NEW COVER

MT

PART ONE

Confidential filing

Correspondence from and Meetings with Mr Walter Salomon, a private banker

ECONOMIC POLICY

PART ONE:
MAY 1979

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~18.6.85~~						S 3001	
~~13.10.86~~							
~~20.10.86~~							
~~26.2.87~~							
~~25.2.87~~							
23.1.87							

PREM 19/2082

PART ONE CLOSED

PART ONE ends:-

HMT Meeting Record 23.1.87

PART TWO begins:-

Sir W. Salomon to TS 19.2.87

3741/055

CONFIDENTIAL

FROM: P D P BARNES
DATE: 23 January 1987

NOTE OF A MEETING HELD AT 3.00 PM ON THURSDAY 15 JANUARY IN ROOM 51/2 TREASURY CHAMBERS PARLIAMENT STREET

Those Present Economic Secretary
Mr M Hall
Sir Walter Salomon, President of Rea Brothers Plc

MEETING WITH SIR WALTER SALOMON

Sir Walter Salomon, President of Rea Brothers Plc, called on the Economic Secretary.

2. Sir Walter thanked the Economic Secretary for agreeing to see him. Sir Walter said that, as he had explained in correspondence with the Economic Secretary, he was concerned that the Bank of England, both now and under the existing provisions of the Banking Bill, were able to wield excessive powers in the exercise of their supervisory duties, and that there were insufficient checks on such power. Sir Walter doubted the supervisory experience and ability of a number of senior Bank officials. For all these reasons, Sir Walter favoured the removal from the Bank of England of supervisory functions, which would be vested instead in a separate Banking Commission. Sir Walter said that he would seek to pursue his case with the Chancellor and the Prime Minister, and if necessary, publicly.

3. The Economic Secretary thanked Sir Walter for expressing his views so frankly. The Economic Secretary said that he had given full consideration to the arguments for a Banking Commission when the Banking Bill was being drawn up. But he had decided that, at a time of rapid change in financial markets, more effective supervision would be provided if supervisors belonged to the same organisation as, and hence learned from, those people responsible for the Bank's banking and market-related functions.

For this reason, the Economic Secretary thought that supervisors in countries with a separate supervisory organisation would need to keep in much closer contact with their central banks than hitherto.

4. The Economic Secretary also said that he did not think that the supervisors would be able to exercise excessive discretionary powers. Immunity from liability to damages of officials acting in good faith was necessary to underpin robust supervision. But the Bank's absolute discretion would in practice be constrained by the existence of the Board of Banking Supervision, to which he thought Sir Walter attached insufficient weight. The Economic Secretary would be re-examining the constitution of the Board before the Report Stage of the Banking Bill, to ensure that Board would be able to operate as intended. The Board would be able to examine individual cases as well as general policy. The appeals system was also being extended to afford individuals a specific right of appeal in fit and proper cases.

5. The Economic Secretary thanked Sir Walter for having come to see him.

PB

P D P BARNES
Private Secretary

cc PS/Chancellor
Mrs Lomax
Mr M Hall
Mr D Jones

CONFIDENTIAL: NOT FOR CIRCULATION

FLG

FROM: P D P BARNES
DATE: 27 January 1987

ADDITIONAL NOTE OF ECONOMIC SECRETARY'S MEETING WITH SIR WALTER SALOMON HELD AT 3 pm ON THURSDAY 15 JANUARY IN ROOM 51/2, TREASURY CHAMBERS

Sir Walter Salomon made one comment during his meeting with the Economic Secretary which he asked should not be included in the minutes.

Sir Walter said that unreasonable interference by the Bank of England had required Rea Brothers to make more substantial provisions for the Amsterdam Crediet en Handles Bank (Amscrediet), a Dutch bank of which Rea Brothers had been a major shareholder, than would otherwise have been the case. The pressure used by the Bank of England included, Sir Walter said, the threat to declare him no longer a "fit and proper person" to run a banking business if he refused to comply with their requirements.

PB

P D P BARNES
Private Secretary


23. II.
PM 8 7

Sir Walter Salomon,

R21/10

DN

SIR WALTER SALOMON

NEPTUNE HOUSE
TRITON COURT
14 FINSBURY SQUARE
LONDON EC2A 1BR
TEL: 01-256 8873

20th October, 1986

One should congratulate your Economics Correspondent, Mrs. Anne Segall, on her succinct and logical analysis of the case for warning this country in the present circumstances against joining the EMS (European Monetary System).

I am glad to see that the Prime Minister is resisting the pressure being put on her in this respect, but she should resist false prophets and listen to people like those who Mrs. Segall represents.

The Editor,
Daily Telegraph,
135 Fleet Street,
LONDON,
EC4

ECONOMIC VIEW

Is EMS entry sterling's balm?

MR LAWSON glories in his reputation for not suffering fools gladly. In the past he would never have wasted his breath trying to convince an unsympathetic audience to back his judgment. Yet, suddenly, last Thursday, the City was confronted by Mr Lawson Mk. II. At the annual Mansion House dinner he stood up and pleaded with the assembled bankers to—in effect—"Please trust me".

The spectacle of Mr Lawson using rhetoric to defend his entire economic strategy was unnerving. The ploy failed and the pound tumbled on the exchanges. Now the Chancellor must be wondering how long before he will have to bow to financial pressure and raise interest rates by another 1 p.c. to 12 p.c.

People with mortgages and those running businesses will be tempted to see the battle between the Chancellor and financial markets as one in which speculators have forced up the cost of money purely to line their own pockets, with scant regard for the real health of the economy. Mr. Lawson himself has gently encouraged this view.

Blaming speculators for the country's ills is as old as the hills. What is new is the sight of a Conservative Chancellor, supposedly deeply committed to free markets, waving his fist at market forces.

What Mr Lawson should have told the nation last Thursday is that interest rates have to go up because he is unwilling to contemplate any other form of remedy for the very real problems which confront the economy.

If you keep the lid on a tube of toothpaste and then squeeze, something's got to give.

Mr Lawson's response to the City's desire for something tangible has been rather like that of a doctor who tells a patient who thinks he has a serious disease, "Don't worry".

Meanwhile, the patient's temperature goes up and up and up....

The medicine which financial markets want at the moment is British membership of the European Monetary System. Attaching the pound to the Deutschmark bloc is an idea which has captured the imagination of the City.

Ten days ago Mr Lawson told the Conservatives at Bournemouth: "Never underestimate the importance of the tide of ideas." He was talking about tax cuts, but he could equally have been referring to the idea of EMS membership for Britain.

Hopes that Britain will finally join the EMS have been building up ahead of today's meeting between Mrs Thatcher and the President of the German central bank, Karl Otto Poehl. The Prime Minister is said to be adamant that EMS membership is an idea whose time may come, but that time is not quite yet. Mr Poehl, market folk are hoping, will change her mind.

They are likely to be disappointed. But they will be disappointed for the right reasons.

Some of the expectations attaching to the idea of British membership of the EMS are fanciful. It is almost an article of faith among financial experts that joining the EMS will automatically provide the foreign exchange market with the anchor it currently lacks. As a result, or so the argument goes, the fear which has gripped international investors will vanish, the pound will settle down and—hey presto—lucky Mr Lawson will be able to knock down interest rates.

Economists like David Kern of National Westminster Bank have tried to quantify the beneficial impact of EMS entry. They believe interest rates could fall by 1 to 1½ p.c. once the uncertainty premium built into current money costs is lifted.

This prompts the question: if nothing else changes, why should we believe that swapping doctor Lawson for nurse Poehl will bring down the nation's temperature? Unless, of course, we assume that nurse Poehl will be less squeamish about dishing out some nasty medicine.

In that sense, joining the EMS is rather like calling in the International Monetary Fund. It is a way of shifting the blame for unpalatable remedies.

At issue is what has gone wrong and what needs to be done. Mr Lawson's claim that all is well in Britain simply will not wash. One look at the accompanying chart reveals that Britain is heading for a good old-fashioned balance of payments crisis, the kind we have forgotten about in recent years, thanks to North Sea oil.

The drop in oil prices has lopped a sudden £4 billion off the country's annual income from abroad. Filling that hole will be a daunting task.

Assuming for a moment that our earnings from invisibles stay constant, British companies would have to increase their overseas sales by 6 p.c across the board to meet that challenge. In addition, exports may have to rise by, say, 4 p.c. to match the increased demand for foreign goods from British consumers.

Mr Lawson and the Governor of the Bank of England were right to argue last week that the pound has fallen far enough. We have had a devaluation of 15 p.c. over the past year against an average of foreign currencies. In terms of the German mark and Japanese yen, sterling has lost a quarter of its value.

But every devaluation in the past has required a squeeze of the domestic economy so that sufficient resources can be switched into the export sector.

A devaluation is supposed to be a punishment, forcing a decline in living standards to pay for the excesses of the past.

In the run-up to an election Mr Lawson will be reluctant to face up to that fact—until he does the pound may have nowhere to go but down and interest rates nowhere but up.

Anne Segall

CONFIDENTIAL

PRIME MINISTER

SIR WALTER SALOMON

Sir Walter Salomon has telephoned to say that he thinks it would be a disaster if we joined the EMS. He would like to come and talk to you before you see Karl Otto Poehl to give you his reasons, although he accepts that a meeting may not be possible.

The problems at Rea Brothers have now been resolved. They have sorted out their accounts and increased their capital. So that is not an objection to your seeing him. But you need no convincing about the arguments against the EMS.

Agree that I should speak to him to say that you were very grateful for his interest, that the meeting with Karl Otto Poehl is a courtesy call and not a negotiating session about the EMS, and that you remain convinced that the time is not yet right for the UK to join?

Yes

DAVID NORGROVE

13 October 1986

Note for the record

I spoke to Sir Walter. He remains concerned about the pressures on the Prime Minister to join the ERM and about the quality of the people being appointed to senior positions in the City supervisory bodies etc.

DRN
15/10.

10 DOWNING STREET

1. MR TURNBULL

2. PRIME MINISTER (4)

The attached was sent by Walter Salomon and I have thanked him for it.

CR.

18 June, 1985

CR

SIR WALTER SALOMON

ALDERMAN'S HOUSE
ALDERMAN'S WALK
LONDON EC2M 3XR
TEL. 01-623 1155

13th June, 1985

Dear Caroline.

I read an article the other day written by the Editor of the "Frankfurter Allgemeine Zeitung", one of the most prestigious papers in Europe, which I found very relevant. It was written in German but I have had it translated into English and enclose a copy herewith because I think the Prime Minister would be very interested to read it. Perhaps you would be good enough to put it before her at an early opportunity.

Kind regards

Yours sincerely

Walter

Mrs. C. Ryder

Translation from "Frankfurter Allgemeine Zeitung" of May 6th, 1985:

"Das ist kein Kapitalismus mehr"

THIS IS NO LONGER "CAPITALISM"

by Jochen Rudolph

For some time now government politicians, including the Prime Minister herself, have been trying to transfer residual stocks of ideas and concepts from Britain's economic past into the present and to breathe new life into them. For instance, Mrs. Thatcher praised the so-called "Victorian virtues" such as diligence, thriftiness and those particular moral standards. But there has not been much of an echo; instead, acid criticism of the purported callousness, bigotry and prudery of the Victorians that nowadays appears somewhat fatuous. Recently she has spoken of her vision, that one day every Briton will be a "capitalist" with his own house and share portfolio. Good as it sounds - the suggestion of a new "capitalism" again stifled applause from the start.

Such attempts to utilize the past for the embellishment of the present and the future obviously have little power of persuasion. They might even annoy some of the audience. The terms "capitalist" and "capitalism" stir up in many people associations of hunger privation, child labour, long daily and weekly working hours, lack of protection against arbitrary dismissal and loss of the home, no provision for old age and illness. Socialists and communists take advantage of that and achieve a propaganda effect on the cheap by dubbing today's market economies as "capitalism" - as if it were self-evident.

In this, they are particularly successful in Britain since the present generation here have not experienced a complete change, a fresh start from scratch. In Germany, total central planning over the twelve years from 1933 to 1945 had proved a complete failure. After that, the market economy had an easier job to convince people of the superiority of an aconomic system founded on personal freedom and initiative.

Britain, of course,had been the first country to develop the original capitalism two hundred years ago, with its high performance but also with its unmitigated harshness. The social legislation to soften its blows came late - in retrospective, far too late.
In Germany, industrial revolution came about two generations after the British one, but then, very soon crucial social reforms were introduced, even before Britain got them. Later, in the twenties and thirties of our century, Britain had a shorter economic boom and a longer depression than the German Reich. Since the second world war the British again have had less growth and a smaller increase in the standard of living than the Germans. No wonder that the people in London, Birmingham and Glasgow are even less roused by the preachers of capitalism than those in Munich, Düsseldorf and Hamburg.

But the differences between capitalism of yore and the type of market economy that can nowadays be found in most Western European countries are greater than the common features. The principle "Laissez faire, laissez passer" has been replaced by a tight framework of legislation and an all-penetrating growth of intervention and interference. Regulation and prohibition are so widespread that many a businessman and executive feels as if he has already one foot in jail. This stretches from such obviously useful provisions as those on technical safety at the place of work and of the product to legislation on minimum wages for certain activities and petty limits to working hours for perfectly healthy sixteen-your-old apprentices. There are laws for the protection of the employee of which neither an employer nor a trade unionist of the 19th century would even have dreamed. In the Federal Republic, most of them have been in force for a long time, and now they exist in Britain as well: protection against arbitrary dismissal, protection for expectant mothers and members of the works council, legal minimum terms of notice, rules for compensation, for re-instatement and for the priority of wage claims in the case of insolvency. There is provision for illness, old age, and premature disability by means of ever-increasing contributions to national insurance.

The tiny income tax at the beginning of the century, in Britain a humble five per cent, was an entirely different kettle of fish from today's top rate of sixty percent. The once seventy hours of work

per week have shrunk to less than forty. "Paid holiday" was hardly heard of - today four to six weeks are normal. The fear of the privations of old age with very little income has almost faded away, since in addition to the national insurance pension millions of workers can claim a pension from an occupational scheme.

Even the soul of the capitalistic system, free prices, has been partly destroyed: in many countries rents are controlled and often subject to an upper limit. Large parts of the energy supply and of public transport are subject to government price regulations. The price of work is negotiated by powerful trade unions - and often enforced. Agricultural prices in the EEC are supported, lifted, and depressed in a most artistic manner.

Today's market economies differ from the old unadulterated capitalism in many ways. Whoever therefore uses the term "Capitalism" in the same way for the old concept and for a social market economy does so either thoughtlessly or spitefully. This is not just a matter of correct terminology. Market economies unfortunately don't nowadays overcome difficulties and crises as promptly as they should. That is not due to their capitalistic features but to the lack of them. The critics are often exactly the same people who previously insisted on the creation and addition of these structural defects and weaknesses. Now they notice mischievously that the system which they themselves have weakened and overburdened is less than capable of coping with high unemployment. Consequently they demand its replacement by more government interference or even central planning.

For the great controversy of our time it is important to choose the proper economic and social terms. What we today have in Western Europe is not capitalism. We could do with some more of it in order to get to grips with our persistent difficulties.

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PRIME MINISTER

MEETING WITH SIR WALTER SALOMON

Sir Walter is expected to argue for changes in the way banking supervision is conducted in this country. He argues that responsibility should be taken away from the Bank of England. (He will probably continue his private vendetta against the Deputy Governor of the Bank.)

In his statement on the Johnson Matthey affair the Chancellor publicly endorsed the Bank of England's role as the supervisory authority, while calling for improvements - Flag A. The report of the Review Committee on Banking Supervision has been published and the Government has stated that its 34 recommendations are being adopted - Flag B.

AF

(Andrew Turnbull)

4 July 1985

[Mr. Nigel Lawson]

million, of which £34 million falls to the bank. Though in many instances recoveries will be only over the long term, JMB's present board of directors is satisfied that the total eventual calls on the indemnity will fall comfortably within the £150 million ceiling.

Since JMB is now its wholly owned subsidiary, the Bank of England stands fully behind it. On 22 November the bank placed a deposit of £100 million with JMB, which has since been converted into £100 million of additional capital to strengthen JMB's balance sheet. This will, of course, be fully reflected in the price the Bank of England receives for the sale of JMB back to the private sector, which it plans to conclude as soon as practicable.

The review committee has made 34 specific recommendations. Their implementation will require action by the Bank of England, by supervised institutions, by their auditors and by the Government. The committee proposes two fundamental changes in the present arrangements, and several important modifications. It has taken the view, which I share, that the JMB case exposes major shortcomings in the present legislative framework and supervisory procedures. I shall, in my statement, outline only the committee's main proposals. A full summary of its recommendations is annexed to its report.

The Banking Act 1979 — which was Labour legislation — draws a distinction between recognised banks and licensed deposit-takers. JMB was, and still is, a recognised bank.

Most of the Act's provisions, and of the bank's powers set out in it, relate to licensed deposit-takers. A dual system of supervision has resulted. Licensed deposit-takers have been subject to a more rigorous regime of supervision, whereas the supervisors have relied heavily on the integrity and co-operation of the management of recognised banks. With most banks, this confidence has not been misplaced. But the banking industry has expanded rapidly, and its activities have diversified. Recognised bank status—as we have seen with JMB—has not always guaranteed prudence and responsibility.

The committee recommends that the two-tier system be abolished and that the powers given to the bank under the Act should apply to all authorised institutions. I accept this recommendation. The committee recommends that all authorised institutions should, in consequence, be entitled to use banking names.

I also intend to tighten the criteria for authorisation, including the minimum net assets required.

The second fundamental change recommended by the review committee concerns bank auditors. In this context, I am grateful to the Institutes of Chartered Accountants of England and Wales and of Scotland for the co-operation that they have afforded the committee.

The committee recommends that there should in future be a regular dialogue between the supervisors and banks' auditors. I strongly endorse this proposal.

A banks' auditors are uniquely placed to monitor its control systems and assess its financial prudence. The accountancy profession at present considers itself prevented by a duty of confidentiality to the client from passing information to the supervisors. At the same time, the supervisors are themselves inhibited by the Banking Act from communicating supervisory information to third parties without the institution's consent.

This is clearly an unsatisfactory state of affairs. It is in cases where consent is not forthcoming that dialogue might be most necessary. That is why I accept the committee's recommendation that the constraints on contact between auditors and supervisors be removed.

I emphasise, however, that it is the directors and senior managers of banks who are responsible for the conduct of their business. They have duties both to depositors and to shareholders. This responsibility cannot be shuffled off to auditors or supervisors. The lesson of the JMB collapse is that banks must have in place adequate management and control systems. I therefore endorse the committee's suggestion that banks should appoint an audit committee and finance director where they do not already have them.

The committee has also made important recommendations on the staffing and organisation of the banking supervision division of the Bank of England.

The work of the supervision division has increased greatly in both complexity and volume in recent years, and the Bank of England now supervises more than 600 institutions. In general, it does a difficult job diligently and well. But in the case of JMB, the supervisors cannot escape criticism for failing to respond more quickly to the danger signals.

The committee has recommended that the staff of the division would benefit from wider commercial experience; that there should be more secondments in both directions between the division and commercial banks; that a significant cadre of experienced long-term banking supervisors must be built up; and that there should be more professionally qualified accountants in the division. It has also been suggested that more staff are needed.

The bank has already begun to implement these recommendations. The division is being strengthened both in numbers and in the range of expertise available. Some rearrangement of responsibilities has taken place within the division and further secondments to and from commercial banks have been arranged. To provide advice at a senior level, Mr. Sidney Proctor, chief executive of the Royal Bank of Scotland group, who retires from that position on 30 September, has accepted the Governor's invitation to serve on a part-time basis as an adviser on banking supervisory issues.

JMB's failure stemmed directly from a number of large, related exposures. The committee recommends—and the Bank of England has accepted — that in future no exposure to a borrower, or to closely related borrowers, should exceed 25 per cent. of the lender's capital base, other than in the most exceptional circumstances.

An effective system of banking supervision is essential, not merely for the protection of depositors but for the financial health of the economy as a whole.

The review committee's report brings out very clearly the lessons to be learnt from the collapse of Johnson Matthey Bankers. But more than that, it proposes a number of important changes to banking supervision in this country, which I am confident will greatly strengthen the system and make a repetition of the JMB affair very much less likely to occur. I commend it to the House.

Mr. Roy Hattersley (Birmingham, Sparkbrook): I wish at the outset to make it absolutely clear to the Government that the Opposition expect an early debate on this subject, for it raises the most serious questions about

77 The first two proposals set out in the previous paragraph can be effected by Statutory Instrument, subject to affirmative resolution by Parliament. We believe that it is not necessary to change the other monetary amounts specified in the Scheme; in particular that the cash fund does not need to be raised to accommodate the increase in the limit on a protected deposit. The third proposal would require an amendment to the Banking Act.

XII Towards implementation of the Committee's proposals

78 If adopted, some of our proposals can be implemented by the Bank administratively; some can be implemented by statutory instrument; while others will require amendments to the Banking Act. Most will require prior consultation with the banking system and other interested parties.

79 We urge the Government to allocate time for a Banking Bill in the 1986/87 Parliamentary session. If this is agreed, drafting instructions would need to be prepared for Parliamentary Counsel by the beginning of next year. That would suggest that a White Paper should be published in the Autumn. Some of the proposals for amendments to the Banking Act are covered in this report; others will be considered further by the official group. Many of our proposals deal with complex matters and will require detailed consultations before they could be implemented. If the proposed timetable is to be met, informal consultations should be started with the Banking Associations and other interested parties as early as possible in the Summer.

XIII Summary of recommendations

80 The following is a summary of our recommendations:-

The two-tier system of authorisation under the Banking Act

i) The present two-tier system of authorisation should be replaced by a single authorisation to take deposits under the Act. All the powers given to the Bank under the Act should apply to all authorised institutions and all authorised institutions should be entitled to use banking names (paragraph 16).

ii) The new criteria for authorisation should include both a requirement that all directors, controllers and managers are "fit and proper" and a requirement that the business of the bank should be carried on with integrity, prudence and appropriate professional skills (paragraph 18).

iii) The minimum net assets criterion for authorisation should be increased from £250,000 to £1 million (paragraph 19).

iv) Banks already authorised should be required to meet the £1 million minimum net assets criterion on a change of ownership (paragraph 20).

v) If a two-tier system were to be retained, the Bank's powers to obtain information from licensed deposit-takers should be extended to recognised banks (paragraph 15).

<u>The relationships between the managements, supervisors and auditors of banks</u>

vi) Banks should consider the appointment of an audit committee and a finance director where they do not already have them (paragraphs 23, 24).

vii) A mechanism should be established to enable a regular dialogue to take place between the supervisors and banks' auditors. Existing confidentiality restraints on both parties should be removed, initially by obtaining the agreement of each bank to a dialogue taking place and, as soon as possible, through legislation (paragraph 27).

viii) The dialogue between the supervisors and banks' auditors should not interfere with the present relationship between a bank and its auditors. The bank should commission from the auditors information required by the supervisors and should normally attend meetings between the two (pargraph 28).

ix) Powers should be taken to permit direct communication between the supervisors and the auditors in exceptional circumstances (paragraph 28).

x) The Bank should be given powers to require that statistical returns used for supervisory purposes are examined by the auditors. This should not become a matter of routine but the powers should be used to carry out spot checks and to follow up any inaccuracies which are detected (paragraph 31).

xi) The Bank should have powers to require a bank to commission a report covering similar ground to a statutory audit from a second firm of accountants where the Banking Supervision Division considers that the bank's auditors are not competent or have been negligent (paragraph 33).

xii) The Bank should be empowered to pass information to the appropriate professional body about a bank's auditors or other advisers to assist that body to consider whether disciplinary action should be taken against the advisers (paragraph 34).

