information from companies on service transactions, overseas borrowing and deposits, and associated interest payments.

9. This note is also being submitted to the Secretary of State for Trade by officials in his Department.

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MR HANCOCK

CONSEQUENCES OF EXCHANGE CONTROL ABOLITION

The Chancellor has asked me to bring this little lot to your attention and to ask your advice.

PETER CROPPER

28th November 1979

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434/11

PRINCIPAL PRIVATE SECRETARY

cc PS/Chief Secretary
PS/Minister of State (C)
PS/Minister of State (L)
Mr Cropper
Mr Ridley
Mr Cardona

CONSEQUENCES OF EXCHANGE CONTROL ABOLITION

The Financial Secretary has seen Mr Cropper's minute of 19 November.

He strongly agrees with point (i): if the Government are going to legislate in the 1980 Finance Bill - and in his view it may look incompetent if it does not - then a quick Revenue submission will be needed.

SAJL

S A J LOCKE

21 November 1979

4.30/11 97

cc: Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Mr. Ridley
Mr. Cardona

MR. CROPPER

CONSEQUENCES OF EXCHANGE CONTROL ABOLITION

The Chancellor has read with interest your minute of 19th November. The view is that these issues, including the revenue cost of your suggested remedies, and the opportunity cost of inactivity, are sufficiently substantial to merit early and complete investigation by officials (including those in other Departments, and possibly the Bank of England).

2. You may find it helpful to discuss this in the first place with Mr. Hancock.

pp (M.A. HALL)
21st November, 1979

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cc Chief Secretary
Financial Secretary
Minister of State (Commons)
Minister of State (Lords)
Mr Ridley
Mr Cardona

CHANCELLOR

CONSEQUENCES OF EXCHANGE CONTROL ABOLITION

I sense that we may not be doing enough research on the consequences of exchange control abolition in the fields of (i) tax evasion and (ii) securities dealing.

(i) Tax Evasion. There is a general awareness that ending of exchange control opens up new channels of tax evasion - particularly in the field of CTT, but probably in income tax as well. My impression is that the Inland Revenue have not done much forward planning and that they are waiting for problems to arise. (Although, I admit, they would not be in a hurry to tell anyone even if they had.)

Whether we will be pushed in the direction of taxing world income on the basis of nationality as the Americans have done, I cannot judge. However I do think we will be vulnerable to a public outcry if we are not careful - eg "avoidance" schemes in Sunday newspapers. I have already reported to you Denzil Davies' reference to "enormous scope for tax evasion following the ending of exchange control" in his speech to the Douglas French tax conference last week.

(ii) Securities Dealing. You have seen the slightly panicky post-script letter of 7th November from Nicholas Goodison adding "abolition of exchange controls" to his list of reasons why stamp duty should be reduced. It is my understanding that the Stock Exchange is very worried indeed about the risk that business in securities will leave London and go to overseas markets.

One is entitled to comment that any market which holds its level of minimum charges well above that of its competitors makes itself vulnerable to competition. Nevertheless stamp duty at two per cent on equities is a serious impediment in its own right.

As I have suggested before, there is a strong case for offering the Stock Exchange a trade-off of lower stamp duty in return for lower commission rates. Formerly I was suggesting this as a way of bringing the private investor back into the equity market. Now I am adding a second reason - preventing the institutions taking their business abroad. The loss by London of the market in Kaffirs is a nasty example. We would not like to lose the market in oil shares next.

The small private client will not be likely to transfer his dealing to an overseas market - it would be too complicated and possibly risky. But institutions may well do so; I understand that the only pre-requisite is the establishment by companies of overseas stock registers. A lot of companies already have them.

All in all, the case for a swift move towards the EEC harmonisation level of 0.6% for stamp duty seems to me overwhelming. It could well be self-financing in a year or two if it could be linked with lower commissions.

A move towards 0.6% for securities would presumably cover housing too. This would be an alternative to indexing the existing thesholds for house purchase stamp duty. Indeed it might be sensible to proceed towards a universal flat-rate stamp duty of say ½ per cent.

PJC

PETER CROPPER

19th November 1979

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Mr Copy Lunched to:
Mr Hancock
Mr Lovell
Mr Calett
Mr McIntyre

PS/INLAND REVENUE

cc Principal Private Secretary
PS/Financial Secretary
PS/Minister of State (C)
PS/Minister of State (L)
Mr Hodges 5/xii
Mr Cropper
Mr Springthorpe
Parliamentary Section

ORAL PQ's, 6 DECEMBER

MR TAM DALYELL'S PQ ON EXCHANGE CONTROL

The Chief Secretary will be dealing with Mr Dalyell's PQ

"To ask Mr Chancellor of the Exchequer, what assessment he has made of the effects of his decision to abolish Exchange Controls."