Large exposures

xiii) No exposure to an individual borrower, or to a group of closely related borrowers taken together, should exceed 25% of a bank's capital base, except in the most exceptional circumstances (paragraph 42).

xiv) The Bank should continue to monitor and investigate all exposures in excess of 10% of a bank's capital base (paragraphs 42, 43).

Quality of assets and control systems

xv) The Bank should take further steps to ensure that effective procedures are in place to check that banks' control systems, particularly for lending, are adequate and are being properly applied in practice (paragraph 46).

xvi) To broaden their knowledge of banks' managements and to help in the assessment of their control systems, the supervisors should increase the number of visits paid to banks. The frequency and length of the visits would vary from case to case (paragraph 47).

xvii) Where suspicions of problems arise, a detailed investigation of a bank should be undertaken more readily than has been the case in the past. The increased number of visits recommended above should reduce the risk that such an investigation might itself cause a loss of confidence in the bank (paragraph 48).

xviii) Banks should consider introducing loan grading systems if they do not already have them. The Banking Supervision Division should make use of the information provided by such systems to monitor changes in the quality of a bank's assets (paragraph 49).

The adequacy, scope and timeliness of data received for supervisory purposes

xix) The present integrated system for collecting statistical data for various uses, including supervision, should be retained (paragraph 51).

xx) The Bank should tighten its procedures for ensuring that all returns used for supervisory purposes are submitted promptly and should consider carrying out an investigation into any bank which fails to provide information within the time allowed (paragraph 53).

Parental support

xxi) We endorse the Banking Supervision Division's proposals on comfort letters (paragraphs 57, 58).

Staffing and organisation of the Banking Supervision Division

xxii) Some further increase in staff numbers is justified to meet the existing workload and to carry out certain of our other recommendations (paragraph 59).

xxiii) The staff of the Banking Supervision Division would benefit from wider commercial experience to assist them in their work as supervisors (paragraph 60).

xxiv) The programme of secondments in both directions between the Division and commercial banks should be expanded (paragraph 60).

xxv) A significant cadre of experienced, long-term banking supervisors needs to be built up (paragraph 61).

xxvi) Some increase should be made in the number of professionally qualified accountants working in the Division (paragraph 62).

xxvii) We endorse the proposals produced by the Banking Supervision Division for clarifying the lines of communication within the Division, defining more clearly responsibilities and work practices and improving information flows (paragraph 63).

Consolidated supervision

xxviii) Barriers to the exchange of information between supervisory authorities should be removed (paragraph 68).

xxix) The relevant government departments and supervisory authorities should consider carefully the issues raised by the supervision of financial conglomerates, parts of which are supervised by different supervisory authorities (paragraph 69).

Matters raised with the Committee by the official group considering the desirability of amendments to the Banking Act

xxx) The Bank, with the consent of the Treasury, should be able to disclose information to other government departments (except the Revenue departments) where it considers this to be in the interests of depositors or in the public interest (paragraph 73).

xxxi) The Bank should be given powers in respect of unauthorised institutions similar to those enjoyed by the Department of Trade and Industry under Sections 447 and 448 of the Companies Act 1985 in order to facilitate investigation of offences under the Banking Act (paragraph 75).

xxxii) The amount of a protected deposit under the Deposit Protection Scheme should be increased from £10,000 to £20,000 (paragraph 76).

xxxiii) The amount of the minimum initial contribution to the Deposit Protection Fund should be increased from £2,500 to £10,000 (paragraph 76).

xxxiv) The provisions of the Deposit Protection Scheme which allow the exemption of certain overseas banks should be repealed (paragraph 76).

R. Leigh-Pemberton

C W McMahon

W.P. Cooke

P E Middleton

[illegible]

[illegible]

31 May 1985

Meeting with Governor

TOP COPY FILED
ON: ECON POL -
Domestic Monetary Policy
Pt 13

(B)

14 May 1985

PRIME MINISTER

JMB

The announcement of total provisions of £245 million against total loans of £450 million at Johnson Matthey Bankers comes as no surprise - we knew the news was going to be bad. The original suggestion by the Bank that they would return JMB early to the private sector has slipped, and the cost has mounted. It is doubtful whether the Bank will recover the £100 million of special deposit which it made last year, and which it is now converting into equity and loan capital. Nonetheless, the Bank should be encouraged to press on with the task of restructuring and returning to the private sector as soon as possible, and writing off any loss as an unfortunate episode in its history as a regulator.

The Bank's Press Notice publicly denies this.

Walter Salomon has sent me the attached memorandum concerning banking supervision, which he has asked that I show to you.

He is right that the system of banking supervision needs a substantial overhaul, and it may well need new blood to strengthen the vigilance of the regulators. At the moment we have the worst of all possible worlds. The system is reluctant to take early action to limit banks building up

unreasonable exposure. And yet, when the position becomes obvious - as with JMB - the Bank is all too ready to take it over and to pump public money in to pay for the costly mistakes that have been made.

This means that for many banks there is no encouragement in the system to be prudent, as they know that ultimately they can be bailed out by the Bank of England; whilst the effort that goes in to monitoring and regulating is wasted for most of the time, as nobody is prepared to take a hard decision early enough to prevent disaster.

This ignores the fact that Johnson Matthey PLC lost £180 million, though it is not clear whether it be guilty executive have lost their jobs.

I suggest that I say to Sir Walter that you are interested in his views, and that the appropriate time to review it is when the Report is available on JMB.

JR

JOHN REDWOOD

MEMORANDUM

1. There can be no doubt that the Banking Act and Banking Supervision need a thorough overhaul.

2. The first point is that it should be seriously considered (as in other countries) that banking supervision is taken out of the hands of the Bank of England and an independent authority set up to deal with it.

3. When the Banking Act was originally introduced I gave an address at The Institute of Bankers City of London Centre on 1st April, 1980, a copy of which I have already sent to you, in which I explained my reservations about it. I think events have proved how right I was.

4. The present supervisory authority consists of a number of people hardly any of whom can be called "practical bankers".

5. When I challenged Peter Cooke as to where they got their knowledge to enable them to make their judgments, he said they learned it by doing it, to which I retorted that this might be an extremely costly and not necessarily successful cooperation. Again, I have not been far off the mark.

6. The recent case concerning Johnson Matthey is, in my opinion, a glaring example of total inefficiency and inexperience. Those responsible are still in charge of banking supervision. If this were a private enterprise business I assume the Board would have dismissed them straight away.

7. However, as our friend does not like criticism without practical suggestions as to what should be done, here are my practical suggestions which are, of course, open to discussion.

   - A separate supervisory body should be formed.
   - In the first instance this should be by way of a loose consultant committee, and here are the names of those I would suggest:

   Apart from Sir Peter Middleton and his officials -

From the Bank of England - one should call on Mr. George Blunden and, of course, the Governor could ex gratia always attend every meeting.

From the banking side - I would suggest Sir Timothy Bevan, Chairman of Barclays Bank, and as well Mr. D. Vander Weyer, formerly Deputy Chairman of Barclays Bank.

From the industrial side - I would suggest Dr. David V. Atterton of Foseco Minsep.

A further member should be Mr. Robin Hutton, Director General of the Accepting Houses Committee, and he should be appointed Secretary to the Committee.

As temporary consultants before the thing is finalised I would recommend Lord Seebohm and, with due humility, myself as both he and I have got the practical experience which might be helpful to the committee.

I recommend also The Rt Hon Sir Patrick Nairne, GCB MC, formerly Permanent Secretary at the Ministry of Pensions, and now Master of St Catherine's College, Oxford.

WHS
22.4.1985

FILE: Sir W Salomans.

SIR WALTER SALOMON

ALDERMAN'S HOUSE
ALDERMAN'S WALK
LONDON EC2M 3XR
TEL. 01-623 1155

Prime Minister

Copy of Sir Walter Salomon's letter to John Hoskyns. CR.

STRICTLY PRIVATE
AND CONFIDENTIAL

12th February, 1985

mb

I am reading with interest the articles which you are at present contributing to The Times.

As you know, you and I agree on very many things and also on the things which should be done. Many are writing and talking today about these matters and much criticism is at present heard about the government and some of the things it is, or is not doing.

You will recall that when you came to my place and we discussed these matters I suggested at the time that a small committee should be formed to set out in very distinct form an emergency programme - spelling out clearly in a language which the general public understands the main things which should be tackled immediately. I thought Tebbitt on television last night was extremely good in this respect. This little committee should then put the programme before the Prime Minister - monitoring it and propagating it as much as possible. I think that is priority No. 1.

The criticism which is today being levelled by all sorts of people is never backed by any workable practical solution to improve the situation - whether one is talking about Roy Hattersley, David Owen, David Steel, or some of the Tories.

I have tried to get you on the telephone today but you were not there at the time - hence this letter. I hope you don't mind my comments.

With kind personal regards.

Sir John Hoskyns

10 DOWNING STREET

From the Private Secretary

23 January 1985

Many thanks for your letter of 22 January which I will ensure the Prime Minister sees as soon as possible.

(Caroline Ryder)

Sir Walter Salomon

File

Prime Minister. ④

Sir Walter sent this in. It is rather silly as it ignores the fact that since 1966 the $ has appreciated against the DM by 14%, while inflation was 45% more.

AT
23/1

THE TIMES - 22nd January, 1985

..ength of dollar

From Sir Walter Salomon

Sir, In this country we perceive the US dollar in rather parochial terms. I have been looking at comparisons between the Deutschmark and the US dollar since the war and I think your readers may find the results somewhat surprising.

September, 1947	=4.20DM
After the first DM revaluation in March, ~~1981~~ 1961	=4.00DM
After the second DM revaluation in October, 1969	=3.66DM
Obligation of dollar towards gold terminated (August, 1971)	=3.42DM
After the dollar revaluation in February, 1973	=2.90DM
Lowest rate during Carter's term of office (January 3, 1980)	=1.71DM
Rate when Reagan took office in January, 1981	=2.26DM
Rate on January 15	=3.20DM

Is the dollar really so high?

Your faithfully,
WALTER SALOMON,
Alderman's House,
Alderman's Walk, EC2.
January 15.

file RM

10 DOWNING STREET

THE PRIME MINISTER

5 November 1984

Dear Sir Walter,

Thank you for your letter of 31 October together with the various enclosures.

I shall bear in mind what you say - although I doubt if Jack Straw would be given the right chair.

Yours sincerely,

Margaret Thatcher

Sir Walter Salomon

10 DOWNING STREET

Prime Minister (2)

Sir Walter is continuing his vendetta against Kit McMahon. Caroline has acknowledged.

Agree no further action?

AT

I think I should 1/11 sign a brief formal reply not

SIR WALTER SALOMON

KING'S HOUSE
36-37 KING STREET
LONDON EC2V 8DR
TEL. 01-606 4033

AT
I have acknowledged
CR. 1/11

31st October, 1984

Dear Prime Minister,

I wrote a letter to Nigel Lawson yesterday, a copy of which I enclose, and sent him some enclosures. In the letter I made a remark about "some delicate personal observations". When I last saw you I mentioned the subject matter, which refers to the Deputy Governor of the Bank of England, Mr. C.W. McMahon. During our conversation I mentioned that I thought his a totally unsuitable appointment and if the time comes when a new appointment has to be made (which I understand will not be later than next March) I think it would be very badly received by many if it were the same person. The latest affair with Johnson Matthey should confirm that.

David Scholey, who has now had certain experience of the working of the Court would, in my opinion, be an ideal choice and he might well accept the position if there were any prospect that he could later become Governor. In my discussion paper (the Salomon Plan) I mentioned that we are not so much short of money as of human resources. In this case I don't think there is a great choice.

Yours sincerely,

Walter

The Rt. Hon Mrs. Margaret Thatcher, MP

30th October, 1984

I learn from an article in today's Financial Times, a copy of which I enclose, that you are considering making changes in the present Banking Act.

When the Act was originally introduced I was one of the very few to raise my voice to criticise it sharply. This I did under the guise of an address given to the Institute of Bankers on 1st April, 1980, headed "Banking Through the Eyes of the Private Banker". When considering changes to the Act you may like to consider the observations which I made at the time, a re-print of which I enclose herewith.

There is a further matter I would like to raise and which is referred to in a discussion paper I published recently called "The Salomon Plan". I enclose a copy of this in case you have not already seen it, although I understand that the Prime Minister has passed a copy to you. In no circumstances (with strong emphasis on the word "no") should the central banks be involved in the supervision of the bankers. As you are of course aware, in Germany this is done by the Bundesaufsichtsbehorde, and in the United States by the various Controllers of the Currency. However, I think the greatest difficulty we shall encounter is finding the people to do the job. There is a dearth of human resources.

When I discussed this subject some time ago with members of the supervisory team at the Bank of England, I pointed out their lack of qualification to do the supervising, to which they replied that they were learning. This is far to serious a matter to have "learners" on the job. What we need are very experienced and practical people, and where are they to be found?

I would be happy to discuss this matter with you at any time you so wish but I think the initial discussion, if any, should be between you and me because it could involve some delicate personal observations.

The Rt. Hon. Nigel Lawson, MP.

Johnson Matthey affair prompts Lawson to examine Banking Act

BY PETER RIDDELL AND DAVID LASCELLES

THE GOVERNMENT is considering whether to change the framework of banking supervision in the light of the Johnson Matthey Bankers' rescue a month ago.

Mr Nigel Lawson, the Chancellor, will examine whether the 1979 Banking Act needs to be amended. The Act set up the present system of supervision in the wake of the secondary banking crisis of the mid-1970s.

In a Commons written answer yesterday, Mr Lawson said the Bank of England was "considering what lessons the failure of JMB may have for the banking supervision system" for which the Bank is responsible under the Act. "If it appears that changes to the statutory framework for banking supervision may be needed, I will give this very careful consideration."

Treasury ministers have made no secret of their concern and unhappiness about possible inadequacies in the current system of supervision, which allowed JMB's problems to develop to the point where the Bank of England had to step in to organise a rescue.

The Bank of England did not appear last night to have been aware of Mr Lawson's written answer, adding to the impression that the Johnson Matthey Bankers affair has created something of a rift between them.

Nonetheless, the Bank would probably welcome a review of the Act, which has proved to have some weaknesses and needs a fresh look after five years.

Although the Act gives the Bank a strong supervisory role, the JMB case highlighted the fact that, while the Bank can command an institution to supply it with information, it has limited powers to examine banks itself, as U.S. bank regulators do.

This makes it hard for the Bank to be sure an institution is supplying it with all the information it might and that what it is producing is correct. Although the Bank had been worried about the state of JMB for some time, it was not until very late in the day that the full extent of its troubles emerged.

Some of the Act's definitions might also be improved, and changes might be sought to the appeals procedure when the Bank wants to revoke an institution's licence.

DB

CF

I have had a word with the Governor's office.

DMB 19/4

10 DOWNING STREET

The Gov. of the Bank of England's Office 'phoned to say that they had heard that Hen Poel would be in this country on 8 or 9 or 10 May.

It seems from the file that the idea has already been shelved that the PM should meet Hen Poel.

Shall I phone the bank?

19/4

Sir Walter SALOMON

20/3 FILE da

(1) 26/3
(2) 2/4

10 DOWNING STREET

From the Private Secretary

9 March 1984

We have had an approach from Sir Walter Salomon for the Prime Minister to meet Herr Poel who apparently holds an equivalent office to Robin Leigh-Pemberton.

I would be grateful if you could give us your advice as to whether it would be a good idea for the Prime Minister to meet this gentleman or not.

Caroline Ryder

John Bartlett, Esq.,
Bank of England.

Pl. put both Depts. on Reminder List

dr

Also BE Treasury - see little below.

(T) 26/3

10 DOWNING STREET

From the Private Secretary

9 March 1984

We have had an approach from Sir Walter Salomon for the Prime Minister to meet Herr Poel who apparently holds an equivalent office to Robin Leigh-Pemberton.

I would be grateful if you could give us your advice as to whether it would be a good idea for the Prime Minister to meet this gentleman or not.

Caroline Ryder

Miss Judith Simpson,
HM Treasury.

10 DOWNING STREET

From the Private Secretary

AT.

Sir Walter Salomon called. He wants to give a dinner for Her POËL [the equivalent of Robert Leigh-Pemberton in Germany] on the P.M.

Shall we, in the first instance, ask the Treasury for advice?

CK

8/3.

and the Bank of England.

Try and avoid

FILE JD

10 DOWNING STREET

THE PRIME MINISTER

4 April, 1984

Dear Sir Walter,

I gather you spoke to Caroline a little time ago kindly suggesting that I might meet Dr. Pohl, President of the Bundesbank.

I very much regret that I am not going to be able to offer you a date. I am so sorry, but my diary for the spring and summer is particularly bad this year, not least because of the Economic Summit, a number of major speeches, and overseas trips.

With all best wishes, and thank you for making the suggestion.

Yours sincerely

Margaret Thatcher

Sir Walter Salomon

→ Ms Ryder [or Ms Stevens]

Otto Pohl. – Gov of Bundesbank

Sir Walter Salomon is anxious to host a dinner for the Gov of the Bundesbank and would very much like the Prime Minister to meet him.

Would the Prime Minister think this is appropriate?

AW 2/4/84

PRIME MINISTER

Sir Walter Salomon rang recently to suggest that if you wanted to meet Dr. Pohl, President of the Bundesbank, he would be happy to arrange a dinner.

I have taken soundings about this from the Bank of England. The Governor would not object to such an arrangement though he would regard it as somewhat odd for his German counterpart to be invited to London to meet the Prime Minister through a private dinner rather than through the Bank. He would, however, be put out if he were not invited to the dinner. The Bank would advise against inviting Dr. Pohl to come to 10 Downing Street to meet you officially. This could create a misleading impression about UK policy. For example it could set unnecessary hares running over our intentions on EMS.

My advice would be against following up this suggestion. If Dr. Pohl comes to London I believe it should be as the guest of the Governor. Sir Walter could be told that, while you are grateful for his proposal, you do not believe it would be appropriate for Dr. Pohl to be invited to London to meet you at a private dinner. It would, in any case, be difficult to maintain the entirely private character of the occasion.

Agree?

AT

I just have no time available at present.

~~much as I should like~~

to

Seen by CR

Andrew Turnbull
28 March 1984

CONFIDENTIAL

cc Miss Harden

NOTE FOR THE RECORD

Sir Walter Saloman came to see the Prime Minister today. He raised a number of points:

i) He was full of praise for the new Governor of the Bank of England and for the changes which had been made to the Court. He was particularly impressed with the choice of Dr. Atterton.

ii) He suggested that proposals to build roads financed by shadow tolls be revived.

iii) He expressed surprise that the Prime Minister had not supported the American intervention in Grenada and he was critical of the fact that the Prime Minister had actually expressed disapproval of the American action. (The Prime Minister defended herself by arguing that the reasons given for the intervention were very much those used by the Soviet Union to justify intervention in a neighbouring State of whose policies it disapproved).

iv) He suggested that Professor Hayek be recommended for a British honour. The Prime Minister said that this was difficult because Professor Hayek was resident for almost all of his time abroad but she nevertheless agreed to consider this.

X/

AT

A. TURNBULL
24 January 1984

CONFIDENTIAL

16th January, 1984

Having only recently returned from abroad, I apologise for not having replied earlier to your letter dated 29th December. I am sure you will forgive me.

You may recall that at the World Bank Meeting last September when you gave the Per Jacobbson Lecture you invited questions at the end of your lecture. The last question you took was the one which I put, although you did not know that at the time. The question was "would you agree that a great number of the leading bankers have behaved in a totally irresponsible manner and, furthermore, would you agree that we have no guarantee that they will not do so in the future?" After some consideration, you replied that, with hindsight, this was easy to say and that, from a political point of view, was the only answer I could have expected.

However, I did not think that the behaviour of those bankers had anything to do with hindsight. I think they were totally irresponsible, bad judges of the situation, and certainly very poor bankers. Without going into detail, I can imagine that a number of those bankers to whom I refer are as well connected with your committee. They have not been dismissed by their banks for gross negligence and misjudgment nor, as far as I know, have their banks cut their salaries - and so we roll on, papering over the cracks because it appears no one really has the courage to call a spade a spade and do the necessary in order to change the situation. If there are such people, they are cold-shouldered and not listened to.

I am not writing this letter in anger but in great sorrow, particularly as I have such a high regard for you who have rendered such exemplary services to banking.

You have sent me a number of booklets which are, in my opinion the usual turn-out - more from a theoretical rather than a practical point of view. I will read them as soon as I have time but you will understand that it is impossible to read all the papers which are sent to one.

I have written two books, one in 1972 called "One Man's View" and the other last October. I did not write them with hindsight, but in order to pass on the message and if you have the time and patience to read them you may even be in agreement with the views expressed therein.

I have taken no profit out of these books but have given the royalties to the Young Enterprise movement here in this country. This movement is equivalent to Junior Achievement in America. However, as you have sent me some free copies I shall return the compliment and send you a copy of each of my books. In particular, I would refer you to "Fair Warning" which should set at rest the view that one needed hindsight in order not to get into the calamity in which the world of finance finds itself today. I enclose a cutting from the Sunday Telegraph in which my book was reviewed. Might it not perhaps be a good idea if you were to circulate it amongst the members of the Group of Thirty.

I have been in banking for over sixty years and have seen a lot of things happen. I only hope that I shall be spared seeing the monetary system totally disintegrate, thus bringing true Lenin words "one should not worry about capitalism - it will destroy itself through the destruction of its monetary system" - or something similar.

You will understand therefore that, under the circumstances, I feel totally unable to consider your appeal.

Mr. H. Johannes Witteveen

c.c. Professor Sir Alan Walters
Mr. George Blunden

GROUP OF Group of Thirty
CONSULTATIVE GROUP ON INTERNATIONAL ECONOMIC & MONETARY AFFAIRS, INC.

H. JOHANNES WITTEVEEN
Chairman

PHONE: (212) 775-9160
TELEX: 233427 CG IUR
CABLE: CONSUGROUP NEW YORK

December 29, 1983

Dear Sir Walter,

I am writing as chairman of the Group of Thirty which, as you may know, is a non-profit organization examining some of the most important problems confronting the world economy. The purpose of this letter is to enquire whether your institution could be interested in supporting our activities.

The Group of Thirty conducts a continuing review of the functioning of the international monetary system. Among the subjects under study are the exchange rate regime, international banking, the outlook for foreign direct investment, and the future role of international institutions such as the IMF and World Bank.

Much of the Group's work involves the exploration of linkages between the financial markets and official policy. We aim to make sure at every stage that the views of commercial banks and other private sector institutions are fully integrated in our research. This is accomplished through confidential questionnaire surveys, which enhance the validity of our reports and policy recommendations. The Group also calls meetings in Europe, Asia and the U.S. at which bankers, central bankers and officials discuss matters of common interest. In such ways we provide channels through which those who formulate official policy are made aware of the views of senior bankers.

The Group disseminates the results of its work widely throughout the world. Our publications have become well-known and are frequently quoted: 44.000 of our books have been distributed in the past year alone. We will be sending separately our reports on "Commercial Banks and the Restructuring of Cross-Border Debt", "The IMF and the Private Markets" and "World Money and National Policies". I enclose a copy of the Group's latest Annual Report.

-2-

TWO WORLD TRADE CENTER, SUITE 9630, NEW YORK, NEW YORK 10048

GROUP OF

This year we plan to step up our work on banking and bank supervision, the Eurocredit and Eurobond markets, and to review new developments in key financial centers around the world. A committee chaired by Dr. Jelle Zijlstra, former president of the Bank for International Settlements, is preparing a report on the future of the IMF and other international institutions.

The Group has received financial contributions from a large number of central banks and commercial banks (60 at the last count), including the Bank of England. To finance an expansion of our studies of the monetary system, we are now making an appeal to the merchant bankers of the City. We are seeking contributions of 1.000 pounds per year for three years.

We shall distribute complementary copies of all our publications to contributors, and also supply regular information about our activities on a confidential basis.