In discussion of this Question, Treasury Ministers concluded that the main line of attack in supplementaries might be directed at tax avoidance and evasion. The Chief Secretary would therefore be grateful for notes for supplementaries and background briefing on the Vestey case in particular and on tax avoidance and evasion, in the context of the abolition of Exchange Controls, in general.

A C PIRIE
4 December 1979

20/12

CONFIDENTIAL

6 DEC 1979

FINANCIAL SECRETARY

cc Chancellor of the Exchequer
Chief Secretary
Minister of State (C)
Minister of State (L)
Sir Douglas Wass
Sir Kenneth Couzens
Mr Barratt
Mr Hancock
Mr Unwin
Mr P G Davies
Mr Slater
Mr Ilett (o.r.)
Mr McIntyre

Mr A Burgess (FCO)
Mr R Collins (DOT)
Mr D A Dawkins (B/E)
Mr R Armitage (T Sol)

RHODESIA: REMOVAL OF EXCHANGE CONTROLS

I heard from the FCO this afternoon that an announcement is virtually certain tomorrow of the appointment of a British Governor who will be due to arrive in Salisbury on Tuesday 11 December. His arrival will mark the return to legality in Rhodesia and so the point when, as stated by the Lord Privy Seal on 7 November (H of C OR col 407), the UK's remaining sanctions are to be lifted. This includes the removal of the last of our exchange control restrictions.

Statutory Instruments are being made under the Exchange Control Act 1947 and the Emergency Laws (Re-enactments and Repeals) Act 1964 and are to be laid (assuming no last-minute hitch) on 11 December, to come into operation the following day - i.e. from mid-night on 11/12 December. The Bank will be sending out a supplementa exchange control notice drawing attention to this and also pointing out that the general exemption in the Treasury Order does not extend to the obligations, in Part of Schedule 5 to the 1947 Act, to furnish information and produce documents in connection with evasion of the Act.

The Department of Trade intend to issue a Press release on the day of the British Governor's arrival about removal of the remaining trade sanctions. This refers to Treasury action on exchange control and indicates that we will be issuing our own press notice, of which I attach a draft.

C H W HODGES
6 December 1979

DRAFT TREASURY PRESS NOTICE

EXCHANGE CONTROL - RHODESIA

Following the restoration of legality to Rhodesia, action was taken today to remove all exchange control restrictions in respect of Rhodesia. Statutory Instruments under the Exchange Control Act 1947 and the Emergenc Laws (Re-enactments and Repeals) Act 1964 have been laid before Parliament to come into operation as from midnight 11/12 December. A supplementary exchange control notice is being issued by the Bank of England, drawing attention to the action taken and pointing out that the obligations remain to furnish information and produce documents in connection with evasion o the 1947 Act. The complete ~~relaxation~~ abolition of exchange control thus becomes worldwide.

Note for editors

The statutory instruments comprise a general exemption order, and two sets of directions revoking 1965 and 1966 directions on certain aspects of exchange control in relation to Rhodesia. The order made under the 1947 Act and the directions given under the 1964 Act are subject to the negativ resolution procedure in Parliament.

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17 DEC 1979

PS/FINANCIAL SECRETARY

cc Principal Private Secretary
PS/Chief Secretary
PS/Minister of State (C)
PS/Minister of State (L)
Sir Douglas Wass
Sir Kenneth Couzens
Mr Barratt
Mr Hancock
Mr Unwin
Mr P G Davies
Mr Slater
Mr Ilett (o.r.)
Mr McIntyre
Mr Drane
Mr Dawkins (B/E)
Mr Armitage (T Sol)

RHODESIA: LIFTING OF SANCTIONS
(My minute of 6 December)

This confirms my hearing from the FCO this morning that the planned date for the British Governor's arrival has slipped from 11 to 12 December. So, unless there is a further change, our operative date goes back accordingly.

You told me that, at the end of the proposed Treasury Press Notice, the Financial Secretary wished to replace "relaxation" by "abolition". In the penultimate sentence, after the word "documents" we would now replace "in connection with evasion" by the more precise wording "if so directed during Treasury investigations of past evasions".

I shall report again if we hear of more changes of plan.

C H W HODGES
7 December 1979

Mr McIntyre
Mr Russell R B
cc Mr Lovell
Mr Hedges 18/xii
DH. 18/12.