I hope that your bank will consider our appeal for support and I look forward to hearing from you.

Yours sincerely,

Encl.

Sir Walter Salomon
Rea Brothers plc
36/37 King Street
London, EC2V 8DR
England

R WALTER SALOMON

KING'S HOUSE
36-37 KING STREET
LONDON EC2V 8DR
TEL. 01-606 4033

Previous papers & item to Andrew Turnbull CR

AT B/F 23/12

22nd December, 1983

MT

Dear Mrs. Ryder,

Thank you for your letter dated 19th December. Sir Walter will be very pleased to attend at 10.15 on Tuesday, 24th January, to see the Prime Minister. He is very grateful to her for providing the time.

The main topics which Sir Walter would like to discuss with the Prime Minister are

1) The Bank of England and certain aspects connected therewith, and

2) Certain aspects of public relations.

He would like as well to discuss very briefly Professor von Hayek and Sir Alan Walters.

Yours sincerely,

Maeve Byrne

(Miss) Maeve Byrne
Secretary to Sir Walter Salomon

Mrs. Caroline Ryder

(1) Public Relations for the rank and file.

Said to Brian Walden.

Must keep down inflation.

Support the aero-industry.

Saved Cows - Health / Soc. Service / Defence

Mismanagement

~~Unemployment. How many are employed.~~

HL

10/1

19 December 1983

Dear Private Secretary,

Further to my conversation with Sir Walter this morning, I am writing to confirm that the Prime Minister is looking forward to seeing him at 1015 on Tuesday 24 JAnuary for half-an-hour.

I would be grateful if you could let me have a list of the topics Sir Walter wishes to raise with the Prime Minister. Could this please reach us as soon after Christmas as possible.

Yours sincerely,

Mrs. Caroline Ryder

The Private Secretary to
Sir Walter Saloman

8

10 DOWNING STREET

From the Private Secretary

Prime Minister

Sir Walter Salomon would like to come & see you after Christmas. Your diary is getting very overcrowded. agree?

CR

Yes NT

16/12

SIR WALTER SALOMON

KING'S HOUSE
36-37 KING STREET
LONDON EC2V 8DR
TEL. 01-606 4033

4th October, 1983

Dear Prime Minister,

I feel I have to write to you to thank you for your graciousness in coming to our launching party for my new book, "Fair Warning". I must as well thank you for the kind words you said at the opening which really made me blush.

I have sent you a copy of the book and once you have had time to read it you will find that it is along the lines of your philosophy of the market economy, liberty and no inflation, and I hope it will convince a number of doubters.

Once again, many thanks.

Yours ever

Walter Salomon

The Rt. Hon. Mrs. Margaret Thatcher, MP

"FAIR WARNING" BY WALTER SALOMON

DELIGHTED TO BE PRESENT AT THE LAUNCH OF THIS IMPORTANT BOOK.

SIR WALTER'S LAST BOOK "ONE MAN'S VIEW" GAVE US A SET OF FINANCIAL AND ECONOMIC VIEWS WHICH, AT THAT TIME, WERE FAR FROM ORTHODOX.

SIR WALTER'S POWERS OF PERSUASION, AND THE POWER OF THE VIEWS THEMSELVES, HAVE MADE THESE IDEAS COMMON CURRENCY HERE AND ABROAD.

/ SIR WALTER

SIR WALTER IS TIRELESS IN HIS WARNINGS OF THE RUIN WHICH INFLATION WILL BRING TO AN ECONOMY.

I WHOLEHEARTEDLY AGREE.

WE MUST NEVER FALL INTO THE TRAP OF THINKING THAT WE CAN TREAT WITH THIS DEVIL; THAT WE CAN LIVE INDEFINITELY WITH INFLATION AT WHAT PEOPLE CALL THE PRESENT LOWER LEVEL.

AN INFLATION RATE OF 5% HALVES THE VALUE OF OUR MONEY IN 14 YEARS.

WE THANK SIR WALTER FOR HIS INSIGHTS.

I WISH HIS NEW BOOK WELL.

15 September, 1983

Thank you very much for your letter of 15 September with its enclosed letter to the Prime Minister.

I am placing the latter before Mrs Thatcher at the earliest opportunity.

M. C. SCHOLAR

Sir Walter Salomon

SIR WALTER SALOMON

KING'S HOUSE
36-37 KING STREET
LONDON EC2V 8DR
TEL. 01-606 4033

Prime Minister

MIS 15/9 (book sent up to flat.)

15th September, 1983

Dear Prime Minister,

I am delighted that you will honour us with your presence at the launching of my book, "Fair Warning" on 3rd October.

I thought I would send you an advance copy of the book (not to be released until 3rd October) so that you are informed of its contents, and I enclose this herewith.

With kindest regards.

Yours sincerely

Walter Salomon

The Rt. Hon. Mrs. Margaret Thatcher, MP

SIR WALTER SALOMON

KING'S HOUSE
36-37 KING STREET
LONDON EC2V 8DR
TEL. 01-606 4033

15th September, 1983

Dear Mr. Scholar,

I enclose herewith a letter addressed to the Prime Minister and I should be most grateful if you would kindly put it before her at an appropriate moment.

Yours sincerely,

Walter Salomon

Michael Scholar, Esq.

Prime Minister (1)

Isn't this a bit too much?
Agree decline?
MCS 15/7

PRIME MINISTER

SIR WALTER SALOMON'S NEW BOOK

Walter Salomon enquires whether you would possibly look in for a few minutes at the launch of his new book, some time in the autumn.

He says that the book is meant as a great boost for your principles and your policies. From the fragments of it I have read, I would agree that that is the case. But like all Walter's works, it exhibits great shrewdness and insights together with his characteristically dogmatic tone. That is the nature of the man.

I will do, I can. He has been very generous re Alan - indeed without W-S - we should not have had Alan. And his book will be sound and pithy. MCS

ALAN WALTERS
15 July 1983

Tim/

Alan is
telling W.S. No doubt
it will somehow come to
you to arrange.

MCS 18/7

Econ Pol

da

c. Hunt
DM
DI
WOD
FCO

10 DOWNING STREET

THE PRIME MINISTER

21 December 1982

Dear Sir Walter,

Thank you for your letter of 7 December (and for the papers you sent with your letter of 8 December to Caroline Stephens). I much appreciate your kind words.

You raise two important matters in your letters. On the first of these, the railway workers and the last Government's closed shop legislation, I have always made it clear that I fully sympathise with the three railmen and I wholeheartedly welcomed the European Court's ruling in their favour. As you know, we have consistently condemned their dismissals and the iniquitous legislation of the previous Government which allowed the dismissals to take place. However, I do not believe that the Government should, as you suggest, have let the case before the European Court drop when we took office. The fact was that it raised a number of key issues, not least of which was whether the Government was responsible under the terms of the European Convention of Human Rights for the actions of nationalised industries, which the Government thought it essential to argue before the Commission and the Court. It was also crucially important for the Commission and the Court to be fully aware of the changes which the Government was making to the law on the closed shop in order to prevent any repetition of cases of this kind in the future.

As regards the railmen's compensation, the European Court recently awarded them a total of £81,000 for material loss plus £65,000 for legal costs, the latter representing by far the largest award of costs ever made in relation to a case before the European Court of Human Rights. The Court's conclusion was that £65,000

/ represented

8-5

represented the maximum legal costs which were necessarily incurred and reasonable in amount, and, as you may have seen, the Court expressed its concern that unnecessarily high legal costs could be an impediment to other people seeking to exercise their rights under the Convention. In view of the Court's judgement it would, as I think you will appreciate, have been very difficult for the United Kingdom Government to justify paying more in legal costs than the Court ordered.

On the matter of compensation for shipbuilding companies, I know that you feel strongly about our decision not to seek amendment of the compensation terms in the 1977 legislation. I ask you to understand that I did inquire into the circumstances personally, and that careful consideration was given by the Government as a whole before the decision was taken. I understand that you have covered the ground extensively and received answers to your points in exchanges with Patrick Jenkin, and earlier with Sir Keith Joseph.

I will not go over all this ground again, since to do so would be to repeat what you have already heard. I can understand that you nevertheless maintain your own, different views. I can assure you, though, that I have considered the matters you raise, and I trust you will appreciate that the decisions have not been taken easily, or lightly.

Yours sincerely

Margaret Thatcher

Sir Walter Salomon

10 DOWNING STREET

(3)

Prime Minister

Sir Walter Salomon's letter of 7 December

I obtained advice from the Attorney General's, Mr Jenkin's and Mr Tebbit's offices (without disclosing the identity of the author).

They have suggested a very long draft reply (flag A). (I'm afraid they correctly guessed the author, too.) I think the aim of the long draft is to forestall further letters from Sir W Salomon.

I thought you would prefer

PTO

a shorter draft, which looked less as if it had been drafted in Departments.

MLS 20/12

CONFIDENTIAL

Foreign and Commonwealth Office

London SW1A 2AH

16 December 1982

Dear Michael,

Thank you for your letter of 8 December enclosing a paragraph from a personal letter received by the Prime Minister dealing with the closed shop and compensation for nationalisation cases at the European Court of Human Rights.

As requested, I attach a draft passage for inclusion in the Prime Minister's reply produced in conjunction with the Law Officers' Department, Department of Employment and Department of Industry. You may find that the draft is longer than necessary. As we agreed, you will yourself consider how best to adapt it to your needs.

You are probably familiar with the 'closed shop' case. The European Court of Human Rights recently awarded £146,000 to three dismissed railmen, Young, James and Webster in respect of costs and damages flowing from the Court's decision last year that their rights under the European Convention of Human Rights had been violated by their dismissal from BR for refusing to join a Trade Union under the last Government's closed shop legislation.

On compensation for nationalisation of shipbuilding companies, you may find it helpful to have the following background, provided by the Department of Industry.

Sir Walter Salomon's company manages funds which were indirectly invested in Hall Russell, one of the shipbuilding companies nationalised in 1977. Negotiations on compensation had not been completed before the General Election in 1979. In 1980, after discussion between the Prime Minister and Sir Keith Joseph, Cabinet considered and decided that the terms of compensation enacted by the Labour Government should not be amended. Sir Keith announced this to the House on 7 August 1980. Shortly afterwards, the Government negotiated a settlement of compensation for Hall Russell of £1.5m. Although formally an agreed settlement, Hall Russell is one of the nine companies nationalised which are now the subject of complaints to the European Commission of Human Rights alleging breaches of the Convention and seeking increased compensation.

/Sir Walter Salomon

CONFIDENTIAL

Sir Walter Salomon is bitterly opposed to the Government's decision not to amend the terms and has corresponded at length with Mr Jenkin, and with Sir Keith Joseph before that. At a meeting with Mr Jenkin on 2 November, Sir Walter proposed that the Government should stop arguing the cases before the Commission, agree a settlement, and pay all the costs. Mr Jenkin explained that he could not accept or put forward such proposals.

The enclosed draft contribution on these matters is largely self-explanatory. The reference to a letter from the Chairman of the Stock Exchange has been included on the advice of the DOI. This is, I understand, a matter which Sir Walter has raised repeatedly. The amounts being claimed before the Commission in respect of further compensation for shipbuilding and aircraft companies which were nationalised are between £350m and £450m - though there are further claims for interest, inflation and costs - and if there are eventually decisions against the Government there might be implications for other companies which have not complained to the Commission. The Commission have arranged a hearing on some of the issues for the week beginning 24 January 1983. On the wider implications of the legal issues involved, it is worth noting that some of them also arise in relation to the Duke of Westminster's complaint about the Leasehold Enfranchisement Act, which will be considered by the Commission at the same hearing.

I am copying this letter to the recipients of yours.

Yours ever,

(R B Bone)
Private Secretary

M Scholar Esq
10 Downing Street


5 DEC 1982

DSR 11C

I much appreciate your kind words.

Thank you for your letter of 7th December (and for the papers you sent with your letter of 8 December to Caroline Stephens).

Draft Contribution to Letter

NP You raise two important matters in your letter. On the first of these, the British Rail railway workers and the last Government's closed shop legislation,

~~1. As far as the British Rail case is concerned,~~ I have always made it clear that I fully sympathise with the three railmen and I wholeheartedly welcomed the European Court's ruling in their favour. As you know, we have consistently condemned their dismissals and the iniquitous legislation of the previous Government which allowed the dismissals to take place. However, I do not believe that the Government should, as you suggest, have let the case before the European Court drop when we took office. The fact was that it raised a number of key issues, not least of which was whether the the Government was responsible under the terms of the European Convention of Human Rights for the actions of nationalised industries, which the Government thought it essential to argue before the Commission and the Court. It was also crucially important for the Commission and the Court to be fully aware of the changes which the Government was making to the law on the closed shop in order to prevent any repetition of cases of this kind in the future.

As regards the railmen's compensation, the European Court recently awarded them a total of £81,000 for material loss plus £65,000 for legal costs, the latter representing by far the largest award of costs ever made in relation to a case before the European Court of Human Rights. The Court's conclusion was that £65,000 represented the maximum legal costs which were necessarily incurred and reasonable in amount,

/and, as you

and, as you may have seen, the Court expressed its concern that unnecessarily high legal costs could be an impediment to other people seeking to exercise their rights under the Convention. In view of the Court's judgement it would, as I think you will appreciate, have been very difficult for the United Kingdom Government to justify paying more in legal costs that the Court ordered.

On the matter of compensation for shipbuilding companies, I understand that you have covered the ground extensively and received answers to your points in exchanges with Patrick Jenkin, and earlier with Sir Keith Joseph; nevertheless, I consider that it would be useful for me to cover the main points again.

I know that you feel strongly about our decision not to seek amendment of the compensation terms in the 1977 legislation. I ask you to understand that I did inquire into the circumstances personally, and that careful consideration was given by the Government as a whole before the decision was taken. As a party we have deplored retrospective legislation. The decision recognised that it would have been impossible, in retrospective legislation of the kind that would have been necessary, to have provided fairly for those who had dealt in the shares of the companies. Moreover, we considered that in such

/dealings

8

dealings there must be a presumption against change because, although we criticised the legislation in Opposition, we have never made any commitment to change the terms. The further background is that, to my knowledge, there has never been a case where a Parliament altered compensation terms which were the subject of a safeguarding statement and enacted by an earlier Parliament. Our decision was thus based on principle - although we also had to recognise that legislation to amend the terms would not be straightforward and would certainly involve both political controversy and difficulties about the content of legislation.

I appreciate that you have not been able to accept these views, and that you have, for example, cited a letter which the Chairman of the Stock Exchange wrote in 1980 as evidence that the view about the relevance of share transactions is wrong because a selling shareholder cannot argue that the terms on which he sold in the market have been invalidated by subsequent events. I did consider this at the time of the correspondence and my view is that the letter did not bear directly on the decision the Government had to make. The question for the Government was not about the way in which the Stock Exchange operates, but whether we would have a moral responsibility towards the selling shareholder in the event of a retrospective change in compensation terms. Our unequivocal conclusion was that we would. You have also suggested that the 'windfall' tax on banks was retrospective and creates a precedent for changing the nationalisation and compensation

8

terms. We do not accept this. Contrary to the present position on nationalisation compensation the banks were told well in advance that a special tax was under consideration.

As your meeting with Patrick Jenkin on 2 November, and in l later correspondence, you proposed that the Government should present 'no defence' in the current proceedings before the European Commission of Human Rights on a number of applications concerning compensation for nationalisation. Patrick Jenkin has already informed you that he finds that proposal unacceptable. We have long ago taken a considered decision not to amend the terms of compensation, as I have explained above, and there is nothing in the applications to the Commission which would justify re-consideration. It follows that we must continue to contest these applications in the context of our announced policy. Further, we do not accept, as a matter of law, that the 1977 legislation, and what was done under it, involved a violation of the UK's legal obligations under the Convention. We could not, therefore do other than resist the applications made to the Commission.

/You have

You have also suggested that the Government should pay the expenses of those who have made application to the Commission, in the same way that the Government paid the expenses of stockholders' Representatives during the compensation negotiations. Payment of the Stockholders' Representatives' remuneration and expenses was provided for under the 1977 legislation. The circumstances of the applications made to the Commission are in no way similar, and, given the view which we take about the lack of foundation for the complaints of violation of the Convention, your proposal is not one we can accept.

~~Much of what I have said,~~ you have already heard ~~and~~ I can understand that you ~~have~~ nevertheless ~~chosen to~~ maintain your own, different views. I can assure you, though, that I have considered the matters you raise, and I trust you will appreciate that the decisions have not been taken easily, or lightly.

I will not go over all this ground again, since to do so would be to repeat what

Ecar Pol

Correspondance from Solomas

May 79

SIR WALTER SALOMON

KING'S HOUSE
36-37 KING STREET
LONDON EC2V 8DR
TEL. 01-606 4033

8th December, 1982

Dear Caroline,

Further to my letter to you dated 7th December and in order to make it easier for the Prime Minister to evaluate the situation, I enclose herewith copies of the following letters:

1. My letter to Mr. Patrick Jenkin dated 3rd November, 1982
2. Mr. Jenkin's letter to me dated 19th November, 1982
3. My letter to Mr. Jenkin dated 25th November, 1982
4. His letter to me dated 6th December, 1982
5. My letter to him dated 8th December, 1982

I should be most grateful if you would add this copy correspondence to the letter which I sent you yesterday.

Kind regards

Yours sincerely

Walter

Miss Caroline Stephens

SIR WALTER SALOMON

KING'S HOUSE
36-37 KING STREET
LONDON EC2V 8DR
TEL. 01-606 4033

8th December, 1982

The Rt. Hon. Patrick Jenkin, MP.,
Secretary of State for Industry,
Ashdown House,
123 Victoria Street,
London, SW1

Dear Secretary,

Thank you for your letter dated 6th December, 1982. This letter makes it quite clear that neither you nor your officials are prepared to listen to reasoned argument; neither are you prepared to answer any reasonable questions and clarify points which arose during our meeting on 2nd November. In the circumstances, it is my duty in the public interest to pursue the matter through other channels.

I hope you saw on BBC television at 11.30 last evening a programme in which Sir John Hoskyns was interviewed by David Dimbleby. It was very relevant to the subject matter.

Yours sincerely,

Walter Salomon

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB

Telephone *Direct Line* 01-212 3301
Switchboard 01-212 7676

JU350
Secretary of State for Industry

6 December 1982

Sir Walter Salomon
Chairman
Rea Brothers Ltd
36-37 King Street
London EC2V 8DR

Dear Sir Walter,

I have received your further letter of 25 November following mine of 19 November.

In the course of our correspondence from October 1981, and at our meeting on 2 November, I have considered what you have said about compensation for nationalisation under the Aircraft and Shipbuilding Act, 1977. I have examined the background to points you have raised, I have explained my conclusion and tried to leave you in no doubt about my views, and I have given you my answer on the proposals you made at our meeting. My predecessor as Secretary of State also corresponded with you in some detail. You have, if I may say so, made it abundantly clear to me - in terms that I do not recollect ever having received from any other correspondent - that you disapprove of the Government's decision not to alter the compensation paid under the Act. Equally, I feel that the Government's considered decisions have been made plain. As you are aware, applications have been made to the European Commission of Human Rights in connection with some of the compensation paid, and the Government intend to continue to contest these applications in the proceedings before the Commission. In all the circumstances, I do not consider that it would be useful - or, in some respects, even appropriate - for me to add anything to our earlier corespondence and discussion.

Yours ever

Patrick Jenkin

NS - Econ Cut

SIR WALTER SALOMON

KING'S HOUSE
36-37 KING STREET
LONDON EC2V 8DR
TEL. 01-606 4033

25th November, 1982

The Rt. Hon. Patrick Jenkin, MP.,
Secretary of State for Industry,
Ashdown House,
123 Victoria Street,
London, SW1

Dear Mr. Jenkin,

I have received your letter of 19th November in reply to mine of 3rd November.

I would have thought the delay in answering was due to your making detailed enquiries with regard to the questions raised in my letter. Apparently that was not so because, almost studiously, your reply avoided dealing with the very specific questions and observations which I made. The only new point in your letter is that you say I am wrong to suggest that you had not previously seen the correspondence. I made this remark only because you specifically said so during our meeting on 2nd November, 1982, at which my Assistant, Mr. Trevor Edwards, was present. It may be that, on reflection, you now recall having seen the correspondence.

You have, no doubt, read the article published in the Financial Times last week by Mr. John Elliott, the Industrial Editor, regarding your Department. One might assume that his assessment that after the departure of Sir Keith Joseph the Department had low morale and no real role to play may still be correct. I cannot personally see any logic in the attempts at the self-justification of yourself and your officials reflected in that article, but it might explain the total disregard in dealing in substance with letters such as mine.

In order now to avoid any further misunderstanding, I am enclosing a memorandum which will perhaps help you, or your officials to deal now with the subject.

I regard this matter as one of considerable public interest, not only because of the matter itself, but also on account of the way in which the public is being treated by Government Departments

Yours sincerely,

Walter Salomon

b.c. Professor Alan Walters

MEMORANDUM

of Points requiring Answers

1. Letters from Chairmen of The Stock Exchange and Investment Protection Committee

You say that you studied these letters towards the end of 1981, although at the meeting of 2nd November, 1982, you clearly stated that you were unfamiliar with them. You said that certain subsequent explanations were given by "Ministers of Government". You have not included copies of these and it would be interesting to see these copies. They are, no doubt, written by politicians who believe that they understand the workings of the securities markets better than the experts.

The point made in my letter of 3rd November, 1982, was that we had been informed that the decision not to reconsider compensation payable had been taken by full Cabinet. No doubt at that time the Cabinet was not aware of the views of the Chairmen of The Stock Exchange and Investment Protection Committee and could not have taken them into account. You do not shed any light on this in your letter.

In my letter of 3rd November, 1982, the Department's detailed reasons for rejecting the views of Sir Nicholas Goodison and Mr.Tom Hayes were requests. These have not been received, and I am now expecting to receive them.

2. "Windfall" Tax

You refer to Sir Keith Joseph's letter of 22nd July, 1981, which included a parliamentary report of a speech by Mr. Leon Brittan seeking to justify the "Windfall" tax. I replied both in a telephone conversation and in writing to Sir Keith ending my letter as follows:-

"To try to make out that the windfall tax on the banks is not retrospective legislation is an insult to the intelligence of the ordinary man and woman".

3. Legal Advice received through the Attorney General

At the meeting on 2nd November, 1982, and in my letter details of the advice received from the Attorney General regarding the feasibility of offering no defence in Strasbourg were requested. You have ignored these requests and I am now expecting to receive these details.

4. Payment of professional expenses by plaintiffs

You do not refer to this except to state that you could not accept the proposals made at the meeting. I refer you to the second paragraph of my letter in which I state that you seemed to have a closed mind regarding this issue. My views seem to have been borne out by the manner of your response. I would like to have your detailed reasoning why you have turned down my request.

WHS
25th November, 1982

c.c. Prof. Alan Walters

NS - Eur - Court

JU168

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
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LONDON SW1E 6RB
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Secretary of State for Industry

19 November 1982

Sir Walter Salomon
Chairman
Rea Brothers Ltd
36-37 King Street
London EC2V 8DR

Dear Sir Walter,

You wrote to me on 3 November, following our discussion on 2 November.

I am sorry that you should view our discussion in the terms you did, but there is little I can usefully add to that discussion and my earlier letters. The Government's decision that there is no satisfactory way of amending the compensation terms under the Aircraft and Shipbuilding Industries Act, 1977, was not taken lightly. It follows that - as I explained - I cannot accept the proposals you made at our meeting.