EF(2)CS
21 DEC 1979

NOTE FOR THE RECORD

Principal Private Secretary
PS/Chief Secretary
PS/Minister of State C
PS/Minister of State L
Sir D Wass
Sir L Airey
Sir K Couzens
Sir F Atkinson
Mr Littler
Mr Bridgeman
Mr Middleton
Mr Unwin
~~Mr Hancock~~
Mr Riley
Mr Gill
Mr Ridley
Mr Cardona

FINANCIAL SECRETARY'S LUNCH WITH KLEINWORT BENSON

The Financial Secretary attended an informal lunch at Kleinwort Benson on Friday 14 December.

The discussion started off on a fairly general plane. But it soon came round to the question of monetary policy, and in particular the effect of the removal of exchange controls. The following points were made in this context:

(i) there was a danger that Euro-currency lending would increase sharply, thereby endangering the Government's control of domestic liquidity. To prevent this, it was suggested that the group of ten major industrialised countries should each consolidate Euro-currency deposits into their bank balance sheets, and re-base reserve requirements, quantitative controls, etc accordingly. As a support to such an initiative, it was suggested that some sort of "concertation" of reserve ratios would be necessary;

(ii) it was strongly felt that inflows would present a serious danger to the monetary aggregates, whatever the

Government's intervention policy. There was thus some support for the possibility of inward controls on a contingency basis, which could be introduced at very short notice if necessary. More fundamentally, however, it was proposed that the Government should introduce some kind of withholding tax on foreign currency dividends, which would make British assets less attractive to foreign buyers.

SAJL

S A J LOCKE
17 December 1979

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cc Mr Middleton
Mr Unwin
Mr Bridgeman
Mr F E R Butler
Mr Hancock
Mr Hedley-Miller
Mr Battishill
Mr Hodges 22/1
Mr Ashford
Mr Scholar
Mr Davies
Mr Bottrill
Mr Turnbull
Mr P Rayner
Mr J Thomson
Mr C Baker (2 copies
Mr Mercer
Mr Folger
Mr Towers
Mr Anslar
Mr Cropper
PS/Inland Revenue

22/1/80

SPEECH TO ASSOCIATION OF ECONOMIC REPRESENTATIVES IN LONDON - LUNCH, MONDAY 28 JANUARY 1980

I attach a first draft. I am most grateful to Mr Mercer for the first section on the international outlook. Mr Thomson has said he would look at the EEC section to see if there are any new points to feed in. Could Mr Davies and/or Mr Towers please also see if IDT has anything to add?

2. I would be glad of any comments from copy recipients by close on Thursday 24 January.

G P MACKIN
22 January 1980

THE INTERNATIONAL OUTLOOK

Its conventional at this time of year to adopt the posture of Janus: surveying where we've come from and where we might be going. Frankly, this is a pretty uncomfortable posture at the moment. An uneasy sensation of deja-vu is unavoidable.

2. The tentative recovery in the world economy that began to emerge in 1978 gave grounds for some optimism. There were indications in some countries that growth was once again beginning to sustain itself: that business confidence and private investment was starting to turn up. Many countries, of course were still at the convalescent stage. But there seemed to be the chance of a respite in which it would be possible to tackle the structural factors impe~~n~~ding rehabilitation without the immediate imperitive of having to cope with external spas

3. But in 1979 this recovery was interrupted by just such a spasm. In 1980 it is likely to be aborted. The hard reality is that, in rea terms, oil price developments over the last year or so rep~~ø~~resent a shock to the system almost as big as it sustained in 1973-74. The prospect of any growth in the OECD area next year now seems very slim. The recession will be most pronounced in the US and the UK, where the intractibility of inflation has forced especially tough pol action. But no major country is likely to escape a significant deceleration in growth. And some may find it necessary to tighten policy further. This, and the continuing uncertainty over oil prices and supply, means that even the present gloomy prospect is fragile. The risks remain firmly on the downside.

4. What is certain, though, is that there can be no return to the growth rates and increases in living standards we once took for grant until inflation has been decisively conquered. Even if the prospect of adequate and predictable supplies of energy was suddenly restored, the inflation constraint on growth would still remain. Neither shoul we deceive ourselves into thinking that this constraint exists solely because of recent oil price increases. It exists also because of deep - seated weaknesses in the structure of many of our economies. These weaknesses have reduced our responsiveness, and so increased our vulnerability to new circumstances: they've led to a sharp decline in the trend of productivity growth: they've created supply bottlenecks. They mean that inflation has tended to move dangerously upwards at much lower levels of growth and capacity utilisation than

EXC/94/04 (T)

in the past. So even if we are successful in getting on top of the immediate upsurge in inflation that now faces us, the battle will be far from won.

5. But perhaps the gloom is punctured by one ray of light. I belie[illegible] that the industrial countries might now be able to staunch the inflationary effects of higher oil prices rather more successfully than in 1974. This is because of the encouraging uniformity with which governments have responded: the almost universal acceptance th[illegible] there is no feasible alternative but to stick with and if necessary reinforce policies of caution and restraint. Policies which treat the immediate problems of oil and inflation as inseparable. Which recognise on the one hand that reduced dependence on imported oil re[illegible] higher oil prices to be passed on to consumers in full; and on the o[illegible] hand that the resultant increase in relative prices must be prevent[illegible] far as possible from triggering a self-defeating wage-price spiral. Such policies are obviously costly in the short run. They mean high[illegible] interest rates, at least in nominal terms, and little if any growth in real incomes. But they are not an exercise in collective masochi[illegible] Nor are they a self-centred response which ignores the consequences [illegible] others less well placed to help themselves. Instead, they are an acknowledgement of the folly of relaxing policies in an attempt to offset the loss of activity caused by a major transfer of purchasing power to the oil producers. This acknowledgement is not the product of some esoteric theory. Rather, it stems from experience - in some cases bitter experience. After the 1973-74 oil shock some of us attempted to maintain growth by stimulating demand. Any affect this had on the level of activity was ephemeral: it was dissipated as inflation soared. Those countries which recovered fastest were thos[illegible] which resisted inflation and took the loss of output on the chin. [illegible] chins are consequently a good deal tougher today.

6. I think there is already evidence that the more singleminded policies now being followed are beginning to bear fruit. The upsurg[illegible] in inflation in the industrial world over the past 18 months or so has owed relatively little to domestic cost pressures. (There are regrettably one or two exceptions) Measured on the basis of consum[illegible] prices, inflation in the 7 major countries increased from covers only

domestically produced goods and services the increase was much less - from 8 per cent to 9 per cent. But this doesn't mean that any of us can let up. Far from it, given the prospect that the average inflation rate in the major economies is likely to be in double figures this year for the first time since 1975. Perhaps the best that can be said is that the battle has not yet been lost.

7. Its possible that, to the problem of inflation there may now be added in some countries an emerging balance of payments constraint. In 1978, the OPEC surplus had all but disappeared. The impact on world trade and activity of the 1973-74 oil shock was cushioned to some extent by the unexpectedly rapid build up of oil producers' imports. The surplus shot up in 1979 as oild prices rose and OPEC imports faltered. This year, the surplus could reach $100 billion. Few, I imagine, are confident that over the next few years the oil producers will be able or willing to translate such a high proportion of their purchasing power into imports as in the past.

8. Part of the deficit resulting from the increased OPEC surplus will fall on shoulders broad enough to bear it without severe dislocation although not perhaps without the need for tighter policies. But a disturbingly large share seems likely to fall on the shoulders of the LDC's. Their combined deficit this year could be half as much again in 1979 - in real terms, around the same level as their record deficit in 1975. This points to the possibility that, as in 1975, the LDC's will not be able to afford a growth in imports sufficient to match their population growth of some ~~25~~ 2½ per cent a year.

9. But in some ways, the LDC's could be even worse off now than in 1975. They have managed to maintain reasonable import growth only by borrowing heavily, mainly from the private banking system. There is now growing apprehension about whether this process can continue indefinitely. The LDC's have a hugh overhang of debt, much of which matures in the next couple of years: and for various reasons, it may prove difficult to recycle oil producers' surpluses as smoothly as in the past.

10. This is obviously something we shall have to watch very closely. There are, of course alternative sources of finance. Its a pity that the LDC's have been so reluctant to borrow from the international institutions, especially since conditions for access to these funds have become more flexible. I hope the LDC's will have greater recourse to them in the future.

11. I hope, too, that the oil producers will be able to play a larger role in recycling their own surpluses. This would both lighten the burden on the LDC's - especially perhaps the poorer ones - and reduce the pressure on the international banking system.

BRITISH ECONOMY (1) Inflation

12. I have already mentioned the world-wide acceptance in the industrial countries of policies of caution and restraint. In Britain, this means, above all, the Government's determination to squeeze inflation out of the economy with a progressive lowering of our monetary targets and reduction in the money supply. I don't want to spoil your lunch with too technical a discussion of our aims. But I would just like to make two points which lie at the heart of the matter.

13. First, we shall not falter or weaken in our resolve to defeat inflation. It will be defeated. The only open question is : how long will it take? That depends crucially on how quickly those who negotiate pay respond to the fact that settlements which employers do not have the money to afford can only result in fewer jobs, more redundancies, higher unemployment, even bankruptcies. I am not going to single out any particular settlements, but there are already some hopeful signs of negotiators beginning to face reality.