On the "windfall" tax, my predecessor as Secretary of State - Sir Keith Joseph - wrote to you on 22 July 1981 about the reasons for the Government's view that the normal objections to retrospective legislation did not apply in that particular case. Nor is there anything new in the copies of letters you enclosed from the Chairman of the Stock Exchange and the Chairman of the National Association of Pension Funds. Both Chairmen subsequently received explanations from Ministers of the Government view that the question here is not about how the Stock Market operates, but about the responsibility of the Government towards a selling shareholder in the event of a retrospective change in compensation terms. You are wrong to suggest that I have not previously seen this correspondence. I did study it, along with the other papers, when you wrote to me about these matters towards the end of 1981.

Yours ever

Patrick Jenkin

SIR WALTER SALOMON

KING'S HOUSE
36-37 KING STREET
LONDON EC2V 8DR
TEL. 01-606 4033

3rd November, 1982

Patrick Jenkin, Esq., MP.,
Secretary of State for Industry,
Ashdown House,
123 Victoria Street,
London, SW1

Dear Secretary of State,

I cannot recall ever having left a meeting with a Minister or Government official in such a disenchanted frame of mind as I did after my meeting with you yesterday. Of course, I do not mind the fact that you did not wear a jacket to receive someone whom you had never previously met, but if this were meant to demonstrate the hard work you are doing in solving problems, it did not convince me.

I came away from the meeting convinced that right from the beginning you had a closed mind regarding the whole subject, and furthermore I doubt that you had been properly briefed by your officials.

I raised two points:(1) that it was only fair and equitable for the Government to pay (as it did when we had a Stockholders Representative) all the reasonable professional expenses incurred in the shipbuilders' endeavours regarding the European Commission and Court. This proposal you turned down out of hand.

and (2) that the suggestion made by Lord Harris of High Cross in the House of Lords on 11th Feburary, 1982, be taken up, and I quote:

> My Lords,, may I try to help the noble Lord in a rather tight spot? May I ask this? In view of the harsh words the noble Lord himself uttered at the time of nationalisation, in which he said the compensation terms were having a disastrous effect upon confidence, would he personally urge his colleagues that the course of honour might be to present these terms to the European Commission without defence and allow the proceedings to go forward, I hope to the stage known as a "friendly settlement"?"

Again, this proposition was turned down flat.

The reason given in this case was that you had taken legal advice through the Attorney General and had been advised against it. I would be greatly interested to know the details of the advice you sought and the terms of the negative answer you received because according to my own research there can be no valid case for this at all. Stealing remains stealing.

Furthermore, you told me you did not want to re-open a matter which had been decided by the full Cabinet. It seems to me that a number of new points have arisen which might not have been before the Cabinet at the time.

1. As we discussed yesterday the introduction of the "Windfall" tax showed the argument regarding retrospective legislation used by your predecessor, Sir Keith Joseph, was invalid - and I personally informed him that I could devise a proper method by which this would not be necessary in any case - and as you said yourself yesterday no government can bind its successor.

2. You claimed (as did Sir Keith) that there would be a problem from the practical Stock Exchange point of view regarding the payment of fair compensation. Apparently your officials have not put before you either of the letters from the Chairman of The Stock Exchange, or the Chairman of the Investment Protection Committee, and I am enclosing for your perusal copies of both. I think it is essential that your Department should provide us with detailed reasons why they believe Sir Nicholas Goodison and Mr. Heyes to be wrong so that they are at least given the right to reply.

Of course, it makes one wonder what other evidence your officials have not put before you.

I do not know whether you have had sight of a letter which was published in The Times on Monday, 1st December, 1980 under my name and that of Sir Ralph Bateman. That letter still sums up the subject matter ideally.

Furthermore, I do not know what information has been put before the Prime Minister but if one is to go by the latest lecture given by Sir John Hoskyns at The Institute for Fiscal Studies on 12th October, 1982, (I enclose a copy in case you have not seen it), it looks as though the information she receives from her Ministers direct, or through the Civil Service, has not always been complete.

I personally think that the handling of this matter has been and remains a public scandal and that a Conservative Minister or Government should lend a hand in perpetrating it is very discouraging indeed. What can we expect if a Labour Government should come into power?

I hope you will agree that this letter deserves a reply in writing to each of the points which I have raised.

Yours sincerely,

Richard Body

CONFIDENTIAL

Econ. Pol.

10 DOWNING STREET

From the Private Secretary

8 December 1982

The Prime Minister has received a personal letter in which the following passage occurs:

> "It is unacceptable that someone like yourself should not be behind the railway workers who went to the European Court to claim their rights; it is equally unacceptable that someone like yourself should not have wanted to stop what amounted to stealing in the terms of the compensation awarded for expropriated shipyards .... That a government under your leadership should go out of its way to defend before the European Court these matters (which were originally introduced by the Socialists) is totally incomprehensible to the ordinary man and woman in the street who knows anything about it, and it certainly undermines the confidence which people have in your leadership .... It was my suggestion to the Secretary of State, and you have a copy of my original letter, that the British Government should offer no defence at the European Court and should pay all litigants their expenses in connection with the case."

I would be grateful if you, in conjunction with Jonathan Spencer and Barnaby Shaw* to whom I am copying this letter, would let me have a draft passage for inclusion in the Prime Minister's reply to this letter, by Wednesday 15 December.

M. C. SCHOLAR

* and Jim Nursaw (LOD)

Roger Bone, Esq.,
Foreign and Commonwealth Office.

da

10 DOWNING STREET

From the Private Secretary

8 December 1982

Thank you for your letters of 7 and 8 December addressed respectively to the Prime Minister and to me. I will show them to the Prime Minister immediately. She will, I am sure, be replying to you as soon as possible.

CAROLINE STEPHENS

Sir Walter Salomon

File

885

7 December 1982

I am writing to acknowledge your letter of 7 December to the Prime Minister which I will ensure is put in her box for this evening.

CAROLINE STEPHENS

Sir Walter Salomon.

SIR WALTER SALOMON

KING'S HOUSE
36-37 KING STREET
LONDON EC2V 8DR
TEL. 01-606 4033

7th December, 1982

Dear Caroline,

I enclose herewith a letter addressed to the Prime Minister. I should be most grateful if you would kindly put it before her at an opportune moment.

Kind regards

Yours sincerely

Walter

Miss Caroline Stephens

Prime Minister

Would you like me to draft a reply for you, based on material from Mr Jenkin's and Mr Tebbit's offices?

MCS 7/12

SIR WALTER SALOMON

KING'S HOUSE
36-37 KING STREET
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TEL. 01-606 4033

7th December, 1982

Dear Mrs Thatcher,

I am, as you know, one of those who have an unbounding faith in your leadership which now goes far beyond the frontiers of this country. Wherever I travel I hear "I wish we had a Margaret Thatcher". But it is not only your leadership which people admire - they admire as well your integrity, your common sense, and your incorruptibility by cheap options.

The next General Election will be won by you and you alone for the qualities which I have just mentioned, but there can be no doubt in my mind that even amongst your so-called close allies within the Party there are many with daggers hidden who would not hesitate to use them given a chance. As I said to Alan Walters the other day, what you need is a Praetorian guard.

One of the subversive measures being taken by your opponents is that they are trying by administrative measures to cast doubt on your integrity. It is unacceptable that someone like yourself should not be behind the railway workers who went to the European Court to claim their rights; it is equally unacceptable that someone like yourself should not have wanted to stop what amounted to stealing in the terms of the compensation awarded for expropriated shipyards. On the latter subject I have some experience of the behaviour of your Secretary of State for Industry, Patrick Jenkin, and his civil servants. In this connection I have sent either to you or Alan Walters a copy of the correspondence setting out what really happened. In case you have not already seen it, I thought you might like to see a copy of an article which appeared in the Sunday Times of 5th December in which the Political Editor (certainly not my pet commentator) referred to both the closed shop and the compensation to the shipyards.

That a government under your leadership should go out of its way to defend before the European Court these matters (which were originally introduced by the Socialists) is totally incomprehensible to the ordinary man and woman in the street who knows anything about it, and it certainly undermines the confidence which people have in your leadership.

I have to mention that I have an interest in the shipyards case because I represent one of them. It was my suggestion to the Secretary of State, and you have a copy of my original letter, that the British Government should offer no defence at the European Court and should pay all litigants their expenses in connection with the case.

I am quite willing, if you so desire, to explain the situation to you in detail. As the British Government has to give a reply to the European Court by the end of the month there is no time to be lost.

Yours ever

Helmut Schmidt

The Rt. Hon. Mrs. Margaret Thatcher, MP

Thatcherism let loose

SUNDAY TIMES 5.12.82

Inside Politics

by HUGO YOUNG
Political Editor



AFTER THE country, the globe. This is Mrs Thatcher's new promise. The Conservative party is thinking big about what it will do when it has won the next election. Some of the prime minister's thoughts are evidently more specific. The stables having been cleansed at home, Hercules turns to the far horizon.

Reactions to this prospect may be somewhat divided. Mrs Thatcher is already the elder statesperson of the European Community. She has been in power less than four years, but longer than anyone else. Five years further on, she would enjoy such permanence, by comparison with other leaders, as to resemble nothing so much as the Queen herself, agelessly enduring as prime ministers flicker in and out.

Such experience, it is said, would give her matchless authority. She could name her own foreign policy and read the world her lectures. Moreover, it is added, the moment has met the woman. As the world succumbs to ever larger gestures of nationalism, how fortunate that Britain should have a leader better equipped than any of her predecessors to amplify and make the most of that narrow tendency.

And this, in one way, is true. Nationalism is the curse of our age. It is probably going to get worse, maybe not through war but by a steady withering away of international structures and ideals. The failure of the Gatt talks is followed by the insidious wrecking (Britain to the fore) of the Law of the Sea treaty-draft. Some people may feel that, as peaceful hostilities intensify, short-term national victory is preferable to long-term world agreement.

But others will view the foreign visions of Thatcherism rather differently. Precisely because of the burgeoning of nationalism across the globe, a leader already so imbued with nationalist prejudice seems regrettable – and not just because of easy cant about the global village and the world community.

TAKE THE matter of human rights. It is a symbolic touchstone. Typical Conservative attitudes cover a spectrum of hostility. At the extreme is the school of Enoch Powell, who has said, in so many words, that anyone who starts a case under the European Convention on Human Rights is committing treason.

Such rights, say the Powellites, do not exist. With his customary gift for understatement, the old man himself once described any talk about them as "a stringing together of sound without rational meaning".

The present government is rather less emphatic. But its gut tells it the same thing. English law is quite satisfactory, and only by past aberrations have international and European human rights conventions been allowed to get in on the act.

Ministers go to extraordinary lengths to show their discomfort and unease whenever these rights are feared to exist. Mr Whitelaw's wriggling last week may not have been very surprising, but it revealed a state of mind. He had been pushed, only by the European Human Rights Commission, into admitting male as well as female fiances as immigrants. But under political pressure, even this niggardly compliance with an international duty was whittled down.

Much more indicative has been the Tory attitude on matters close to the heart of Thatcherism, of which two are conspicuous. The first was the case brought by three railwaymen against British Rail's closed shop. Far from supporting this appeal, when they took over the case in 1979, the Tory law officers continued to fight it in Strasbourg.

Secondly, the Tory government is fighting tooth and nail a demand for adequate compensation for Labour's nationalisation of shipyards. Almost incredibly, the full weight of the legal machine is being mobilised to crush the yards' claim that they have a case under the Convention. Even property rights, it seems, are not to be protected, if the case depends on – God forbid! – an international body of rules.

To be fair, the Tories are not alone. The Labour government was just about as bad, and officials are active accomplices. But Labour at least has the excuse that individual rights are not the party's primary interest. For Conservatives to be so mulishly hostile shows how deep has gone the worm of nationalism – and how very selective is their respect for law.

For law is what human rights have become. Not many people have noticed it, but they have ceased to be an optional extra. A new book, The International Law of Human Rights, by Paul Sieghart, will be published next month by the Clarendon Press; it collects for the first time the texts of these arduous endeavours which demonstrate that human rights exist, duly ratified by many states, as legal obligations, not moralising waffle.

Britain has been a pious ratifier of conventions. Perhaps someone should show Enoch, to calm his fever. Certainly someone should remind the prime minister, before every nation – with or without its household economics and its glorious common law – is told that it is sufficient unto itself. For, in an ever meaner world, this particular dimension of internationalism should appeal to the very values Mrs Thatcher upholds.

FOR ONE THING, these conventions, however lightly regarded in London, are taken more seriously elsewhere. In authoritarian states, for example. In parts of Latin America it matters quite a lot that a body of human rights law exists, to provide a toehold on freedom and tolerance. Similarly, it was Czechoslovakia's ratification of the International Covenant on civil and political rights which fortified and, for a time, protected, the Charter 77 group of dissidents.

Progress is horribly slow. But for Western countries, living in political freedom, to ignore or quietly sneer at conventions on which less favoured people depend for a glimmer of hope seems shockingly perverse. And there is another reason to uphold them, with appeal to the most insular soul.

Nationalisation may come again. The self-confidence of modern Conservatism deems that it cannot. But that is a very reckless prediction. Labour has moved a long way from the cosiness of Wilsonism. Next time the state moves in, it may be to seize property with even less compensation than the shipbuilders got. Without much doubt, it will set about abolishing private education.

The international human rights apparatus would, in that event, be a court of last resort. Tories, not to mention the average citizen, might be very glad of it. Here, as abroad, it is when the night is darkest that such perception is clearest. Surprisingly – but, when you think about it, not surprisingly at all – it is from Northern Ireland that the insistent call has come to make the human rights convention a fully-fledged part of British law.

This has not happened. On the mainland, we do not have to care enough. Nor do we really believe, any longer, in constructive internationalism. Too many people scoff at the language. With the globe at her feet, would Mrs Thatcher continue to look proudly at our navel?

Prime Minister

MLS 9/11

DEPARTMENT OF INDUSTRY
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JU120
Secretary of State for Industry

9 November 1982

Michael Scholar Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1

Dear Michael,

PRIME MINISTER'S MEETING WITH SIR WALTER SALOMON ON WEDNESDAY 10 NOVEMBER

Since we now understand that the Prime Minister has a meeting tomorrow morning with Sir Walter I am forwarding the brief which our officials had prepared for her lunch with industrialists on Friday but which will serve equally well for tomorrow. Since there has not been time to show the brief to our Secretary of State I propose to let him see it in his box overnight and phone you with any comments he may have first thing tomorrow morning.

Yours ever,

Caroline Varley

CAROLINE VARLEY
Private Secretary

BRIEF: PRIME MINISTER'S MEETING WITH SIR WALTER SALOMON

NATIONALISATION COMPENSATION

1. Sir Walter Salomon, Chairman of Rea Brothers, has campaigned against the Government's "scandalous" decision not to alter the terms of compensation for companies nationalised under the Aircraft and Shipbuilding Industries Act, 1977. He has expressed his views publicly and to Ministers - most notably to Sir Keith Joseph and to the present Secretary of State for Industry. Mr Jenkin made a point of meeting Sir Walter on 2 November but neither this nor earlier explanations seem to have had any effect on Sir Walter's fixed views. Sir Walter said he would speak with the Prime Minister on 12 November.

BACKGROUND

2. Sir Walter's company manages funds which had investments in the owners of one of the shipbuilding companies nationalised - Hall Russell. On taking office, the Government considered in Cabinet and decided against amending the terms of compensation. Sir Keith Joseph explained this to the House on 7 August 1980 and noted that amending legislation to establish new compensation terms retrospectively would be unjust to those who sold shares on the basis of the 1977 terms. Shortly afterwards, £1.5m compensation was negotiated and paid for Hall Russell.

3. Former owners of 9 of the companies nationalised - including Hall Russell - have since applied to the European Commission of Human Rights, claiming breach of the Convention and increased compensation. The Hall Russell claim is for a further £2m (plus interest and inflation adjustment from 1977). Total claims are about £300m (plus interest etc). The Government is contesting the claims not just because of the cost but because they do not accept the applicant's view of the law which, if uncontested could have very wide and damaging implications. Some of the same issues arise also in the case brought by the Duke of Westminster on leasehold enfranchisement.

4. The applications are at an early stage. The Commission will first have to decide whether the applications (or some part) are admissible and, if they are, to form an initial view on their legal merits. In the light of that view, it would explore whether there is a possibility of friendly settlement. If that

is not possible, it would report to the Committee of Ministers of the Council of Europe whether it thinks that there has a been a violation of the Convention. Either the Commission or the Government may then have the cases referred to the European Court of Human Rights. Failing that, the Council of Ministers would deal with them on the basis of the Commission's Report.

BRIEF

5. At the meeting on 2 November, the Secretary of State felt unable to accept suggestions from Sir Walter that the Government should not contest the applications before the Commission, and should pay all costs of applicants. Sir Walter feels that the compensation was unfair, that the decision not to amend it is a breach of Conservative principles, and that Ministers have acted in ignorance and without due consideration. He considers that the reasons given for the decision are bogus. The detailed issues are now for consideration before the Commission but the following may be helpful on Sir Walter's broader points:

(i) The compensation terms were criticised in Opposition but no undertaking was given about amending them.

(ii) Even if he disagrees with the decision, Sir Walter should credit Ministers with having considered carefully, including political aspects. The Prime Minister has in the past enquired personally into the background and Sir Walter should not think that she is unaware of the circumstances.

(iii) The Government decided reluctantly, as a matter of policy, that the best course is not to amend the 1977 legislation, and that decision stands. But quite apart from the policy question, the Government do not accept - as a matter of law - that the 1977 legislation, and what was done under it, involved a violation of the UK's legal obligations under the convention. The Government could not properly, therefore, do other than resist the applications made to the Commission.

(iv) The point that amendment of the 1977 legislated terms would be unjust to those who sold shares on the 1977 terms is a good one. Sir Walter argues that the Chairman of the Stock Exchange did point out that a seller must accept that subsequent events do not invalidate a sale; but as Sir Keith

Joseph explained in reply, this is not a point about the working of the market but a question about moral responsibility if a retrospective change was made by the Government.

(v) The fact that the "windfall tax" on banks has been described as having an element of retrospection does not mean that retrospection on compensation - or anything else - should be automatically accepted. There is a difference between a need to cope with windfall profits, and retrospective amendment of legislation concerning compensation which was approved by Parliament. Moreover, the banks were told far in advance that a special tax was under consideration, and it is quite usual for current tax liabilities to be calculated by reference to previous periods - as with Corporation Tax.

(vi) The Government decision was not made gladly, but it was not made lightly either and the Government cannot be expected to settle with, or finance, those who choose to contest the Government's considered policy.

(vii) The Government have made every effort to lodge with the Commission, without any avoidable delay, the extensive pleadings necessitated by these 9 separate but inter-related applications. The Commission has now set the first confidential hearings on some of the issues for 24-27 January.

Department of Industry
November 1982

Econ Pol

BE

10 DOWNING STREET

I suggest you read Sir W Salomon's letter. I have asked for a short brief on this topic.

MLS 4/11

1. MR. SCHOLAR

2. PRIME MINISTER

CP.

4 November 1982

Thank you very much for your letter of 3 November and for enclosing a copy of your letter to Patrick Jenkin.

I will ensure the Prime Minister sees this correspondence before her meeting with you next week.

CAROLINE STEPHENS

Sir Walter Salomon

[redacted]R WALTER SALOMON

KING'S HOUSE
36-37 KING STREET
LONDON EC2V 8DR
TEL. 01-606 4033

3rd November, 1982

Dear Caroline,

I have, as you know, an appointment with the Prime Minister on Wednesday, 10th November.

A matter has, in the meantime, arisen which I had not originally intended to bring up during my interview with the Prime Minister but about which I feel strongly she should be informed. In order to acquaint her with the subject I am enclosing herewith a copy of a letter which I have today written to Mr. Patrick Jenkin, the Secretary of State for Industry. I should be obliged if you would put it before the Prime Minister at the earliest moment.

Kind regards

Yours sincerely

Miss Caroline Stephens

SIR WALTER SALOMON

KING'S HOUSE
36-37 KING STREET
LONDON EC2V 8DR
TEL. 01-606 4033

3rd November, 1982

Patrick Jenkin, Esq., MP.,
Secretary of State for Industry,
Ashdown House,
123 Victoria Street,
London, SW1

Dear Secretary of State,

I cannot recall ever having left a meeting with a Minister or Government official in such a disenchanted frame of mind as I did after my meeting with you yesterday. Of course, I do not mind the fact that you did not wear a jacket to receive someone whom you had never previously met, but if this were meant to demonstrate the hard work you are doing in solving problems, it did not convince me.

I came away from the meeting convinced that right from the beginning you had a closed mind regarding the whole subject, and furthermore I doubt that you had been properly briefed by your officials.

I raised two points:(1) that it was only fair and equitable for the Government to pay (as it did when we had a Stockholders Representative) all the reasonable professional expenses incurred in the shipbuilders' endeavours regarding the European Commission and Court. This proposal you turned down out of hand.

and (2) that the suggestion made by Lord Harris of High Cross in the House of Lords on 11th Feburary, 1982, be taken up, and I quote:

> My Lords,, may I try to help the noble Lord in a rather tight spot? May I ask this? In view of the harsh words the noble Lord himself uttered at the time of nationalisation, in which he said the compensation terms were having a disastrous effect upon confidence, would he personally urge his colleagues that the course of honour might be to present these terms to the European Commission without defence and allow the proceedings to go forward, I hope to the stage known as a "friendly settlement"?"

Again, this proposition was turned down flat.

The reason given in this case was that you had taken legal advice through the Attorney General and had been advised against it. I would be greatly interested to know the details of the advice you sought and the terms of the negative answer you received because according to my own research there can be no valid case for this at all. Stealing remains stealing.

Furthermore, you told me you did not want to re-open a matter which had been decided by the full Cabinet. It seems to me that a number of new points have arisen which might not have been before the Cabinet at the time.

1. As we discussed yesterday the introduction of the "Windfall" tax showed the argument regarding retrospective legislation used by your predecessor, Sir Keith Joseph, was invalid - and I personally informed him that I could devise a proper method by which this would not be necessary in any case - and as you said yourself yesterday no government can bind its successor.

2. You claimed (as did Sir Keith) that there would be a problem from the practical Stock Exchange point of view regarding the payment of fair compensation. Apparently your officials have not put before you either of the letters from the Chairman of The Stock Exchange, or the Chairman of the Investment Protection Committee, and I am enclosing for your perusal copies of both. I think it is essential that your Department should provide us with detailed reasons why they believe Sir Nicholas Goodison and Mr. Heyes to be wrong so that they are at least given the right to reply.

Of course, it makes one wonder what other evidence your officials have not put before you.

I do not know whether you have had sight of a letter which was published in The Times on Monday, 1st December, 1980 under my name and that of Sir Ralph Bateman. That letter still sums up the subject matter ideally.

Furthermore, I do not know what information has been put before the Prime Minister but if one is to go by the latest lecture given by Sir John Hoskyns at The Institute for Fiscal Studies on 12th October, 1982, (I enclose a copy in case you have not seen it), it looks as though the information she receives from her Ministers direct, or through the Civil Service, has not always been complete.

I personally think that the handling of this matter has been and remains a public scandal and that a Conservative Minister or Government should lend a hand in perpetrating it is very discouraging indeed. What can we expect if a Labour Government should come into power?

I hope you will agree that this letter deserves a reply in writing to each of the points which I have raised.

Yours sincerely,

Gerard Vaughan

The National Association of Pension Funds

PRUDENTIAL HOUSE
WELLESLEY ROAD
CROYDON CR9 9XY
Tel. 01-681 2017

INVESTMENT PROTECTION COMMITTEE

Secretary: B. W. Lofthouse A.C.I.S.

14 October 1980

The Rt. Hon. Sir Keith Joseph, P.C., M.P.,
Secretary of State for Industry,
Department of Industry,
123 Victoria Street,
London, SW1E 6RB.