14. Secondly, there is no question but that recent Government levels of borrowing have been too high and must be brought down. There are arguments here, too, about the extent, the timing, the pace and the methods. But the plain fact is that painfully high levels of interest rates, damaging as they are both to the private citizen with his mortgage or hire-purchase agreement and to the industrial investor, are an inevitable consequence of high public borrowing. There are, of course, two ways of reducing it - by cutting spending or by increasing taxation - or by a combination of the two. But to think that it doesn't much matter which method you use as long as the arithmetical result is the same is a great mistake. Higher taxes to finance heavy public expenditure shift an increasing burden onto the private sector. So even if a reduction in Government borrowing in this way allows some lowering of interest rates, the private citizen or the industrialist wishing to invest are clobbered in another way by the extra taxes they have to pay. We must, therefore, as far as we can, reduce public borrowing by reducing

public spending rather than by increasing taxation. That is never an easy thing to do, especially in a short time. But we have already acted to cut planned spending this year and to hold the total level of spending next year £3½bn below what was previously planned, and we are determined to make whatever further cuts may be possible in our plans for spending next year and the years ahead.

EEC BUDGET

15. With the emphasis firmly placed on reductions in public spending, I am bound to say something about an important part of the total - our contribution to the EEC Budget. Here, again, I will not air in too much detail what might be called a little local family discussion before this wider audience.

16. By 3rd world standards, Britain is, no doubt, still a rich country. By European standards, we are not. Our GNP per head is lower than that of any other EEC member state except two. Yet, under present arrangements, we will be called upon this year to make far and away the largest net contribution to the Community Budget - over £1bn. This public expenditure - of little benefit to the British consumer or taxpayer who must foot the bill - amounts to more than ½ per cent of British national output. It is more than the whole of our overseas aid programme. Yet who is it going to aid? Some of the wealthiest countries, not only in Eu rope, but in the world.

17. This vast and growing net contribution is a burden on our balance of payments - largely responsible for the recent severe reduction in our traditional invisible surplus.

18. It adds to the PSBR at a time when it is vitally necessary to act on that. It weakens our economy, largely for the sake of aiding other member countries' farmers. It was envisaged years ago that, as the Community spread its wings and developed new policies, the CAP would cease to predominate so heavily in the EEC Budget. It would come down to account for no more than half of Budget expenditure That has not happened, not because new policies have not been developed, but because agricultural spending has run away, virtually out of control.

19. It cannot be right, and was not envisaged in the Treaty of Rome, that a country with one of the lowest incomes per head in the EEC should

be its major paymaster, and our partners have already acknowledged as much when the Dublin financial mechanism was agreed. It is not good for us, it is not good for the Community as a whole that our economy should be weakened in this way. We are loyal, committed members of the Community and intend to remain so. But we can, we must, make new arrangements for a fairer distribution of the costs and benefits of membership.

/The trade-switch and/or oil points could, if necessary, be added here7.

BRITISH ECONOMY 2 Supply Side

20. There is plenty of fraternity informing the Community. What I have suggested we need financially at least, is a good deal more equality. Coming back to our policy for the British economy I have something to say about liberty.

21. Since 1973 the real growth of our economy has averaged barely 1% a year, half that achieved in France and West Germany, for instance, countries lacking the contribution to growth which, while it is rising, North Sea oil makes to ours. We have had, in the bulk of our industry, hardly any growth in productivity, low investment and low profits.

22. If putting this right by Government intervention, regulation and assistance was the right way to do it, there would surely have been some signs of resurgence by this time. Heaven knows, we have had interventionist policies by Governments of both parties for decade after decade. Yet here we still are, in a continuing Slough of industrial Despond.

23. We do not believe that Governments or civil servants can, however well intentioned, direct or finance the revival of our manufacturing or service industries, the supply side of the economy. Industry needs to restore its own competitive diversity. What we can do is to remove some of the shackles and burdens which have held the process back, restore the scope for initiative and enterpris and allow it to be fairly rewarded.

24. The first step was to make a very substantial cut in the burden of direct taxation. This helps to restore incentives at all levels, but particularly at the higher end where tax rates were confiscatory. These rates are now round about the average of the other European industrial countries, although, on the whole, we still reach them at lower levels of income. As I have said, on the other side of the PSBR coin, we are insisting that growth in the economy, which has to pay for them, should precede improvements in public services. It must not be stunted by the effort of supporting them, however valuable they are in themselves.

25. We have begun the process of relaxing or abolishing some of the numerous bureaucratic rules and regulations which have for too long tied our people up in a cat's-crade of red tape. There is much more, I am sure, to be done in this direction.

26. And we have completely abolished four types of control which have, for years, restricted the working of the free market. Pay controls have gone with all its rigidities and harmful effects on differentials and incentives. Dividend controls have gone, with all their distorting effects on the domestic capital markets. Price controls have gone - another attempt to distort the market and the efficiency which free price competition alone can give to its working - backed up by our Competition Bill to inhibit monopoly power. Exchange control has gone. Perhaps to an international audience, that is the most interesting.

27. I will make just a few ~~two~~ points about it. ~~First, that this elaborate structure of exchange control on British investment overseas was never, in practice, an effective substitute for sound economic policy in preventing major speculative capital flows. Our experience of such flows since the last war shows that all too well.~~ There is no substitute for the confidence of world markets in Government economic policies in protecting any country from unstable financial markets.

28. Secondly, far from "exporting jobs overseas", there is plenty of evidence to suggest that abolition of control will help British industry to do better in its markets overseas. Above all, perhaps, the existence of a completely free market for investment ~~undistorted by controls~~ will allow it to flow where the likely return is the greatest, whether at home

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~~at abroad. This will give an added incentive to make investment here at home more profitable, as well as ensuring that British firms and people can invest in profitable ventures overseas, restoring our invisible earnings which will be of particular importance when our oil production begins to decline.~~

I have said that, in guiding a free-trading economy like ours, there is no substitute for the confidence of the world's financial leaders and the world's financial markets. There is every sign that this Government is winning that confidence throughout the industrial world. We intend to go on deserving it.

Reference
EXTRACT FROM HANSARD
DATE. 21/3/80
COL. WH 327

84/04

Exchange Controls (Removal)

31. **Mr. Dalyell** asked the Chancellor of the Exchequer what has been the effect on the economy of the removal of exchange controls.

Sir Geoffrey Howe: Capital outflows in the second half of 1979 as a result of the relaxation and subsequent removal of exchange controls probably totalled about £2 billion. These capital flows were more than offset over the same period by overseas purchases of sterling assets. It is too soon, however, to quantify the broader economic effects of the abolition of exchange controls.

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Pl type for Ch's sign — Sept date. ✓25/ 116

DRAFT LETTER

FROM: CHANCELLOR

TO: SECRETARY OF STATE FOR THE ENVIRONMENT

INDUSTRIAL MONITORING AND THE ABOLITION OF EXCHANGE CONTROLS

I was invited at MISC 14(80)4th Meeting to consider, in consultation with the Secretary of State for Industry, whether any further action was needed to monitor the impact on our industrial position of the abolition of exchange controls. I attach a note by officials which reviews this suggestion in the light of our expectations at the time of abolition of exchange controls and subsequent trends.

2. Their conclusion (summarised in paragraph 11), with which both Keith Joseph and I agree, is that there is no case for increased monitoring. It would involve extra administrative costs to the public sector and a renewed reporting burden on industry, to very little purpose.

3. Copies go to other Members of MISC 14.

[G.H.]

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to discharge the remit. We have incorporated comments made by the Financial Secretary (Mr Locke's minutes of 11 and 21 July). Paragraph 11 summarises the arguments. The basic message is that we never expected abolition of exchange controls to lead to a significant increase in overseas direct investment, nor is there any evidence yet that it is doing so; that in any case such investments tend if anything to support investment and employment at home rather than the reverse; that financial outflows benefit domestic manufacturers through their effect on the exchange rate; and that to step up monitoring of outward direct investment as it takes place would involve administrative costs to the Government and to industry to little purpose.

... 4. I also attach a draft covering letter. Department of Industry officials are showing the draft paper in parallel to Sir Keith Joseph. If you are happy with it, the simplest course might be for private offices to make contact to ensure that the words in square brackets in the covering letter can stand.

5. The next meeting of MISC 14 will not be until after the Party Conference, so there is no great urgency. But it might as well to aim to get the paper circulated within the next weeks - and, therefore, if you could find the time to consider either tonight or on your brief return to London early next week.

DCP

D L C PERETZ
17 September 1[illegible]

EFCS Clearance (at last!) received 24 ...

CHANCELLOR OF THE EXCHEQUER

Financial Secretary
PS/Chief Secretary
Sir D Wass
Sir K Couzens
Mr Ryrie
Mr Britton
Mr Dixon
Mr Lovell
Mr Lavelle
Mr Butt
Mrs Heaton
Mr Allan
Mr Mitchell
Mr Ridley
Mr Cardona

MISC 14: INDUSTRIAL MONITORING AND THE ABOLITION OF EXCHANGE CONTROLS

At Misc 14(80)4th Meeting on 8 July you acquired a remit "to consider in consultation with the Secretary of State for Industry, whether any further action was needed in order to monitor effectively the impact on our industrial position of the abolition of exchange controls".