Dear Secretary of State,

SHIPBUILDING NATIONALISATION TERMS

I write concerning the statement you made in the House on 7 August 1980 concerning legislation to enable the nationalised shipbuilding and shiprepairing companies to be offered back to private enterprise. In this statement you re-affirmed your view that the compensation terms imposed by the 1977 Act were grossly unfair to some of the companies, but said that the injustice could not be put right on the grounds that legislation to establish new compensation terms retrospectively would be unjust to the many people who had sold shares on the basis of the previous terms.

The Committee of which I am Chairman is formed of the four institutional investor associations, many of whose members held shares in the companies concerned, or in their holding companies, and many of these holdings may have been sold since the nationalisation legislation was enacted. Nevertheless we reject the argument advanced in your statement for refusing to put forward legislation amending the compensation terms. It is an established principle of the stock market that the current price of a share reflects all the known facts and expectations of the company concerned at that time. If those expectations are subsequently changed by legislation or otherwise, no shareholder who has sold in the meantime has any reason to feel aggrieved. There have been countless instances where this has occurred. In the case of the shipbuilding companies, one of the expectations was that an incoming Conservative Government, in view of its statements when in opposition, might amend the compensation terms in the 1977 Act.

The members of my Committee are therefore of the opinion that no adequate reason has yet been given to support your decision that the injustices suffered by some of the companies under the 1977 Act cannot now be put right.

Yours faithfully,

T. Heyes
Chairman
Institutional Shareholders' Committee

THE STOCK EXCHANGE

[redacted] P GOODISON
CHAIRMAN

LONDON, EC2N 1HP
TELEPHONE 01-588 2355
TELEX 886557
TELEGRAMS STOCKEX LONDON EC2

18th September, 1980

Dear Mr Willett

Compensation under the Aircraft and Shipbuilding Industries Act 1977

Thank you for sending me a copy of Sir Eric Yarrow's letter of 12th September about the possibility of amending legislation to establish new compensation terms for businesses nationalised under the Act.

I entirely agree that Sir Keith Joseph's explanation is not valid. The Government admit that they share the commonly-held view that the compensation terms were grossly unfair to some of the companies. But it is irrelevant to argue that such injustices cannot be rectified because many shareholders will already have sold their shares on the basis of the original terms. The argument has no validity in the context of the stock market. Dealings take place on the basis of full disclosure of all relevant information as it exists at the time of dealing. Investors may be influenced in their dealing decision by many facts, hopes or fears. These include political considerations. Everyone was fully aware of the possibility of a change of Government, and might have reasonably hoped for a re-consideration of the compensation terms under the Act. Those who have already sold are likely to have considered this possibility. But whether or not this was so in any particular instance, a selling shareholder cannot argue that the terms on which he sold in the market have been invalidated by subsequent events. Were it otherwise, the stock market could not operate. The Minister must understand the working of the market sufficiently well to appreciate this. In my view, his argument has no foundation in either market logic or practice.

Yours sincerely

Nicholas Goodison

G.H. Willett Esq.,
Grieveson Grant & Company.

LETTERS TO THE EDITOR

Nationalization and compensation

From Mr Walter Salomon and Sir Ralph Bateman

Sir, The Secretary of State for Industry has agreed (statement, August 7, 1980) that the compensation terms under the Aircraft and Shipbuilding Industries Act are "grossly unfair".

It is now approaching seven years since the end of the so-called "reference period" of six months to February 28, 1974, the date for the valuation of the businesses nationalized. There were 19 such shipbuilding businesses and compensation was to be based on the average Stock Exchange share prices at that time even though it was known that only one of the businesses concerned had its ordinary shares directly listed in the market; the other 18 had to be valued quite hypothetically as if they had been listed in that totally unrepresentative period.

It is little wonder that nearly seven years later there are still many of those businesses which cannot stomach the outrageous terms, and have either gone to arbitration, where they can expect cold comfort, since the arbitrators are not allowed to be independent under the Act, or are considering action under the Human Rights Convention.

If such terms had been imposed on foreigners they would be a flagrant breach of the Washington Agreement, ratified by the United Kingdom in 1966, which requires that compensation should be (a) paid to the dispossessed owner, (b) sufficient to enable the owner to replace the lost asset with one equivalent, and (c) calculated at the date of dispossession. Only foreigners, however, are accorded such proper respect for their property. The long-suffering British, accustomed to expropriation under socialist administrations, are now to be denied yet again, and under a Conservative Government, anything remotely resembling fair redress.

The promises that were made by the Conservatives in their manifesto were quite unequivocal. While in Opposition the Conservatives said that the compensation terms were unconscionable, and ought to be based on values at the date of vesting, ie at the date of dispossession. Now it seems that the Cabinet has reneged both on the manifesto commitment to offer to sell back the shipyards, and on the application of fair compensation under the Washington Agreement, using the excuse that it would involve "retrospective legislation".

To invoke the bogeyman of "retrospective legislation" serves merely to frighten the naive and to obscure the injustice. And we have it on the authority of the Chairman of the Stock Exchange that the implication of the use of the word "retrospective" by Sir Keith Joseph is not valid, and that his "argument has no foundation in either market logic or practice".

This view has been supported by leading groups representing institutional and other investors who earlier sold or accepted settlement terms for shares, to whom Sir Keith says that "retrospective legislation" would be unjust.

People have been robbed. Restoration is right. Mrs Thatcher was elected because of her manifest integrity. Needlessly and perhaps thoughtlessly the Cabinet decision has considerably eroded her credibility. Yet we are convinced that, if only the advice of practical people had been sought, it would have been possible to provide not only for fair compensation at the vesting day, July 1, 1977, but also for an indexing adjustment up to the date at which that compensation is paid. Instead, the Cabinet has embraced a solution which, if bureaucratically neat, is morally indefensible.

Many think the Government have put up the excuse of avoiding retrospective legislation, in order not to have to find the money or stock necessary to give the shipbuilders fair treatment. Others (and here it is not a question of political views) think they have supinely allowed themselves to be over-persuaded by civil servants who lack the business experience and competence to find the right practical solution.

Whichever it is, the injustice is outrageous. And injustice is not the only outcome. Who in the future is going to invest, whatever the Government, in the country's basic industries? Who will invest in the face of an expropriation risk? New employment, the most urgent economic need in the United Kingdom at the present time, is dependent on investment, and an investor requires to be confident of fair treatment and stability.

The Conservatives may yet find, unless they think again about their wanton and incompetent abandonment of the shipbuilders, that they have grievously damaged the capital-raising prospects of the basic industries, where the employment problems are worst and the need to attract investors greatest.

As Lord Hailsham, the Conservative elder statesman and constitutional authority, has declared, "there can be no constitutional authority whatever for legislation which overrides our natural sense of right and wrong".

Yours, etc,

WALTER H. SALOMON,
Chairman, Rea Brothers Limited,
RALPH BATEMAN,
Deputy Chairman, Rea Brothers Limited,
Kings House,
36-37 King Street, EC2.

November 27.

MFJ

MR WHITMORE

17 May 1982

Many thanks for your letter of 17 May and for sending me a copy of the letter written by Senator Ibanez. I will ensure that the Prime Minister see this tonight.

CS

Walter Salomon, Esq.

Econ Pol 4

Prime Minister

The Chancellor's reply - which seems to me fairly convincing - to Walter Salomon's latest letter.

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

10 June 1981

W H Salomon Esq
Rea Brothers
King's House
36-37 Kings Street
LONDON EC2

MT

Dear Walter

TL 10/6

Flag A

I had been thinking about how best to respond to your letter of 5 May before our unexpected meeting on the Cote d'Azur a few days ago.

Let me say at once that I appreciate your concerns: but I do not expect to be able to satisfy you. Your real objection is to the two tier system established by the Banking Act 1979. There is, of course, room for more than one view about the merits of that system. However, the Bill - which in fact reached the statute book before and not (as you told your 1981 AGM) after the General Election - was the subject of extensive debate, and it would not have been right for the present Government to have sought to set it aside immediately on taking office. Indeed such a course would not have been consistent with the attitude adopted to the Bill by the Conservative Party in Opposition. Moreover we had a Community obligation to introduce an appropriate framework of statutory banking regulation, which the present Act discharges. I continue to take the view, therefore, that we should bring into effect the system laid down by the Act, and give it a chance to prove itself. I do not at all exclude the possibility that experience may in due course suggest the desirability of some amendment, but it would be wrong now to prejudge this issue.

Perhaps I might add two more detailed points. First, you mentioned in your letter my assurance at the meeting with the Prime Minister on 1 July, when I said that "the Bank have a duty to report to me and to Parliament on the operation of the supervisory system", and suggested that nothing had been done in accordance with this. In fact on 30 July last year the Bank of England published, and I laid before Parliament, their first report under the provisions of section 4 of the Banking Act.

/Second, you said

Second, you said in your letter of 13 February that if Copleys Bank had by chance been owned by a parent outside the UK, carrying the same name, they would have been allowed to keep the world "Bank" in their name. I assume that you are referring to the provisions of section 36(8) of the Banking Act. However, the provisions of section 36(8) only allow a branch of an overseas bank to use the banking name of its head office - provided, of course, that wherever the banking name is used the words "licensed deposit taker" appear in immediate conjunction (and in equal prominence) with the banking name. (The Act makes this provision to avoid the obvious problems which would arise if an institution which was properly known by a banking name in its home country were required to use a different name for its UK branch when both formed part of the same legal entity.) But, contrary to your assumption, the provision does not extend to the UK subsidiaries of overseas banks who do not face the same problem if their name differs from that of their parent company.

I am copying this letter to the Prime Minister.

Yours ever,

Geoffrey

GEOFFREY HOWE

Econ Pol. May 79

JUN 1981

R H

8 May, 1981

Thank you for your note of 5 May and I have shown the correspondence you enclosed to the Prime Minister.

CAROLINE STEPHENS

W H Salomon Esq

BOX 2

10 DOWNING STREET

PRIME MINISTER

Walter Salomon is continuing his acrimonious correspondence with the Chancellor about the Banking Act and how it affects Copleys Bank. I do not think there is any need for you to get involved in this, but I thought you should be aware of the correspondence. Caroline can write to Mr. Salomon saying that you have seen the correspondence.

T P L

7 May 1981

Caroline.

Yes. Agreed.

Mr [illegible] for advice

A characteristically engaging minute: but I fear it calls for [illegible] reply.

KING'S HOUSE
36-37 KING STREET
LONDON EC2V 8DR
TEL. 01-606 4033

5th May, 1981

Dear Sir Geoffrey,

Copleys Bank

Thank you for your letter dated 28th April, 1981, with regard to the above matter. I am sure that before replying to my letter of 13th February, 1981, you will have discussed the matter with your officials. Unfortunately, they are probably the same officials who devised the Banking Act on behalf of the Labour Government and I am afraid that they cannot have read my letter to you very carefully as most of the points I made are either ignored or summarily glossed over.

In my lecture on the Banking Act given at the Institute of Bankers on 1st April, 1980, I set out clearly what I consider to be the short-comings of this Act and in order to refresh your memory, or those of the officials advising you of what I said at that time, I enclose herewith a re-print of the lecture.

Let us therefore assume that I am fully aware of the details of the Act.

You were present on 1st July, 1980, at a meeting with the Prime Minister in which I mentioned amongst other things the short-comings of the Banking Act and in your letter dated 11th July, 1980, you assured me that "the Bank have a duty to report to me and to Parliament on the operation of the supervisory system, and I can assure you that we will keep the system under review bearing in mind the concerns you expressed in your April lecture and at our meeting".

In spite of my representations to the Bank on the subject matter it appears that no recommendation in this respect has been made to you.

The case with which I am at present dealing is one which involves discrimination and expropriation and quite apart from this particular case the principle involved is a matter of great public interest. The support which your Government got at the last Election was based on the assumption that a Conservative Government would not ride rough-shod over individuals or smaller firms. This is exactly what you are now doing in this case although my suggestions were practical and reasonable and, if implemented, would correct the wrong which has been done. The advice which you received, i. e. that my suggestions would undermine the two-tier system of authorisation embodied in the Act, is simply not correct.

Perhaps although not directly connected, the speech which I made on 14th April, 1981, on the occasion of my firm's Annual General Meeting is relevant to the attitude which the

public faces today from Government departments. I am therefore taking the liberty of enclosing a re-print of this as well in order to acquaint the officials who have been advising you with the consensus of opinion which, although expressed by me as an individual, is supported by many.

I have been debating with myself whether in view of her tremendous commitments on important matters I should acquaint the Prime Minister with our correspondence; I feel I ought to do so because points are at stake which affect the liberty and freedom of the individual and those of us who believe in this philosophy consider the Prime Minister to be its leading advocate.

I am therefore sending a copy of this letter to the Prime Minister.

In conclusion, I would say that I sincerely hope that you will reconsider your letter dated 28th April, 1981.

Yours sincerely

Norman Lamont

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

28 April 1981

W H Salomon Esq
Rea Brothers Limited
King's House
36/37 King Street
LONDON EC2

Dear Mr Salomon

I undertook in my letter of 23 February to write to you again in response to your letter of 13 February about Copleys Bank Limited, and more generally about the Banking Act.

On the particular case of Copleys Bank, the granting of authorisations under the Banking Act (and if so in which category) is entirely a matter for the Bank of England to decide under the provisions of the Act. As you will be aware, the Bank is required to judge each application against the minimum criteria for deposit-taking institutions laid down in Schedule 2 of the Act (Part I for recognised banks and Part II for licensed institutions). In view of this, I cannot comment on the position of Copleys Bank.

You also suggested in your letter, two amendments to the provisions in the Banking Act relating to the use of banking names and descriptions. The policy on banking names and descriptions, set out in Section 36 of the Act, is a natural concomitant of the two-tier system set up under the Act, and the object of th εprovisions in section 36 is to enable depositors to be clear about the category of institution with which they are dealing. As you may be aware, during the Banking Bill's Parliamentary Stages, Part II (which deals, inter alia, with banking names and descriptions) was the most fully discussed aspect of the Bill's provisions. The Act as it now stands contains certain modifications of the original proposals in response to representations from the institutions affected. Under the provision of section 36, licensed institutions may in certain circumstances describe themselves as providing banking

/services, and also

services, and also as banks where this is necessary to take advantage of other laws and customs relating only to banks. However, either of the suggestions in your letter would seriously undermine the two-tier system of authorisation embodied in the Act. I do not think it would be right - given the full Parliamentary consideration this issue received in 1979 - now to alter the structure of that system.

Yours sincerely

GEOFFREY HOWE

Geoffrey Howe

REA BROTHERS LIMITED

GENERAL OBSERVATIONS MADE BY MR. WALTER H. SALOMON AT THE ANNUAL GENERAL MEETING HELD ON TUESDAY, 14th APRIL, 1981

It is my customary task on this day to deal with a number of points of general and public interest and I wish today to continue with this tradition.

For the believers in the market economy and the liberty of the individual there are no new fundamentals. All are very old. However, I feel that not enough opportunities present themselves to re-state those fundamentals. I have previously quoted the words of André Gide who once opened a lecture by noting:

"All this has been said before, but since nobody listened, it must be said again".

The Reformer

In the course of my travels abroad I have the opportunity to see and speak to a great number of people of importance and influence, and since the advent of Mrs. Margaret Thatcher as our Prime Minister time and time again I have been told how lucky we are here in Great Britain to have a person of her calibre as our Prime Minister. Usually the remark "we only wish we had someone like her" is added. I do not think that the people in this country appreciate sufficiently that in Mrs. Thatcher we have as our Prime Minister for the first time in many a decade a reformer of great vision, dedication and ability. It is often said "a prophet is not without honour save in his own country". But that Mrs. Thatcher is a reformer is not sufficient. Unless she has loyal and energetic disciples assembled around her to implement the policies, many of her efforts will be frustrated, or even in vain.

During a recent interview, Professor Friedrich von Hayek, that great liberal economist, whilst pronouncing his admiration for our Prime Minister expressed his anxiety that she will not succeed in her aims because she stands almost alone. He went on to explain that in England during the past thirty years Socialism with its state paternalism has become part of the specific philosophy of certain elements of the Conservative Party. He added that he was more optimistic for the future of the United States because Americans are still prepared to change their views radically and the present President, Mr. Ronald Reagan, has assembled around himself a team of men and women devoted to labour for the ideals on which he was elected. Under the American Constitution he is able to do this and can draw on a wide spectrum of experienced people. In Britain, unfortunately, many of the people in key positions who now surround our Prime Minister have been members either of previous governments or are administrators who keep their jobs whichever government is in power. It is they who in the past have failed to take the right decisions. They lack conviction and courage. They are opportunists waiting and hoping for political change.

As recently mentioned by one of our economic journalists (Samuel Brittan)*, the really dangerous thing is that the establishment uses its influence to participate in appointments and "in particular in blocking anyone controversial, 'opinionated', colourful, or merely too keen on Mrs. Thatcher's own economic policies". The problem is that although such appointments would be beneficial to the country they would adversely affect their own positions. It is essential that in order to be successful the Prime Minister must fill positions of influence with people who believe her own philosophy and who will energetically pursue her policies. Nothing has brought home this point better than the current television series, "Yes Minister". Although this is a light entertainment programme it brilliantly shows how a Minister, inexperienced in the subject matter of his Department, is hood-winked by his Civil Servants. If you have not already done so, then I recommend that you see this award-winning show; it will support the point which I have just made.

Moral Issue

Prior to the General Election a great deal of lip-service was paid to the changes which would take place if only we could get away from Socialism. Much was said about the totally new moral and ethical outlook which would create a sense of urgency and dedication and bring people together to work and to build together for the common good. There would be less governmental interference, there would be less bureaucracy, there would be no support for lame duck industries, and there would be no retrospective legislation. Let us examine some of the things which have happened since.

A new Banking Act was introduced with the result that we now have more bureaucracy, less freedom, and greater injustices in this industry. At the time the Act was introduced the Chancellor of the Exchequer assured the public that he would keep the Act under constant review. No such review has yet taken place.

The Aircraft and Shipbuilding Industries Act was quite unequivocally opposed by the Conservative Party in their manifesto. In Opposition they said that the compensation terms were unconscionable and ought to be based on values at the date of vesting, i.e. at the date of dispossession. Now the Cabinet has reneged both on the manifesto commitment to offer to sell back the shipyards, and on the application of fair compensation under the Washington Agreement, using the excuse that it would involve "retrospective legislation". Almost in the same breath they have introduced a massive retrospective "windfall" tax on the banks. It is essential that members of the government should clarify their thinking on these two points. On the one hand, the wickedness of the Aircraft and Shipbuilding Industries Act must be put right because it is a clear violation of the basic principle that theft, whether by individual or state, cannot be tolerated. Only a cynic would call putting right something which is so manifestly evil "retrospective legislation". On the other hand, in the case of the "windfall "tax, the Government has ignored the very principle so sanctimoniously invoked to avoid redressing the wrong done to the shipbuilding industry. Quite apart from the fact that this retrospective tax is unethical it highlights the moral swamp into which governments can slide on the tendentious grounds of expediency.

At this stage it is important to point out that in our form of government these kinds of measures are introduced by the collective decision of the Cabinet and it is in no way certain that the Prime Minister personally would either have suggested or agreed with this attitude. As I have pointed out before, I think a clean sweep of the key positions in the Government and Civil Service might have a resounding effect. In this respect let us take a leaf out of the American book.

Inflation

I now come to the last point I would like to raise and that is Public Enemy No. 1, inflation. Whilst there has been a certain welcome reduction in the rate of inflation this has, in part, been achieved by the wrong methods, squeezing the private sector to support wasteful and inefficient public sector industries. The decision-makers in this respect were not experienced business people but either politicians or civil servants and, on occasion, they have in their decisions gone totally against the implied promises of the Conservative manifesto.

Let us repeat and repeat again, inflation can only be created by government. Therefore, it can only be stopped by government and the efforts which have so far been made in this respect have, to a very large extent, been inefficient, incompetent, and damaging to the market economy.

**Financial Times,* 22nd January, 1981.

The adjustment has been made more painful and prolonged by our labour legislation. The trade union laws are archaic and the closed shop, restrictive practices, etc. have played a great part in this malaise. The placid acceptance of these laws by our Secretary of State for Employment is unacceptable. These iniquities must go.

What is necessary above all, and here I quote from my evidence to the Radcliffe Committee in 1957—is a new respect for money and ethical principles associated with economic and monetary policy. Inflation must come to be regarded as morally wrong and politically dangerous. "Unsound" money means deceit, misrepresentation, breach of contract, injustice and in the end impoverishment, chaos, revolution, tyranny and dictatorship. It is a primary responsibility of government in a free society to maintain a trustworthy monetary unit of account and medium of exchange. If it cannot do that, it has abdicated. In the Middle Ages, Florence, Venice and Amsterdam owed their well-being, stability, and prosperity to the trustworthiness of their currencies. The British world market has been based largely on the dependability and prestige of the pound. There is no reason, except a failure of political leaders to lead, why the British economy should not recover its strength on a basis of the reputation of sterling.

Let me finish my address to you today by quoting Plato*:

"An excessive desire for liberty at the expense of everything else is what undermines democracy and leads to the demand for tyranny . . .

It becomes the thing for father and son to change places, the father standing in awe of his son, and the son neither respecting nor fearing his parents . . . . The teacher fears and panders to his pupils, who in turn despise their teachers and attendants; and the young as a whole imitate their elders, argue with them and set themselves up against them, while their elders try to avoid the reputation of being disagreeable or strict by aping the young and mixing with them on terms of easy good fellowship . . .

You find that the minds of the citizens become so sensitive that the least vestige of restraint is resented as intolerable, till finally, as you know, in their determination to have no master they disregard all laws, written or unwritten . . . Well this is the root from which tyranny springs . . . a fine and vigorous beginning. So from an extreme of liberty one is likely to get, in the individual and in society, a reaction to an extreme of subjection . . ."

As I said at the beginning, I make no apologies whatsoever for returning to themes I have dwelt upon before. Obviously contemporary events to some extent influence one's remarks but it should not be surprising that the major issues—fair-dealing, the balance of power and responsibility, intellectual honesty, freedom for the individual—remain the same.

**The Republic,* Book VIII, 8. *Tyranny.*

Copies of the 1980 Report and Accounts may be obtained from the Secretary, Rea Brothers Limited, King's House, 36-37, King Street, London EC2V 8DR.

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MFJ

Econ Pol

(1) Mr Lankester Tr

(2) Prime Minister

C/ For X.

2 March 1981

MT

please file

Cl. 4/3.

Thank you for your covering note enclosing a letter for the Prime Minister.

X I will ensure that she sees it as soon as possible.

CS

W.H. Salomon, Esq.

DSS

KING'S HOUSE
36 - 37 KING STREET
LONDON EC2V 8DR
TEL. 01-606 4033

PRIVATE AND CONFIDENTIAL

2nd March, 1981

Dear Caroline,

I enclose herewith a copy of a letter which I have today sent to the Chancellor of the Exchequer. I should be most grateful if you would kindly put it before the Prime Minister at an opportune moment.

Yours sincerely,

Miss Caroline Stephens

WALTER SALOMON

Mr Lankester

With

Mr. Walter H. Salomon's

Compliments

King's House,
36-37, King Street,
EC2V 8DR

KING'S HOUSE
36 - 37 KING STREET
LONDON EC2V 8DR
TEL. 01-606 4033

2nd March, 1981

Dear Sir Geoffrey,

Thank you for your letter dated 23rd February.

The points which I made with regard to Capital Gains Tax in my letter to you dated 17th February were as follows:

1. It is not a tax on gains; it is very often simply a levy on capital.

2. In essence, this amounts to confiscation.

3. It also impinges, particularly on entrepreneurs and risk-takers who are mainly responsible for the mobility and growth so desperately needed in these times of rapid change.

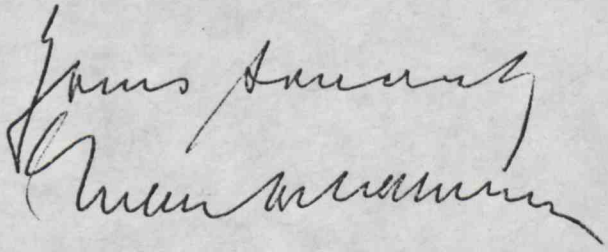
4. Eliminating confiscatory tax on enterprise should surely have the very highest priority in the depth of this depression.

5. To continue Capital Gains legislation as it is at present is simply supporting the philosophy of the Socialists to carry out social engineering by taxation, something to which we all know our Prime Minister is deeply opposed.

6. To do so, and use as an excuse the fact that one needs the money, has no basis from a moral point of view.

7. It may, of course, be impossible to include in the forthcoming Budget the necessary changes but an announcement to the effect that you will deal with the matter as soon as possible, but not later than the following Budget, might be a way out.

Regarding Exchange Control legislation, you say you do not expect the Act to remain on the Statute Book indefinitely in its present form. May I remind you of the old saying: "he who gives quickly, gives double". There may come a day when you bitterly regret not having dealt promptly and expeditiously in this matter.



The Rt. Hon. Sir Geoffrey Howe, QC., MP.

FILE

ECON. POL

17 February, 1981

Thank you for your letter of 17 February, and for sending various pieces of correspondence to the Prime Minister. I will ensure that these are shown to her at the earliest opportunity.

CAROLINE STEPHENS

W Salomon, Esq

KING'S HOUSE
36 - 37 KING STREET
LONDON EC2V 8DR
TEL. 01-606 4033

17th February, 1981

Dear Caroline,

I enclose herewith a letter addressed to the Prime Minister. I should be most grateful if you would kindly put it before her at an opportune moment.

Yours sincerely
Mark Bonham

Miss Caroline Stephens.

KING'S HOUSE
36 - 37 KING STREET
LONDON EC2V 8DR
TEL. 01-606 4033

17th February, 1981

Dear Prime Minister.

I saw Sir Geoffrey Howe yesterday and put before him three points. I have written to him to confirm our meeting and what transpired and I enclose a copy of my letter which might be of interest to you.

Warmest regards

Yours sincerely

Margaret Thatcher

The Rt. Hon. Mrs. Margaret Thatcher, MP.

KING'S HOUSE
36-37 KING STREET
LONDON EC2V 8DR
TEL. 01-606 4033

17th February, 1981

I am writing to thank you for your courtesy in seeing me yesterday and, for record purposes, I thought I would put on paper the three points which I raised with you.

1 Copleys Bank:

I left with you a letter dated 13th February clearly setting out the case, and it refers in part to your letter to me dated 11th July, 1980. I hope you will be able to amend the legislation as soon as possible in order to remedy the injustice which in this case the Banking Act has perpetrated.

2 Capital Gains Tax:

In this connection I refer to that part of the letter dated 28th July, 1978, written to you by our mutual friend, John Baring, dealing with Capital Gains Tax. I gathered from our conversation that you agreed that this tax is now to a large extent a tax on capital and not on gains and it continues the social engineering which the Socialist government introduced into its tax legislation. You mentioned that for administrative reasons it would be difficult to make any changes. I find it

hard to believe that a practical way could not be found around what really amounts to a capital levy on a small group of people. I offered, if required, to provide advice on how it could be done.

3 Foreign Exchange Control Act, 1947:

You agreed with me that to keep this Act in being is very unsatisfactory, but you were concerned that under a Council Directive of the European Community you had to have an instrument through which you would be able to introduce a number of measures immediately and you could only do this through the Foreign Exchange Control Act, 1947.

There are two possibilities - either you leave only that part of the Act which gives you this power and repeal the remainder, or you repeal the Act and deal with the European Directive under the Banking Act, 1946. The first option is, in my opinion, rather "messy" and might be difficult to achieve, whereas the second proposition should be easy and if, as you say, it would be legally difficult to exercise the authority which you are seeking under the 1946 Act, I do not think it should be too difficult to amend the Act accordingly.

In the hurly-burly of daily business the matters which I mentioned to you may appear to be rather trivial but they constitute part of our liberty and the support

which the Prime Minister had at the General Election was, in part, based on the understanding that matters of this nature would be dealt with expeditiously. In any case, it would generate in many people a feeling of confidence and it is confidence which will create an upsurge in the general economic climate.

The Rt. Hon. Sir Geoffrey Howe, QC., MP.

REA BROTHERS LIMITED

13th February, 1981

I refer to your letter to me dated 11th July, 1980, dealing with the Banking Act. In your letter you referred to our meeting in the presence of the Prime Minister on 1st July last during which I made some criticisms of the Banking Act which criticisms were contained in the lecture I gave at the Institute of Bankers on 1st April last.

In your letter you stated as follows: "In the exercise of all its powers under the Act, the Bank (and this refers to the Bank of England which is the supervisory authority) is subject to the test of reasonableness and in the case of abuse there are remedies at common law. Moreover, the Bank have a duty to report to me and to Parliament on the operation of the supervisory system, and I can assure you that we will keep the system under review bearing in mind the concerns you expressed in your April lecture and at our meeting".

I would now like to acquaint you with the case of Copleys Bank Limited which is a wholly-owned subsidiary of Rea Brothers Limited, and in this connection I would like to mention

COPY

that Rea Brothers is a fully recognised bank under the Banking Act. Copleys Bank applied to become a recognised bank but this request was turned down by the supervisory authority and at this particular moment I do not wish to argue this point.

I simply want to say that Copleys Bank was established in 1916 and subsequently developed a diversified banking business, gaining acceptance in the City of London as an independent private bank of good repute. Unlike some other institutions, it continued to gain in strength and stature during the banking crisis of 1974/75 and at no time during that period did it require support from any third parties. It is not therefore to be numbered among the banking institutions whose activities were one of the main reasons for the enactment of the Act.

On turning down the application the Bank indicated that if we were to apply for a licence as deposit-takers, this would be granted. For this privilege we would have to pay a minimum of £2,500, but on the other hand we would still have to change the name, and the word "Bank" would have to be eliminated. I remonstrated with the Bank and drew attention to the fact that if, by chance, Copleys Bank had been owned by a parent outside the UK, carrying the same name, they would have been allowed to keep the word "Bank" (as evidenced by Bank of Credit and Commerce International). I consider this a case of undisguised discrimination against a British institution.

A further point I wish to raise is that if the word "Bank" were withdrawn it would deprive us of a very valuable asset without compensation. This amounts to expropriation. I do not wish at this stage to quantify this because it would make this letter far too long.

COPY

BROTHERS LIMITED

There are easy ways and means to remedy this injustice, for instance, one could introduce and add to the Act a "Grandfather" clause, or if that were not suitable one could say that the restrictions should not apply in cases where the company would be wholly-owned by a recognised bank.

I do not know whether the supervisory body has already drawn your attention to this injustice and asked for a change in the Act but, if not, they have, in my opinion, failed in their duty.

I now appeal to you to take immediate action to rectify the matter.

The Rt. Hon. Sir Geoffrey Howe QC. MP

COPY

NOTE FOR THE RECORD

Mr Walter Salomon

Mr. Walter Salomon called upon the Prime Minister at 0930 this morning.

He reminded the Prime Minister that he had produced what was in effect a manifesto in his annual report which had appeared in April 1979. In that he had suggested a number of measures which an incoming Conservative Government should take, and he had believed then, as he did now, that his proposals reflected the Prime Minister's own views very closely. Those ideas were as up-to-date today as they had been then. They amounted to a crash programme, and he regretted that, because of political factors, they had not been implemented in the twenty months of Conservative Government.

When the Prime Minister interjected that some of his proposals had been put into effect, Mr. Salomon agreed that this was the case but went on to say that the problem was that not all of them had been implemented. He thought that the Prime Minister should go to the country by means of a referendum on his key proposals, e.g. on the closed shop, and she would receive an overwhelming vote in her favour. To remind the Prime Minister what were the central issues he would leave a copy of the document for her to glance through again.

He went on to say that the purpose of his call today was to make an altogether different point. The Prime Minister was trying to re-establish the market economy in the United Kingdom and she was facing two major obstacles. First, she was meeting inbuilt opposition from the Civil Service. He had chapter and verse to show that civil servants blatantly lied in order to deceive Ministers. They withheld vital information from Ministers. Some of her colleagues were

/totally

totally in the hands of civil servants. The second obstacle was the Bank of England where some of the key figures were Keynesians. The Bank was not spreading the gospel of the market economy and of money discipline. Nobody at meetings of the Court spoke out, and in his view its membership should be changed. For example, he would replace Leo Rothschild by his cousin, Evelyn Rothschild. Moreover, Lord Robens should not be forced to go when he reached retirement age. A good addition to the Court would be the present Deputy Chairman of Warburg's, Mr Scholey. Sir Jasper Hollom had been forced out of the Bank prematurely, and a good man, Mr George Blunden, had been pushed on to the sidelines. It would be an excellent choice if Mr. Blunden became Deputy Governor. It would also help to offset the ill-conceived advice of the Bank's economists if Lord Harris was appointed to the Court.

He agreed with the view which Mr. Sam Brittan had expressed in the Financial Times recently that the Civil Service and the Bank of England would prevent anyone moving into an influential position in either organisation if he was a supporter of the Prime Minister. To deal with this very unsatisfactory situation the Prime Minister should infiltrate her supporters into key offices in the Civil Service and the Bank. This would not be easy as the Civil Service would fight hard not to give up its present power.

Mr. Salomon then turned to the Prime Minister's recent interview on the Weekend World programme. He thought that many of her answers had been good, but she should remember that the ordinary men and women watching the programme had no idea what £M3 was. When the Prime Minister intervened to say that she had warned Mr. Walden that his questions were getting too technical but that she could not let it appear that she did not know the answers to them, Mr. Salomon

/said

said that while he accepted that the Prime Minister had to reply to the questions, she should have explained what £M3 was. The same applied to the use of the term monetarism. Whenever the Prime Minister mentioned it, it was important to explain what it was. He had written a pamphlet about this in 1976, the forecasts in which had all since come true, and he would leave a copy with the Prime Minister (which he did). He had also written a letter to the Times in October of last year explaining in simple terms what monetarism was, and he would give the Prime Minister a copy of that too (which he also did).

Mr. Salomon then moved on to complain that the Inland Revenue had Trotskyists and other Leftists in its ranks who used their position to promote social engineering. The Capital Gains Tax, for example, was a form of social engineering. The Inland Revenue never brought forward legislation for the people but only against them, and this was causing a great deal of resentment.

Mr. Salomon summed up all he had had to say by remarking that something had to be done quickly. The Prime Minister had to get more of the right people around her.

He left at 1000.

AJW.

10 February 1981

Prime Minister

Would you be prepared to see Mr. Salomon. Diary is v. full. C.S. 21/1

Yes

Arranged for 27th January at 10.00. No briefing required but please make Meetings Folder for this letter. C.S. 22/1/81

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TELEPHONE: 01-606 4033
TELEGRAMS: WALSA, LONDON, TELEX
CABLES: WALSA, LONDON EC2
TELEX: LONDON 886503
TELEX: 883611 FOREIGN EXCHANGE

PRIVATE AND CONFIDENTIAL

21st January, 1981

Dear Prime Minister,

Since I last saw you, and I refer to our meeting on 1st July, 1980, at which Sir Geoffrey Howe and Sir Keith Joseph were present, some six months have passed, and I thought I would write to you today because I hope that in spite of your tremendous programme you will be able to make half an hour available in which to see me.

You know the tremendous admiration I have for you and for the principles for which you stand. As someone said to me recently - you are really the new Jean d'Arc.

I am only worried that with the numerous problems you are facing on so many fronts, and for which you must seek "technical" advice, whether those people from whom you are seeking such advice have, in every circumstance, the practical and human experience necessary and, furthermore, whether they are totally impartial and basically support your philosophy. Too many times, such people, particularly if their backgrounds are academic, or if they are in the professions, such as lawyers and accountants, approach ideas and propositions from the standpoint of why they should not be carried through, instead of how they can be done. In this connection I refer you to Sir Geoffrey Howe's reply to me when I suggested that the Exchange Control Act, 1947, be abolished.

Another point of great importance is that your supporters should not be disappointed by measures which are being taken by various of your Ministers, which measures shake the confidence of your supporters in the seriousness of the philosophy to which you are committed. There might, of course, be cases in which one has to make a temporary concession but then, in order to avoid any misunderstanding, this should be explained to the wide public in basic English. I think this is called "public relations".

"Public relations" is something which at present many of your friends consider to be totally insufficient. It is vitally important that the people in charge of it should be your dedicated disciples.

Faith is a very strong and powerful medium and whilst when you personally are explaining something you convey your faith to your listener, this does not always happen in the case of your Ministers and Civil Servants.

It is on these points that I have some practical suggestions to make and for this reason I would like you to spare me half an hour of your time.

I have been in close touch with Alan Walters and my first thought was that he would convey to you my views in detail. However, it was he who suggested that I write to you direct.

I am leaving for the United States on Saturday next and will be away for a week, returning to London on Friday, 30th January.

Warmest regards
Yours sincerely
Maurice Falconer

File

Sup

Econ B.

10 DOWNING STREET

MR. HOSKYNS

Walter Salomon has sent a tape of a BBC Radio Four programme about "Enterprise".

The Prime Minister really has not got time to listen to this and I wonder whether one of you could do so on her behalf and let her know if it contains anything of interest.

CAROLINE STEPHENS

25 July 1980

FILE

RH

24 July,1980

Thank you for your note and for sending the tape on the BBC Radio Four programme about "Enterprise".

I hope that the Prime Minister may have a chance to listen to this during the Recess.

With all good wishes.

CAROLINE STEPHENS

W H Salomon, Esq

RH

KING'S HOUSE
36 - 37 KING STREET
LONDON EC2V 8DR
TEL. 01-606 4033

24th July, 1980

Dear Caroline,

A programme took place on BBC Radio 4 at 10.02 on Thursday, 10th July, under the general heading "ENTERPRISE", and I enclose a tape recording herewith.

The programme gives an insight into the whole idea behind the Young Enterprise movement which in the past the Prime Minister has supported.

In view of the present unemployment situation, and the lack of productivity, this movement might in future years make a considerable impact in promoting a change. I therefore thought the Prime Minister would be interested in hearing the programme. Perhaps you could arrange for her to hear the tape at an opportune moment.

Kind regards
Yours sincerely
Walter Salomon

Miss Caroline Stephens

WALTER SALOMON.

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

11 July 1980

W.H. Salomon Esq.
Rea Brothers
King's House
36/37 King Street
LONDON EC2

Dear M Salomon

At our meeting with the Prime Minister on 1 July, you elaborated on some of the criticisms of the Banking Act contained in your April lecture to the Institute of Bankers and suggested that it would be preferable if the Exchange Control Act were altogether repealed rather than amended. I thought it would be helpful if I wrote to you setting out my views on the points you raised at the meeting.

On the Banking Act, there is always a balance to be struck between importing more precision into legislation on the one hand and on the other hand maintaining any supervisory authority's flexibility to respond to new developments. The danger of circumscribing the Bank's powers under the Act would be that this could ossify the system - a risk to which you referred in your 1st April lecture. Equally the position of any particular institution may progress from the licensed to the recognised sector as the services it offers and/or its standing change. In the exercise of all its powers under the Act, the Bank is subject to the test of reasonableness and in the case of abuse there are remedies at common law. Moreover the Bank have a duty to report to me and to Parliament on the operation of the supervisory system, and I can assure you that we will keep the system under review bearing in mind the concerns you expressed in your April lecture and at our meeting. As I am sure you know, the Bank would be happy to receive comments on their foreign currency exposure and liquidity papers which are consultative documents on which the views of the market are being sought.

/Turning now to



Turning now to your points about the Exchange Control Act 1947, I explained at our meeting that if exchange controls ever had to be reintroduced, the Bank of England Act 1946 does not provide the necessary powers. All our Community partners - including the Germans under their External Trade and Payments Law of 1961 - have existing legislation enabling them to meet the requirements of the European Community Council Directive 72/156. So while we envisage over time the 1947 Act being made a more satisfactory piece of legislation, we still intend to retain it at least for the time being, without expecting any resulting damage to confidence or, for that matter, the return of a Labour Government.

Yours ever,

Geoffrey Howe

GEOFFREY HOWE

11 JUL 1980

KING'S HOUSE
36-37 KING STREET
LONDON EC2V 8DR
TEL. 01-606 4033

12 847

7th July, 1980

Dear Caroline,

When I saw the Prime Minister on Tuesday last we were not alone so I was unable to talk to her about some correspondence which I have had with Professor Hayek. I enclose a copy of my letter to the Professor together with a copy of his reply and I should be very pleased if you would place this correspondence before the Prime Minister at the earliest possible moment.

Kind regards

Yours sincerely

Miss Caroline Stephens

URACHSTRASSE 27
D-7800 FREIBURG (BREISGAU)
77216

17 June 1980

Mr. Walter H.Salomon
Rea Brothers Limited
King's House
36-37 King Street
London EC2V 8DR

Dear Mr. Salomon,

I have now had time to read at leisure the enclosures of your letter of the 13th inst and as you expected find myself in close agreement with what you say on the "key issues". As regards the banking act I will merely say that I am shocked by what I learned from your speech. But in the thirty years since I moved first to the States and then to Germany, I have lost contact with the details of British policy and in principle try to refrain from taking positions. Only when I get to upset about what is happening I sometimes cannot refrain from speaking out, but in general try to concentrate on basic principles. At the moment I try to devote all my energy to a final all-out attack on the basic ideas of socialism for which I believe I have now found what ought to be an effective form.

I agree entirely with your estimate of Mrs.Thatcher and fear more and more that with the albatrosses round her neck she will be prevented from doing what she understands need to be done. I had been very hopeful at first and still believe if anybody can save Britain it is she. But the time is getting short and I felt that even at the risk of embarrassing her I ought to speak out. I have no idea yet how my long letter to The Timesx will be received (I still have not even seen the issue - the post both in ENgland and here is becoming impossible!) and I shall probably not be able to visit London again before the end of November. I shall at the end of this month withdraw to my usual summer resort in the Tyrolese mountains in the hope of completing there my book and shall have to go from there immediately to the United States and probably Japan.

I hope very much, however, that on the next occasion I shallbe in London we can meet and ha ve a talk on all this. Normally I visit England (where my children live) two or three times a years and if you should not be there at the end of November I have committed myself to give a lecture at the London School of Economics at the end of next February.

Yours sincerely,

F.A. Hayek

STRICTLY PRIVATE
AND CONFIDENTIAL

13th June, 1980

I have read with the greatest interest your letter which appeared in The Times today. I also saw your recent television interview with Bernard Levin; if you have a transcript of the interview I would very much like to have a copy.

You may not recall that on 11th April, 1979, I made a speech at my firm's Annual General Meeting in which I set out "my suggestions" for putting things right. I enclose herewith a further copy of the speech. As a matter of fact it was at the time accepted by the Financial Times as an advertisement by my firm but later this was overruled by the Editor who refused to publish it because he thought it too political.

As you will see from the speech, you and I are in agreement on a wide front and I think our Prime Minister would also feel some sympathy with these suggestions.

She is, however, surrounded by people who are probably more concerned with being re-elected than with putting the country right. The Conservative Party has, in the past, excelled itself in stabbing people in the back if this would further the Party political cause.

The Prime Minister has invited me to come and see her on Tuesday, 1st July, to explain my views, and I understand she has also asked the Chancellor of the Exchequer and the Secretary of State for Industry to be present at this meeting. I do not know whether you expect to be in London before 1st July; if so, I would very much welcome it if we could have a talk and I could sit at your feet and listen to your wise counsel. Otherwise I would be very pleased to have any suggestions you might have for this meeting.

My regard for the Prime Minister is very high indeed; basically I consider her a person of the greatest integrity, and Ithink she needs all the support that one can give her. I imagine she must at times feel very lonely.

Ostensibly, the meeting has been arranged in order to discuss the new Banking Act and therrepeal of the 1947 Exchange Control Act; both are very important items in the chinks in the armour of the bureaucrats and

politicians. I think I have already sent it to you, but I am enclosing a further copy of the lecture I gave at The Institute of Bankers on 1st April in order to acquaint you with what I said at that time.

The problem we are facing is that the Banking Act is administered by the Bank of England who are building up a new kind of bureaucracy, and the people in charge are really fonctionaires who know nothing about banking in the sense that you and I know about it; they are central bankers and central banking is not what it was because it has become a political play-ball and this is not helpful when it comes to curing inflation.

Professor F. A. Hayek

THE TIMES - 13-6-1980

LETTERS TO THE EDITOR

A testing time for monetarism

From Professor F. A. Hayek, FBA

Sir, The question which Professor Pearce (June 5) raises is at the same time so important and so complex that it is hardly possible even to sketch an adequate answer within the same frame. I am still convinced that, as far as economic causation is concerned, the value of money is wholly determined by the magnitude of the supply of money in relation to the demand for holding it. In this sense I agree with Professor Milton Friedman that there is no such thing as a cost-push inflation. But politically it is unfortunately true that by pushing up wages the trade unions can make it "politically necessary" to increase the quantity of money, ie, create a condition in which government believes it must do so.

For this reason I am even convinced that trade union reform must *precede* monetary reform. It is this which makes the former so exceedingly urgent and is the chief reason why in both fields gradualism cannot help. If, as I believe to be true, with the present power of the trade unions no government that has the power over the supply of money can politically resist the pressure for more money, the urgently needed termination of inflation cannot succeed before the power of the trade unions is curbed. But time is becoming short and it will soon be necessary to proceed on a timetable if the necessary operation is to be completed.

The theoretician must always, and particularly if he lives abroad, hesitate to give advice on what must be a political decision. But if this Government, within its limited life, is to achieve the salvation of Britain, a radical procedure will soon be essential. As I see it, within the time available what is required can be achieved only if the Government, in the near future, obtains through a referendum popular instruction at once to rescind all the special privileges which have been granted to the trade unions by law, and is then ready immediately afterwards to terminate inflation instantly. Only this can make it possible for the beneficial effects of such a policy to manifest itself some time before the term of the present Government runs out.

From the technical point of view there is no serious difficulty about stopping inflation. As the former chairman of the Federal Reserve Board, Arthur Burns, has recently confirmed in a much noticed lecture, the monetary authority can always stop inflation "with little delay". The difficulties are not economic but political and especially problems of government finance. Ending inflation demands that government is deprived of the recourse to the printing press for financing its expenditure. Government must balance its budget and I admit that it is not humanly possible to do so overnight.

The central problem thus becomes how government can be offered a period up to two years or so during which it can reduce its expenditure so that it will be covered by revenue. But all borrowing in sterling at present would be likely to cause further inflation and impose an unbearable burden.

The only escape I can see is that government obtain the funds which will give it a period during which it can balance its budget by issuing a, chiefly internal, loan in terms of an indexed unit called, say, "solids". Large amounts could probably be raised cheaply, at perhaps three or even 2½ per cent, if a public which no longer knows what to do with its savings were offered such an opportunity. It seems to me that the British Government, perhaps undeservedly, enjoys in the world still a reputation for honesty which may make a first experiment of this sort a great success. The "solids", in terms of which the loan would be issued would have to be defined as, and be redeemable with, so much of a bundle of other currencies as would at the time be required to buy on the world market a "basket" of a wide range of standard internationally traded raw materials in precisely stated quantitative combinations. Ultimately this unit might become, if necessary, the basis of a new British currency.

Slowness of procedure might at the time destroy all chances. If the present rightly directed efforts fail because of delay, it may be the loss of the last chance of a British recovery for generations. It is not too late yet, but it may be soon.

Yours faithfully,

F. A. HAYEK.
Urachstrasse 27,
D-7800 Freiburg (Breisgau),
Federal Republic of Germany.

June 7.