2. Mr Wiggins' minutes of 8 and 15 July to Mr Lovell explained that the remit arose from the concern expressed by Mr Heseltine that the abolition of exchange controls could be leading to a drain overseas of good industrial management, and a diversion of UK companies' investment away from the home market into, possibly less secure, investments overseas. Mr Wiggins asked for anote that you might send to Mr Heseltine reminding him of the macro-economic case for exchange control relaxation; and drawing on whatever evidence is available about the micro-economic effects of the relaxation so far.

3. The task of coordinating this work eventually fell to EF, and after discussions over the summer Mr Mitchell has now agreed the attached paper with IP, Department of Industry and the Bank of England. If you are content with it it could now be sent to the Secretary of State for the Environment and other members of MISC 14

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INDUSTRIAL MONITORING AND THE ABOLITION OF EXCHANGE CONTROLS

Note by the Treasury

This note, which has been prepared in consultation with the Department of Industry and Bank of England, reviews the background to the abolition of exchange controls and the possible consequences for outward direct investment; and considers whether any action is now needed to monitor direct investments as they take place.

Abolition of exchange controls

2. The relaxation and subsequent abolition of exchange controls last year formed part of the Government's programme for sweeping away controls that had outlived their usefulness. It gave greater freedom to firms and individuals when taking investment decisions and so furthered the aim of helping markets to operate efficiently. It gave firms freedom to operate on the forward market. By saving staff, it made a useful contribution to cutting public expenditure and ended an administrative burden in the private sector.

3. North Sea oil enhanced the arguments for abolition. Formerly, balance of payments constraints had formed part of the rationale for exchange controls. But with oil benefiting the current account, there was no longer the same need to discourage capital outflows. Rather, increased capital outflows could help ease the adjustment of the UK economy to oil. The private sector can now choose for itself how best to use the income accruing from oil; to the extent that this finances capital outflows it will help prevent the entire burden of adjustment to North Sea oil falling on the tradeable goods sector of the economy. Such outflows from the private sector are, moreover, a useful national investment against the day when North Sea production begins to run down.

<u>Effects of abolition on direct overseas investment</u>

4. While exchange controls were in place most direct investment overseas was financed out of unremitted profits from existing direct investment. Bank of England permission was required for investment financed in other ways. It was normally given if the method of finance was acceptable - foreign currency finance usually being required.

5. The main effect of the abolition of exchange controls on overseas direct investment was thus to remove the restriction on its financing. This will have affected the amount of outward investment which takes place only to the extent that financing difficulties had previously inhibited investment at the margin. Such difficulties may have particularly affected companies which were not large or sophisticated enough to raise overseas finance. But overall it seems unlikely that the ending of exchange controls increased substantially the amount of direct investment overseas. Although it is probably too soon to draw any firm conclusions about the long term impact on direct investment flows, recent figures (see annex) tend to bear out this expectation and show only a modest rise in real terms in relation to those during 1978 and the first half of 1979. The quarterly pattern is somewhat erratic, and in so far as there was an apparent increase in the first two quarters of 1980 this was partly attributable to payments in connection with major purchase of UK companies being made earlier than they would otherwise have been (eg Grand Metropolitan buying Ligget and the Imperial Tobacco take-over of the Howard Johnson hotel chain) and may therefore reflect the changed financing requirements consequent on the abolition of exchange control. The figures for the second half of 1979 also demonstrate that the main effect so far of abolishing exchange control has been repayment of overseas loans by UK companies.

6. Nor is there any reason to expect the abolition of exchange controls to divert managerial talent overseas. Large companies were unlikely ever to have been prevented by exchange controls from

expanding overseas; the constraint on smaller firms was (and still is) as likely to have been a lack of expertise/ resources as administrative controls.

The benefits ofoverseas direct investment

7. The available evidence suggests that most overseas investment projects do not compete with UK production and employment. Some overseas investment, eg in sales and marketing, distribution facilities and after-sales service, helps promote UK exports. In other instances the opportunity for expanding direct exports may be limited by tariff or non-tariff barriers, high transport costs, perishability of the product, pressure from host governments, the unwillingness of customers to depend on imported supplies and the need to locate near the customer. While there undoubtedly are cases involving choice of manufacture either in the UK or abroad, in general it seems that much overseasinvestment either stimulates or has no effect on UK investment or employment. The level of investment in the UK is mainly determined by the prospective rate of return on projects: exchange controls could do nothing to improve this, though they might make sterling capital marginally cheaper. The Wilson Committee has recently confirmed that there is no evidence of a shortage of funds for worthwhile investment projects in the UK.