CONFIDENTIAL

cc D/I GenPol HS

B/F 9-7-80

10 DOWNING STREET

cc Master
Gen Pol: May 79
Exchange Control
Policy

From the Private Secretary

2 July 1980

Dear John.

As you know, Mr. Walter Salomon called on the Prime Minister yesterday morning. The Chancellor and the Secretary of State for Industry were also present.

Mr. Salomon concentrated on two points. First, he argued that the Exchange Control Act 1947 should be altogether repealed, rather than amended. He suggested that, in the event that the Government might conceivably want to reintroduce exchange controls some time in the future, the 1946 Bank nationalisation act would provide adequate powers. The retention of the 1947 Act, even in modified form, was bad for confidence and would provide a Labour Government with too easy an opportunity to reintroduce exchange controls. Mr. Salomon asserted that neither Germany nor Luxembourg had specific exchange control powers; he did not see why we needed them.

Secondly, Mr. Salomon elaborated on his criticisms of the Banking Act 1979, which were set out in his April lecture to the Institute of Bankers. In particular, he criticised the sweeping powers of the Bank, which he implied they were not well qualified to make use of; the two-tier system of authorisation; and the personal questionnaire for directors and managers. In addition, he criticised the Bank's papers on foreign currency exposure and liquidity.

In reply, the Chancellor explained that exchange controls had been abolished, and that the exchange control department in the Bank had been disbanded and a large number of officials released for other work. Nonetheless, he had come to the conclusion after long and detailed consideration that a modified version of the 1947 Act was needed. He disagreed with Mr. Salomon about the powers under the 1946 Act: in theory, these gave the Government power of direction over the Bank, but not over the citizen.

The Chancellor also answered some of Mr. Salomon's criticisms of the Banking Act, but there was not time for him to rebut them in detail. The Prime Minister would accordingly be grateful if the Chancellor would now write to Mr. Salomon on his criticisms

/ of the

CONFIDENTIAL

of the Banking Act, and if he would also set out his answers to Mr. Salomon's various criticisms of the Government's decision not to repeal the Exchange Control Act. Please could you send us a copy of the Chancellor's letter.

I am sending a copy of this letter to Catherine Bell (Department of Industry). I would be grateful if you would not show this letter to the Bank.

Yours ever

Tim Lankester.

John Wiggins, Esq.,
H.M. Treasury.

Econ Pol

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

27 June 1980

T P Lankester Esq
10 Downing Street

Dear Tim,

MR SALOMON'S CALL ON THE PRIME MINISTER, 1 JULY 1980

Caroline Stephens in her letter of 10 June asked us for briefing for Mr Salomon's call on the Prime Minister. I attach material which covers the points in the various items you sent us with your letter of 17 June.

I am sending copies of this letter and the attached briefing to Catherine Bell (Department of Industry).

yours
John

A J WIGGINS

Brief for PM

CALL BY MR SALOMON ON TUESDAY 1 JULY

1. Mr Salomon in his letter of 3rd June to the Prime Minister mentions several items which he would like to discuss. Briefing is attached on:-

1. Mr Salomon's 1st April lecture "Banking through the Eyes of a Private Banker" covering the Banking Act 1979, the Aircraft and Shipbuilding Nationalisation Act and the Consumer Credit Act;

2. Intervention to depress the exchange rate;

3. Retention of the Exchange Control Act 1947 (Mr Baring's Memorandum of 30 May refers).

2. Briefing is not attached on two other issues Mr Salomon raises in his letter: the slowness with which Mr Salomon says that "various of your Ministers deal with Acts which they have to administer and which were introduced by the Socialist Government" and the "great concern in many circles about some of the things which are happening at the Bank of England." Mr Salomon declines to give any examples on either of these two issues - and suggests that he would wish to discuss both questions confidentially at the meeting. Tardiness in administration is not an allegation which can reasonably be applied to the Banking Act which has been implemented fairly speedily. Nor would it seem appropriate to go into any detailed criticisms of the Bank of England without the Bank being able to defend itself.

3. Also attached is a brief biography on Mr Salomon and a potted history on Rea Brothers of which he is the Chairman together with copies of Mr Salomon's 3rd June letter to the Prime Minister, his 1st April lecture on Banking, Mr ~~Baring's~~ Salomon's 30 May Memorandum on the Exchange Control Act and the Prime Minister's 2nd June letter on the Exchange Control Act and the value of sterling.

KING'S HOUSE
36-37 KING STREET
LONDON EC2V 8DR
TEL. 01-606 4033

PRIVATE AND CONFIDENTIAL

3rd June, 1980

Dear Sphere Minister,

For a long time I have been considering writing to you because there are a number of aspects of economic policy about which I am considerably worried.

You know the high regard I have always had for you personally and this has been in no way diminished. As a matter of fact, I would say "regard" is probably an understatement - "admiration" would be more accurate.

When you wrote to me last time you quite rightly pointed out that it would be impossible for you to have individual private conversations as your time would simply not allow it and that I would be the first to understand - and I do.

As I have now received a letter from you, to which I shall refer in a moment, I wonder whether as an exception you could fit in half an hour as I would like to discuss one or two things with you which I do not think I should put on paper. I shall, of course, quite understand if you cannot manage it.

Amongst others, one of the points which I would like to discuss with you is the lecture which I gave at the Institute of Bankers on 1st April last under the heading "Banking through the Eyes of a Private Banker". I would like to tell you some of the background to it which prompted me to give the lecture, and which I found most disturbing. In case you have not got it to hand I enclose a further re-print of the lecture.

Other matters I would like to discuss concern the growing disquiet within private enterprise about the slowness with which various of your Ministers deal with the Acts they have to administer and which were introduced by the Socialist Government. One probably ought not to blame the Ministers concerned but rather their Civil Servants who deal with these matters and who are probably in the main the same Civil Servants as were there when the Socialist Government was in power. However, as a number of these Acts were strongly opposed by the Conservatives when they were in opposition, this tardy attitude creates considerable unrest. I would like to give you chapter and verse on these matters but it would be difficult to do so in writing.

With regard to your letter, I understand the point which you make concerning interfering with the sterling rate and there is, of course, great substance in your argument - perhaps it would be better to fall back and

let the market economy take its toll. I am not so sure I agree with the Exchange Control Act; I can quite see why the Civil Servants should advise that it be kept in being, if only because they do not want to lose any of their power.

John Baring had the Chancellor to lunch on Sunday last and I prepared for him a memorandum dealing with the subject matter. He tells me that unfortunately there was no opportunity to discuss it over lunch as the Chancellor arrived late and anyway there were others around. I feel I can do no better than send you a copy of the memorandum which sets out my views in a succinct manner.

I know that the views of the Bank of England are in no way unanimous on this point but then there is great concern in many circles about some of the things which are happening at the Bank of England and this is another subject which I would like to have the opportunity to discuss with you confidentially.

I am sorry about the length of this letter which I have tried to keep as brief as possible and as I have already said, I shall quite understand if you are unable to see me although, if course, I would very much regret it.

Yours sincerely
Walter H. Salomon

BIOGRAPHICAL NOTE

Walter H Salomon

Mr Salomon is 74 and has been chairman of Rea Brothers Ltd (Merchant Bankers) since 1950 (an extract from Who's Who is attached).

Rea Brothers

Rea Brothers Ltd (established 1919) is a merchant bank and a member of the Accepting Homes Committee. It is also a recognised bank under the Banking Act. The Prime Minister should also be aware that the Bank of England are still considering an application for recognition from Copleys Bank Ltd which is a wholly-owned subsidiary of Rea Brothers. [If this question is raised the Prime Minister is advised to reply that a decision on any particular application for authorisation under the Banking Act is a matter for the Bank of England.]

BANKING THROUGH THE EYES OF A PRIVATE BANKER
Mr. Salomon's 1 April 1980 Lecture to the Institute of Bankers

Mr. Salomon's major criticism in his lecture is of the Banking Act 1979; but he also criticises the Aircraft and Shipbuilding Nationalisation Act and the Consumer Credit Act. Separate briefs are attached on these three points.

BANKING ACT 1979

Background

The Act sets up a statutory framework for the authorisation and supervision of deposit-taking institutions by the Bank of England and these provisions came into operation on 1 October 1979. The Act provides that it is an offence to take deposits unless authorised to do so by the Bank of England. It establishes a two-tier system of authorisation - one tier comprises 'recognised banks' and the other 'licensed deposit-taking institutions'. The Act also provides for restrictions on the use of banking names and descriptions. In general, the use of such names and descriptions will be confined to the recognised sector. There is a right of appeal to the Chancellor against a decision by the Bank. The Bank have now dealt with the majority of applications from existing deposit-taking institutions for authorisation under the Act.

Mr. Salomon's speech-summary

Mr. Salomon wrote to the Chancellor on 2 April enclosing a copy of his speech. The Chancellor replied on 15 May (copy attached at Annex A). In his speech, Mr. Salomon strongly questions the need for legislation and argues that it represents an unwarrantable interference with the liberty of the subject. His main point is that the powers and discretions vested in the Bank are too sweeping and the safeguards against their misuse inadequate. He also argues

that the legislation will have the effect of stifling competition. In particular Mr. Salomon makes the following points.

The Act might have been required at some time to comply with the requirements of the European Community

Comment: Legislation was required by the end of 1979 to satisfy our EEC obligations under the first banking directive. This required a system of prior authorisation of deposit-taking institutions: such a system necessitates legislation because it removes certain rights; and it inevitably leads to extended legislation because it carries with it the possibility of withholding or withdrawing authorisation which in turn entails associated criteria and rights of appeal.

The powers and discretions of the Bank are sweeping and ill-defined

Comment: It would have been possible to import more precision into the Act. But this would have detracted from the ability of the Bank to take remedial measures in unforeseen contingencies, and would have run the risk of ossifying the system. The Act was designed to fill a gap in the regulatory arrangements which was exposed by the secondary banking crisis of 1974 while allowing the Bank to operate, as far as possible within a statutory framework, in the relatively informal and flexible fashion which has always characterised its supervisory relationships with the banking sector. [Mr. Salomon's criticism here would not seem consistent with his fear that the Act will "fossilise market procedures" nor with

his later argument that "a close study of the Act shows that the Bank has very little discretion in the interpretation".]

The Bank's powers are only subject to appeal to the Chancellor

Comment: The exercise of the Bank's powers and discretions is open to potential abuse and the adequacy of safeguards is fundamental. It is not correct that the only recourse is to the Chancellor: the exercise of powers and discretions is subject to the test of reasonableness and in the case of abuse there are remedies available in common law outside the immediate appellate machinery. The Bank is answerable for the the general operation of the system through the Chancellor to Parliament.

The Act will stifle competition because of the minimum capital requirement and the two tier structure

Comment: The minimum capital requirement particularly for licensed institutions is low. A recognised sector which includes several hundred institutions and is wide open to international competition cannot sensibly be said to enjoy a comfortable monopoly. The Bank attach importance to the principle of progression from the licensed to the recognised sector - and the categories will not therefore become ossified.

The Handbook of Banking Supervision makes more stringent demands than the Act itself and requires institutions to consult the Bank prior to acquisitions or disposals of subsidiaries

Comment: It is true that the Handbook contains more information on prudential criteria than contained in the Act. This is so that

interested parties know how the Bank proposes to interpret and administer the Act and that it will do so in a reasonable and equitable fashion. The alternative would have been further elaboration in the Act itself. It is not a requirement that institutions consult the Bank before acquisitions or disposal of the controlling or material interests in other companies: this is an expectation and reflects existing conventions to which banks have not objected in the past.

<u>The personal questionnaire for directors and managers and of institutions is unnecessary and irrelevant</u>

Comment: The Bank have to be satisfied that such persons are fit and proper and consider the questionnaire a necessary check. The questionnaire seeks details of any offences, censure, of bankruptcy or association with companies that become insolvent and - unless the person concerned has anything adverse to disclose - is a negligible (if irritating) imposition.

<u>The Bank's papers on foreign currency exposure and liquidity show the Bank are interpreting the Act inflexibly</u> [This was not raised in Mr. Salomon's speech but could be a later criticism]

Comment: Both these papers - issued by the Bank under the prudential responsibilities conferred on them by the Banking Act - are consultative papers on which the views of the market are being sought. This was made clear by the Governor of the Bank in his speech to representatives of the Foreign Banking Community in London on 20th May. Mr. Salomon is therefore free to comment to the Bank as he wishes.

THE AIRCRAFT AND SHIPBUILDING NATIONALISATION ACT

Mr. Salomon in his speech implicitly criticises the compensation terms under this Act. Mr. Salomon wrote to the Minister of State for Industry in May on this question. Arrangements have since been made for a meeting between Mr. Butler and Mr. Salomon which has been provisionally fixed for 11 July. If this question arises, the Prime Minister is advised to suggest it would be more suitable to be discussed at this later meeting.

THE CONSUMER CREDIT ACT

Mr. Salomon describes this as "another glaring example of unsatisfactory legislation". The Consumer Credt Act 1974 largely implements the recommendations of the Committee on Consumer Credit chaired by the later Lord Crowther. Its purpose was to establish a new legal framework to replace the outmoded existing legislation and not merely to regulate hire-purchase and second mortgage business. The intention was that it should apply to all lending institutions including banks. There are however, contrary to Mr. Salomon's assertion, special provisions relating to current account overdrafts.

The licensing system is not onerous for banks or other creditors, particularly now that licences last 10 years. The "truth in ledning" regulations such as those relating to advertisements coming into operation next October and those in preparation as to the form and content of agreements and other documentation will necessarily entail some cost but we believe that it is outweighed by the benefit to consumers of having more information about the terms on which creditors do business. There will moreover be a benefit to creditors from completing implementation of the Act in that it will then be possible to repeal the Moneylenders, Pawnbrokers and Hire-Purchase Acts. Mr. Salomon's real complaint is that banks no longer enjoy the privilege of being outside the scope of the consumer credit legislation.

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

15 May, 1980

W.H. Salomon, Esq.,
Rea Brothers,
King's House,
36-37, King Street,
LONDON,
E.C.2.

Dear Mr Salomon

Many thanks for sending me a copy of the speech which you delivered at the Institute of Bankers early in April.

I was very interested to read your speech and I can assure you that the Government is well aware of the dangers which can exist in any regulatory legislation and the need for it to be operated flexibly. However, our EEC obligations required us to have legislative backing for a banking authorisation system by the end of 1979 and the secondary banking crisis, of course, offered some clues as to the risks with which such a system needs to be concerned.

The Bank have a duty to report to me and to Parliament on the operation of the supervisory system and, I can assure you that we will keep it under review.

Yours ever

GEOFFREY HOWE

Geoffrey Howe

Intervention to depress the exchange rate

Mr Salomon says he understands the Prime Minister's reasons for turning down his suggestion that the authorities should sell sterling to reduce the value of the pound and seek to offset the domestic monetary impact by cancelling a corresponding amount of debt. He comments, rather grudgingly, that "perhaps it would be better to fall back and let the market economy take its toll".

2. The points put to him were :-

(a) Repaying official overseas debt by drawing on the reserves (which is the Government's policy) has no impact either on the exchange rate or on domestic monetary conditions.

(b) Repaying debt by first intervening in the foreign currency market to sell sterling and acquire foreign currency might depress the exchange rate; but it would also add to the money supply.

(c) Seeking to offset the monetary impact of (b) by selling more gilts would not necessarily help. Interest rates would need to be higher, tending to attract capital inflows and raise the exchange rate back to its initial level. The mobility of international capital limits the effectiveness of intervention policy in affecting the exchange rate other than in the very short term.

(d) Even if we succeeded in holding down the rate without adding to the money supply, we would have to balance any advantage to exporters against the cost of higher interest rates and a loss of the beneficial impact of a high rate on inflation.

3. Since the Prime Minister wrote it has become clear that the foreign exchange markets may be particularly sensitive to interest rates just at present. So when domestic monetary conditions permit a reduction in UK interest rates some fall in the exchange rate can perhaps be expected-unless there were some offsetting event in the world oil market at the same time.

RETENTION OF EXCHANGE CONTROL ACT 1947

Annex A
Annex B

1. Mr Salomon's memorandum, dated 30 May, precedes the Prime Minister's reply to him of 2 June and quotes in full the Chancellor's Parliamentary statement (to which Mrs Thatcher referred) in a Written Answer on 16 May. Mr Salomon however is not persuaded and, in his latest letter, he says "I am not so sure I agree with the Exchange Control Act".

2. In his memorandum, Mr Salomon made three points:

Annex C

(a) He does not believe the Act needs to be retained because of the European Community Directive of 21 March 1972, and suggests that the latter's desired aim could be achieved "via the Bank of England authority"; and he cites Germany as being able to comply without having an Exchange Control Act on the statute book.

Comment

If Mr Salomon is thinking of the Bank of England's powers of moral suasion, these would not suffice without statutory backing for effective use of the instruments which are required by the Directive to be available for regulating capital flows, except as regards fixing minimum reserve ratios, which could probably be done through non-statutory credit control arrangements. The Germans in fact do have powers under existing legislation to meet the requirements of the Directive: there are wide powers to control both inflows and outflows in the Federal German External Trade and Payments Law of 1961; and minimum reserve regulations can be made under the Bundesbank Act of 1957 as amended in 1969. All our other Community partners also have existing legislation enabling them to meet the Directive's requirements. The Directive is not an excuse but a reason for retaining the Exchange Control Act.

(b) He claims that removal of any possibility of reimposing Exchange Control without legislation "but by the mere fiat of Treasury officials" would best protect the British public from overregulation of the banking industry.

Comment

Exchange controls have been abolished by means of the Exchange Control (General Exemption) Order 1979 made under the 1947 Act. Any re-imposition of control would need at least one amending Order which would have to be signed by two of the Lords Commissioners after Ministerial policy approval. So there is no question of "the mere fiat of officials".

(c) He suggest that the Chancellor must rely on the advice of civil servants who would not want power taken out of their hands.

Comment

The Chancellor could, if he wished, say that he had himself reviewed the future of the 1947 Act with his colleagues concerned and point out that exchange controls had been completely removed.

5. The specific points in Mr Salomon's memorandum could be dealt with on the lines of the comments above. More generally, he could be reminded that, by abolishing controls, the Government have shown their determination to remove obstacles to the free working of the market and reduce burdens on the business community; and that a large department in the Bank of England has been disbanded and a number of civil servants released for other work. He might be invited to accept that Ministers are satisfied it is nevertheless necessary to keep the Exchange Control Act on the statute book at least for the time being, with the aim of improving the law as indicated in the Chancellor's statement of 16 May when opportunity permits.

MEMORANDUM

FOREIGN EXCHANGE CONTROL ACT, 1947

1. On 16th May, 1980, in a written question, Mr. Cockeram, M.P., asked the Chancellor of the Exchequer if he had completed his review of the future of the Exchange Control Act, 1947, and whether he would make a statement. In a written answer the Chancellor replied as follows:

"Yes. The House was told on 6th November last that, "following my decision, announced in October, to abolish "exchange controls, I would be reviewing the future of the "Exchange Control Act, 1947. I have now decided that, at "least for the time being, the present Act should be retained.

"I regard the 1947 Act as unsatisfactory in a number of ways, "notably in the wide extent of its powers and in his bias, "natural enough when it was introduced, towards the control "of outflows. I see no prospect of time being made available "in the legislative programme for the early replacement or "substantive amendment of the Act; and simple repeal would "not be compatible with our Treaty obligations.

"I do however envisage that ultimately, and probably most "conveniently in several stages, changes in the law will be "sought with the objectives of making the powers available in this "area less draconian and more symmetrical as between control "of outflows and of inflows.

"In the meantime, the Act needs to be kept in being because the "United Kingdom Government are required, under the European "Community Council Directive 72/156 of 21st March, 1972, to "have available certain instruments for effective regulation of "international capital flows and for neutralising those effects of "such flows on domestic liquidity which are considered undesirable. "The Directive also requires that these instruments may be able, "where necessary, to be put into operation without further enabling "measures. The Exchange Control Act, 1947, is the only current "legislative authority in the United Kingdom under which the "Government could take such action."

2. It will be seen from the above reply that the Chancellor agreed that he regarded the 1947 Act as unsatisfactory in a number of ways "notably in the wide extent of its powers and in its bias". He then went on to say that the Act needed to be kept in being "because the "United Kingdom Government are required, under the European "Community Council Directive 72/156 of 21st March, 1972, to have "available certain instruments for effective regulation of international "capital flows and for neutralising those effects of such flows on "domestic liquidity which are considered undesirable. The Directive "also requires that these instruments may be able, where necessary, "to be put into operation without further enabling measures". I have carefully perused the Directive mentioned above and a copy is attached hereto.

3. It seems odd to me that other countries can comply with the Directive without having an Exchange Control Act on their Statute Books and I refer in particular to Germany. I would have thought it a very simple matter, via the Bank of England authority, to achieve the desired aim of the Directive. To use this Directive as an excuse to retain the Exchange Control Act is, in my opinion, unwarranted.

4. In a lecture which I gave at The Institute of Bankers on 1st April, 1980 I called for the repeal of the 1947 Act; I attach a re-print of my lecture in which I have marked the appropriate passage. The removal of any possibility of the re-imposition of Exchange Control, without legislation but by the mere fiat of Treasury officials, would be the best possible protection for the British public from over regulation of the banking industry. Knowing the Chancellor as I do, I am quite sure he would sympathise with these sentiments, as would the Prime Minister.

5. In dealing with these matters the Chancellor must, of course, rely on the advice given him by his Civil Servants and the removal of any controls might be against their direct personal interest as it would take power out of their hands.

6. I am, in the meantime, making enquiries of other E.E.C. countries to ascertain what measures they have taken in order to deal with the Directive.

WHS/MB
30th May, 1980

ANNEX B

10 DOWNING STREET

THE PRIME MINISTER

Dear Mr. Salomon,

Thank you for your two letters of 28 April about the Exchange Control Act and the value of sterling.

With regard to the Exchange Control Act, the future of this legislation involves other factors besides the temporary need to retain powers while exchange controls had to continue (till 13 December last) in relation to Rhodesia. In particular, repealing the Act would not be compatible with our Treaty obligations in the European Community since the Council Directive 72/156 requires us to have available, without further enabling measures, certain instruments for the regulating of capital flows. The 1947 Act provides the only current legislative authority. While we do envisage ultimately seeking some changes in the law on exchange control, there is no prospect of finding time in the legislative programme for the early replacement or substantive amendment of the present Act. You may have seen that the Chancellor of the Exchequer recently made a statement in Parliament to this effect.

In your other letter you suggested that we should sell sterling to reduce the value of the pound, at the same time offsetting the domestic monetary impact by cancelling a corresponding amount of debt; I assume that you have in mind repayment of debt to overseas. (If we were to re-pay a corresponding amount of debt held in the UK, this would simply add to the money supply).

It is our policy to reduce substantially the burden of our foreign currency borrowing during the lifetime of this Parliament. But this policy does not offer a solution to the problem that I posed in the House. The monetary effect of intervention depends on

/its scale and

11/1

its scale and how it is financed. Any net inflow to the private sector would not be offset if we then used the additional reserves to repay overseas debt. Such repayments have no impact on domestic conditions at all; no private sector transactions are involved. Sooner or later, as I said, any attempt to hold down the exchange rate by intervention would jeopardise monetary control.

Even if we sought to offset the domestic monetary impact by, say, selling additional gilts there might well be little lasting impact on the exchange rate, although interest rates would need to be higher to achieve the necessary gilt sales. Mobility of international capital limits the extent to which intervention can effect the exchange rate, other than in the very short term. And if we succeeded in holding down the exchange rate, we would have to balance the advantage to exporters against the cost - some of which would be borne by exporters - of the higher level of domestic interest rates. We would also lose the beneficial effects of a higher exchange rate on inflation and monetary control.

Warm personal wishes.