8. Overseas investment may in a few instances be riskier than investment at home. To the extent that such investment is a necessary corollary to exporting, some involvement in riskier markets can hardly be avoided by a major trading nation like the UK. But the risks should not be exaggerated. Most direct investment by UK companies takes place in the developed world. particularly North America and the EEC. That in some developing countries (particularly in south east Asia) is covered by investment promotion and protection agreements (IPPAs) which protect existing and new investment against expropriation and where expropriation occurs guarantee prompt, adequate and effective compensation. Although we have only a limited number of IPPAs to date, even when it has not been possible to conclude an agreement, the negotiations with host

governments have the benefit of drawing attention to those factors which we and UK industry consider conducive to increasing the flow of investment to developing countties. In the end, however, it is for companies to assess these risks - and the prospective returns, which may often compensate for higher risks - and decide what is sensible. There is no reason for Government to claim to know better.

Monitoring

9. The abolition of exchange controls, and with it the Bank of England's role in authorising outward investment, entailed the loss of information about prospective investment. It was recognised that this would be so at the time controls were abolished, and it would not be consistent with the philosophy underlying the abolition if the Government were now to seek to monitor closely the investment decisions made by industry. We have accepted some deterioration in the quality of balance of payments information as a result of exchange control abolition. On the other hand, aboliti made possible substantial staff savings at the Bank of England and to a lesser extent in the Treasury and Customs and Excise - not all of which would have been possible without this deterioration.

10. The main statistics on outward direct investment have always been collected largely independently of exchange control by Department of Industry questionnaires to companies. These will continue to provide historical information on overseas investment. It may thus in due course be possible to seek to analyse what if any impact the abolition of exchange controls had on direct investment abroad, though it will be difficult to disentangle this effect from other factors such as the effects of a high exchange rate, North Sea oil and world economic developments. But in the light of the considerations set out in paragraphs 1-8 above we do not think the costs involved for both Government and industry in seeking to use this same machinery to monitor investment at the time that it is being proposed would be worthwhile.

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Conclusion

11. We did not expect the ending of exchange controls to lead to a marked increase in overseas direct investment by UK companies, nor is there any evidence that it has done so. It follows that the ending of controls in itself is most unlikely to lead to diversion of UK managerial talent abroad either. The main effect, as we expected, has been on the financing of such investment. To the extent that capital outflows have increased following the ending of exchange controls this can help ease the adjustment of the UK economy to North Sea Oil. Where companies chose to exploit their skills and market opportunities by investing abroad this is likely to be beneficial; such investment generally either stimulates or has no effect on investment and employment in the UK. Additional monitoring of direct investment abroad as it takes place would thus be inconsistent with the thinking underlying the abolition of exchange controls, and impose renewed administrative costs on the Government and UK companies to very little purpose.

HM Treasury
17 September 1980

ANNEX

(£ million)

	1978				1979				1980	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
UK direct private investment overseas	-525	-700	-575	-575	-575	-975	-525	-675	-875	-1025
Overseas currency borrowing to finance UK investment overseas	+250	+200	+150	+350	+200	+400	-525	-225	na	na

cc: Chief Secretary
Financial Secretary
Sir Douglas Wass
Sir Kenneth Couzens
Mr. Ryrie
Mr. Britton
Mr. Dixon
Mr. Lovell
Mr. Lavelle
Mr. Butt
Mrs. Heaton
Mr. Allan
Mr. Mitchell
Mr. Peretz
Mr. Ridley
Mr. Cardona

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254/25/9

EF(2)CS

29 SEP 1980

(1) Mr. Bedford -x

(2) EF2CS - PA on relevant overseas investment file pl. 25/9.

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

25 September 1980

The Rt. Hon. Michael Heseltine, M.P.,
Secretary of State for the Environment

Dear Secretary of State,

INDUSTRIAL MONITORING AND THE ABOLITION OF EXCHANGE CONTROLS

I was invited at MISC 14(80)4th Meeting to consider, in consultation with the Secretary of State for Industry, whether any further action was needed to monitor the impact on our industrial position of the abolition of exchange controls. I attach a note by officials which reviews this suggestion in the light of our expectations at the time of abolition of exchange controls and subsequent trends.

Their conclusion (summarised in paragraph 11), with which both Keith Joseph and I agree, is that there is no case for increased monitoring. It would involve extra administrative costs to the public sector and a renewed reporting burden on industry, to ver little purpose.

Copies go to other members of MISC 14.

Yours sincerely

P. S. Jenkins

pp GEOFFREY HOWE
Approved by the Chancellor & signed in his absence.

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