Yours sincerely

Margaret Thatcher

W.H. Salomon, Esq.

18.4.72 Official Journal of the European Communities No L 91/13

COUNCIL DIRECTIVE

of 21 March 1972

on regulating international capital flows and neutralizing their undesirable effects on domestic liquidity

(72/156/EEC)

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community, and in particular Articles 70 and 103 thereof;

Having regard to the proposal from the Commission;

Whereas exceptionally large capital movements have caused serious disturbances in the monetary situation and in economic trends in Member States; whereas these disturbances may hinder the establishment by stages of an economic and monetary union; whereas the Council, in its resolution of 9 May 1971, agreed to discuss before 1 July 1971 the adoption of appropriate measures to deal with this situation;

Whereas, so that contingencies of comparable character and magnitude do not recur, the Member States should supplement the instruments that are available for regulating domestic liquidity;

Whereas to this end it is imperative that Member States adopt measures immediately in order to have available, should occasion arise, the appropriate instruments for purpose of discouraging exceptionally large capital movements, in particular to and from third countries, and of neutralizing their effects on the domestic monetary situation, thereby creating the conditions required for concerted action on the part of the Member States in those fields in order to ensure smooth trading conditions within the Community and the achievement of economic and monetary union;

Whereas exceptionally large capital movements can produce serious stresses on the exchange markets of the Member States, the smooth operation of which constitutes the object of the policy with regard to rates of exchange which each Member State must, by virtue of Article 107 (1), treat as a matter of common concern;

Whereas, in order to ensure the efficacy of the measures to be taken to prevent exceptionally large capital movements, the regulation of loans and credits not related to commercial transactions or to provision of services and granted by non-residents to residents must be extended to medium- and long-term loans and credits; whereas for this purpose a derogation from Article 3 (1) of the First Directive for the implementation of Article 67 of the Treaty,[1] as amended by the Directive of 18 December 1962,[2] should be permitted;

HAS ADOPTED THIS DIRECTIVE:

Article 1

The Member States shall take all necessary steps to ensure that the monetary authorities have available the following instruments and are able, where necessary, to put them into operation immediately without further enabling measures:

(a) for effective regulation of international capital flows:

— rules governing investment on the money market and payment of interest on deposits by non-residents;

— regulation of loans and credits which are not related to commercial transactions or to provision of services and are granted by non-residents to residents, if need be by derogating from Article 3 (1) of the First Directive for the implementation of Article 67 of the Treaty;

[1] OJ No 43, 12.7.1960, p. 921/60.
[2] OJ No 9, 22.1.1963, p. 62/63.

(b) for the neutralization of those effects produced by international capital flows on domestic liquidity which are considered undesirable:

— regulation of the net external position of credit institutions,

— fixing minimum reserve ratios, in particular for the holdings of non-residents.

Article 2

1. The Member States shall forthwith adopt the necessary measures to comply with this Directive

2. Each Member State shall, where necessary, and taking account of the interests of the other Member States, apply all or some of the instruments mentioned in Article 1. To this end the Commission, in cooperation with the Monetary Committee and the Committee of Governors of Central Banks, shall ensure close coordination between the competent authorities of the Member States.

3. The Commission, after consulting the Monetary Committee and the Committee of Governors of Central Banks, shall keep the Council informed of the situation and its development.

Article 3

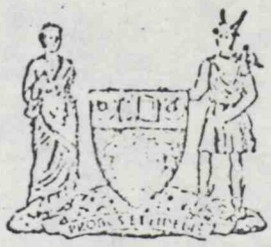
This Directive is addressed to the Member States.

Done at Brussels, 21 March 1972.

For the Council

The President

G. THORN



THE INSTITUTE OF BANKERS City of London Centre

ADDRESS GIVEN BY MR. WALTER H. SALOMON FIB., CHAIRMAN OF REA BROTHERS LIMITED, PRIVATE BANKERS, AT THE CITY OF LONDON CENTRE OF THE INSTITUTE OF BANKERS ON 1st APRIL, 1980

"BANKING THROUGH THE EYES OF A PRIVATE BANKER"

Some nine years ago I had the privilege of addressing the members of the Institute at the City of London Centre on the subject: "Merchant Banking through the Eyes of a Private Banker".

I want to return today to some of the issues I discussed on that occasion, but perhaps on a wider front, under the title: "Banking through the Eyes of a Private Banker".

In particular, I want to comment on the Banking Act, 1979, which received Royal Assent on 4th April, 1979. But more about that later.

If I repeat some general observations on banking, which I have reiterated for many years, I would remind you of the words of the eminent novelist and philosopher, André Gide, who opened a lecture by noting:

> *"All this has been said before, but since nobody listened, it must be said again."*

I understand from your Chairman that he would like a questions and answers period after my talk and for this reason I will curtail my remarks and be as succinct as possible.

There are a great number of kinds of operation which in some way or other come under the heading of "Banking" including clearing banks, the investment banks, the merchant banks and the foreign banks, etc. etc. The words "Private Bank" are rarely used these days and I hope you will not mind my repeating what I said in my last address to you on 30th November, 1971, when I quoted what Walter Bagehot said in 1858 about the old private banker. He said:

> *"I can imagine nothing better in theory or more successful in practice than private banks as they were in the beginning. A man of known wealth, known integrity, and known ability is largely entrusted with the money of his neighbours. The confidence is strictly personal. His neighbours know him, and trust him because they know him. They see daily his manner of life, and judge from it that their confidence is deserved. In rural districts and in former times, it was difficult for a man to ruin himself except at the place in which he lived; for the most part he spent his money there, and speculated there if he speculated at all. Those who lived there also would soon see if he was acting in a manner to shake their confidence. Even in large cities, as cities*

ther were, it was possible for most persons to ascertain with fair certainty the real position of conspicuous persons, and to learn all which was material in fixing their credit. Accordingly, the bankers who for a long series of years passed successfully this strict and continued investigation, became very wealthy and very powerful. The name 'London Banker' had especially a charmed value. He was supposed to represent, and often did represent, a certain union of pecuniary sagacity and educated refinement which was scarcely to be found in any other part of society. In a time when the trading classes were much ruder than they now are, many private bankers possessed a knowledge and a delicacy of attainment which would even now be very rare. Such a position is indeed singularly favourable. The calling is hereditary; the credit of the bank descends from father to son: this inherited wealth soon brings inherited refinement. Banking is a watchful, but not a laborious trade. A banker, even in large business, can feel pretty sure that all his transactions are sound, and yet have much spare mind. A certain part of his time, and a considerable part of his thoughts, he can readily devote to other pursuits. And a London banker can also have the most intellectual society in the world if he chooses it. There has probably very rarely ever been so happy a position as that of a London private banker; and never perhaps a happier."

Those were the days! In more recent times, starting in August, 1914, the then generally accepted private banks formed themselves into the Accepting Houses Committee and it was from that day on that the words "merchant bank" came into being. It is significant to note that of the twenty firms who joined together only two were Limited Companies. In other words, family involvement and the sense of the proprietor were their hall-marks. Even in the two firms which were Limited Companies the founder families had a substantial stake in the bank.

I have to remind you that in a private partnership each partner is fully responsible for the entire indebtedness of his firm and that in itself provides a healthy restraining influence on the decision-making.

The words "merchant bank" have long since become a misnomer; there may at the time have been some members of the Accepting Houses Committee who were both "merchants" and "bankers" but that can hardly be said today of many of the Accepting Houses Committee, or others who trade as merchant bankers. Nor are there any significant private bankers left who trade as a partnership.

This development is regrettable and is largely promoted through the confiscatory nature of our tax system where either by Capital Transfer Tax, or by ordinary taxation, private partnerships are being taxed out of existence. It is worth remembering that this is not the case on the Continent where some of the leading private bankers are today still partnerships. The argument advanced was that by becoming a Limited Company it would be easier to raise fresh capital and be competitive in meeting the growing demands being made on the services of the banks.

I said in my 1971 address that a bank does not automatically improve by becoming bigger. There can be no objection to organic growth which is the natural process resulting from internal development. The danger to sound banking comes from the forced growth which is now held to be necessary for business success. I may say that some of the merchant banks which supported this philosophy have since found by experience that the truth lies somewhere else. When growth is forced and takes the firm into areas beyond its experience, the managers, called directors, can no longer be involved as individuals in the fortunes of the business.

As I have said before, a banker should be someone of independent views and should not fear to express them, even though they may be unpopular. If he is to command respect and justify his position he must support his rejection of commonly held opinions by rational argument. He must be a leader not only in general public causes but also to the young, and by his performance he must inspire the young and create a sense of purpose and loyalty.

Private banking is something to which academic qualifications might make a contribution, but in the final analysis it can only be learned by practical experience. The vast growth of some of the large banks in the world which base their status on the size of the deposits which they have is leading to monolithic organisations. This is a far cry from the personal involvement, ingenuity and imagination with which a sound private bank conducts its business.

It was on the basis of the latter that the London market became what it was: the centre of finance and credit in the world, and the envy of other countries. Later I shall propose that the new Banking Act is a very serious assault on this philosophy. In this connection I think it is equally important to look at the central banks as they are part of the whole structure.

In most cases the central banks were owned originally by the public and had a totally independent management. Of late, most central banks are in the hands of the Government and are therefore subject to the direction of the Government (i.e. politicians). It goes without saying that their decisions are not necessarily based on sound economic banking principles but on the directions they receive from their political masters. We in this country have in the past been lucky in that the Bank of England has been able to keep in close touch with the banking sector so that usually day to-day problems are dealt with by consent. On the other hand, I believe the inflation we are experiencing today would not have been possible if central banks had remained independent. Thus the German central bank is much more independent from government and politicians. Under German Law the Bundesbank is required to maintain the value of the mark and the monetary policy in that country is therefore traditionally much more geared towards maintaining sound money than to helping politicians manipulate the economy. Because Germany experienced hyper-inflation, her bankers certainly know what they are talking about. Hence, inflation in Germany today is minimal.

I recall that in my 1971 address to you, I suggested that the commercial banks should have a single association to represent them. I am pleased to say that since then—and let me add that I take no credit for it—the British Bankers Association, which was originally formed in 1920, has taken on a new lease of life following our entry into the E.E.C. and has made an extremely useful contribution to banking in this country.

I now turn my focus onto the Banking Act, 1979, which the present Government is currently bringing into operation. The Bill had, in fact, been prepared under the Socialists and when the present Government took office it was already on the Statute Book and was put into operation by them. On 20th November, 1979, The Rt. Hon. Lord O'Brien, President of the British Bankers Association, addressed you on the occasion of the Ernest Sykes Memorial Lecture. He spoke in his private capacity and in a very approving manner on the subject of the new Banking Act, and concluded that

> *"the Act should benefit our banking system by ensuring good order and discipline throughout the whole range of deposit-taking institutions, while not to any degree impairing that freedom to do business under the benevolent if watchful eye of our central bank".*

I hold a different view which I believe is shared by a number of other bankers. This does not imply any disrespect for Lord O'Brien as a distinguished central banker; but, of course, it is not surprising that private bankers like myself should see things differently from someone who has made his career in central banking.

There might at some time be the necessity to introduce a Banking Act in order to comply with the requirements of the European Community. However, this Banking Act was introduced as a result of the last Government's over-reaction to the secondary banking crisis of 1974—a crisis incidentally to which the introduction of Competition and Credit Control may well have been a major contributory factor as the massive expansion in the money supply certainly was. It is as if one took a sledge-hammer to crack a nut.

My misgivings are based on humanitarian grounds, libertarian grounds, and on practical consequences. In fact, the Bill cuts right across the professed philosophy of our Prime Minister to encourage smaller businesses, and to make it possible for young and aspiring people to find a place in the sun. Instead, it increases bureaucracy and can be a direct interference with the workings of the market economy.

As legislation now stands, there is little chance for young, enterprising people to start a banking business because they simply could not comply with the requirements laid down by the Act, especially the minimum requirements on capital. Had the Act been in force when Sir Sigmund Warburg was starting his business, or when we were starting ours, we would not have been able to do so. I do not apologise for quoting my personal experience because I speak as one who in the 1930s under the Nazis knew what it was to lose my liberties. That is not a matter to be taken lightly.

What the Act does is create a two-tier system which is divisive. If one is classified as "second class", it is more than difficult to cross the Rubicon. Not only must there already be hundreds whose aspirations and ambitions have been thwarted by the Act. It also creates a comfortable monopoly for those in the favoured first category, and thereby stifles competition.

The liberty for the creation of free enterprise is the most precious of all our assets and the price to be paid is great. I recall from personal experience the discretionary laws introduced at the time by the Government ruling Germany before Hitler came to power. These seemed quite reasonable if dealt with by fair-minded people, but Hitler used them to further his dictatorship. We must make sure that this cannot happen here. As John Philpot Curran, the Irish Judge said

"the price of liberty is eternal vigilance".

The Bank of England has been entrusted with the administration of the Act and its sweeping and ill-defined powers are subject to appeal only to the Chancellor of the Exchequer.

In my view the establishment, growth, licensing and recognition of young new banks will be very difficult indeed under the new legislation. The Bank of England is no doubt very conscious of these problems and has said that within the constraints of the Act it will adopt a flexible approach in its administration. However, a close study of the Act shows that the Bank has very little discretion in its interpretation and the ultimate supervisory powers of the Bank of England are vested in the hands of a few senior officials under one of the Executive Directors. Such a set-up in the wrong hands could be a recipe for bureaucracy or worse.

Already, the Banking Supervisory Division has shown signs of interpreting the Act fairly rigidly. Its Hand-book of Banking Supervision, if anything, makes more stringent demands than the Act itself. There are numerous examples of this but just to mention one, I would point out that certain criteria required by licensed deposit-takers under the Act have been applied to banks in general. Also the Handbook requires licensed and recognised institutions to consult the Bank in advance about, *inter alia*, "the establishment or disposal of subsidiaries", or the acquisition or disposal of "any material interest in other companies". This gives the Bank substantial control over the development of the business and is a further extension of bureaucracy. It prevents banks from making speedy decisions on proposals which require immediate action without waiting for approval from the supervisory authority. Part C of the Handbook "Principles of Supervision" has not yet been issued and appears likely to contain a series of arithmetical "prudential" formulae, none of which are mentioned in the Act. As IBRO, the London clearing banks research organisation has pointed out, the bureaucrats are likely to

> *"fossilise market procedures. It is a vicious circle: the Bank calculates a gearing ratio because it believes the market is relying on a gearing ratio and the market will continue to calculate a gearing ratio because it knows that the Bank is calculating one".*

Many years ago in a speech entitled "The Price of Liberty", I said

> *"Liberty is not taken away in one lump; it is being taken away in little bits and pieces. 'One little bit', you may say, 'why worry?'. But little bits put together make a big lump and if we are not watchful our liberty is gone."*

I understood the philosophy of the present Government to be based upon what Dean Alfange, the American lawyer once wrote:

> *"I do not wish to be a kept citizen, humbled and dulled by having the State look after me".*

Under the Act banks are required to submit certain forms to the Bank of England. In fact, the banks have provided a great deal of information in this way for many years, but in a more or less informal way and by consensus. Now, by direction of the supervisory body of the Bank of England we are, for instance, required to give information on the personal background of the officers of our banks for scrutiny by the officials. (Annex C). This is a lengthy form requiring details of directors and requests information for instance regarding the nationality of a director or manager. I cannot see what this has to do with whether he is a suitable person to be appointed a director or manager of a bank. Furthermore, I fail to see the relevance of how his nationality was acquired. In addition, the form requests information for instance on any offences committed, however trivial, which could even extend to certain categories of motoring offences.

This is a serious matter and I consider the question whether a person is suitable for appointment as a director or manager of a bank should be left to the Board of the bank and, as far as directors are concerned, if necessary to the shareholders, who are best qualified to decide.

There are two subsidiary objections to the administration of the Act. Firstly, a new bureaucracy is being built up. After forty years we have only just got rid of foreign exchange control. It must have been an extremely expensive department to run. In this connection, the only matter still outstanding is the abolition of the 1947 Exchange Control Act. As I have already said bureaucracies are expensive and this is certainly not in line with the declared policy of the Government to reduce public expenditure. At present, the Bank of England supervises approximately 100 banks and 60 other deposit-taking institutions which is a substantial increase compared with 1974. It is thought that with this Act the numbers may increase to 250 banks and between 200 and 300 licensed institutions. This increase is of course largely due to the ever-continuing inflow of foreign banks into London. Secondly, and most seriously, there is no provision for independent appeal. The only appeal is to the Chancellor of the Exchequer who cannot be considered independent because he is the politician to whom the Bank of England is in any case responsible and to whose ultimate authority its affairs are subject.

There is a subsidiary but still important criticism. The Act clearly confers on the Bank considerable powers not only if an institution fails to comply with any obligation imposed by the Act but also if in its opinion the conduct of any institution threatens the interests of its depositors. In these circumstances the Bank may give directions prohibiting *inter alia* the institution from disposing of its assets. For example, any future administration could take the view that it would be in the interests of depositors for the dividend of any bank to be blocked. As a matter of commonsense, it might be argued that it is very difficult ever to justify paying dividends to shareholders if the interest of depositors must be protected over everyone else. But, those who drafted this Act are not bankers. They do not understand that banks are not merely there to allow people to deposit money safely; the Government can always offer safer savings media—with the involuntary support of taxpayers' money. There has to be a balance in private banking between the safety of deposits, the maximising of profits and the financing of productive enterprise.

Now notice the subtle wording of the Act. Even if the stated criteria for recognition as a bank are fulfilled the Bank is not bound to grant a licence, but only "may" do so. (Sec. 3 para. 1). Furthermore, paragraph 6 of Schedule 2 gives the Bank absolute authority to determine whether resources are, in the Bank's view, "commensurate with the scale of operations". This clause means that the Bank can specify what any bank does, e.g. the size of loans, balance sheet totals, exposure to certain countries or types of business. Even worse, the Bank is given wide powers (Sec. 19 para. 6) to disclose confidential banking information to foreign central banks. This power may rightly inhibit foreigners from placing banking business in this country.

Supposing we had a less understanding government than we now have, how could such powers be used? In Chile we had a glaring example of just what happens in such a case. The Communist take-over by Allende began with the confiscation of businesses. The approach, however, was subtle. Allende announced a 50 per cent reduction in interest rates. Debtors were exultant. On the Stock Exchange, the price of bank shares came tumbling down. Then the Government offered to buy the shares at the old price on condition that Communist officials had seats on the Board. The next step was to cut off credits to private industry. Production schedules were disrupted, labour disputes developed. From then on it was a simple matter for Marxist labour leaders in alliance with the new Board officials and Government officers to cause conflicts which provided an excuse for expropriation, nationalisation or plain theft of industrial enterprise.

One favourite tactic was to claim that a particular company had failed to maintain production. Then a government inspector would be sent in to present the management with a list of impossible demands. He might, as happened in the case of a domestic appliance manufacturer, demand to be shown up-to-date records of all business transactions within 24 hours. If the company management failed to meet his demands, he could then obtain an order for the firm to be "requisitioned". You say, "this would not happen here. The U.K. is not Chile". But, have I not explained that the Act gives just the sort of powers as were used in Chile to control dividends, lending, acquisitions, balance sheets ratios and so on. Perhaps you think it is unlikely that a British Government would seek to manipulate the value of companies on nationalisation, but I ask you to recall the Aircraft and Shipbuilding Nationalisation Act. This legislation provided for the acquisition by the state of companies in 1977 with compensation based in most cases on imaginary stock market prices in the winter of 1973–74—the time of the three-day week and one of the bleakest periods in stock market history. The result of all this has been that most compensation claims remain unsettled, even now. A number of the stockholders' representatives are considering going to the Court of Human Rights in Strasburg and the present Conservative administration seems to be bound by the legislation put through Parliament by Mr. Benn. Do you still think it can never happen here?

I do not think it will be necessary for a new Act to be introduced to nationalise the banks. This Act, administered by other than well-meaning officials under the direction of a government of a different complexion, could be a back-door route to nationalisation.

Another glaring example of unsatisfactory legislation is the Consumer Credit Act which was intended to rationalise and regulate the hire purchase and second mortgage business. In practice it has meant imposing yet another licencing procedure on the whole banking system with the usual proliferation of forms, notices and bureaucrats. It also sought to change the basis on which all banks gave credit to the ordinary private borrower although Parliament in its wisdom did not see fit to mention the word "bank" or "overdraft" in any of the Act's 170 odd clauses. The Act is regarded by those unfortunate enough to have to live with it as one of the most impractical pieces of legislation ever to see the light of day and such is the confusion it has caused that nearly six years later much of it has still not been brought into effect. I believe that they should repeal the whole Act and start again with new legislation using a practical rather than an academic approach. It is just another case of the sledge-hammer being used to crack a nut. The saddest aspect is that the Act must raise costs and so increase the charge for credit to the consumer, whilst inevitably failing to stamp out the extortionate charges made by fringe operators to borrowers who cannot obtain finance from any other source.

The amount of delegated legislation that is already effectively law is far too great. Government officials direct our actions in almost every area of life by way of statutory instrument. This is something against which I have always campaigned and written at length.

Discretionary powers cannot today be challenged in law. What we really need is a Court of Administration—on the continental model—through which these powers can be challenged.

I promised to allow adequate time for questions at the end and so I bring my remarks to a close by appealing to every banker in this country. Let us stand up and ask for the repeal of the banking law as it stands or, at least, for its substantial amendment. Let me again quote John Philpott Curran, the Irish Judge, who said

> *"It is the common fate of the indolent to see their rights become a prey to the active".*

Let's become active for a change. In this respect, I am glad to learn that at the last meeting of the Accepting Houses Committee it was agreed that a working party should be formed by the Chairman and Director-General to examine what changes were required in the provisions of the Act and the manner in which it was being implemented and to advise on whether Members wished to seek outright repeal or amendment of the Act or to find ways of operating the Act in a self-regulatory manner.

I hope the British Bankers Association will follow this example as well as any other interested party and that in the end their efforts will be co-ordinated. The banking industry should consider this matter a first priority.

Thank you for having listened to me so patiently.

27 JUN 1980

10 DOWNING STREET

From the Private Secretary

17 June 1980

As you know, the Prime Minister has agreed to see Mr. Walter Salomon at 9.30 a.m. on Tuesday, 1 July. Mr. Salomon has told us that he wishes to go over some points in the letter which the Prime Minister sent him on 2 June, and also to discuss a note on the Exchange Control Act prepared by Mr. John Baring and a speech which Mr. Salomon himself gave "Banking Through the Eyes of a Private Banker".

I am enclosing copies of these two documents; I am also sending a copy of this letter, copies of the two documents referred to above and a copy of the Prime Minister's letter of 2 June to Catherine Bell (Department of Industry).

T. P. LANKESTER

M.A. Hall, Esq., M.V.O.,
H.M. Treasury.

File

B/F 30-6-80

10 June 1980

Call by Mr. Walter Salomon

I am writing to confirm that Mr. Salomon is paying a call on the Prime Minister at 9.30 am on Tuesday, 1 July and the Chancellor and Sir Keith Joseph have kindly agreed to be present at the meeting.

I would be grateful if you could supply us with a full brief and I am therefore enclosing a copy of Mr. Salomon's letter and enclosure setting out the points he wishes to discuss. I am sending a copy of this correspondence to Catherine Bell (Department of Industry).

CAROLINE STEPHENS

Miss Louise Birnie

file BK

10 June 1980

I am writing to confirm that the Prime Minister is looking forward to seeing you at 9.30 am on Tuesday, 1 July at 10 Downing Street. The Chancellor of the Exchequer and the Secretary of State for Industry are hoping to be present.

CAROLINE STEPHENS

W.H. Salomon, Esq.

10 DOWNING STREET

PRIME MINISTER

Yet another letter from Walter Salomon. He asks to see you for no more than half-an-hour, but you remember how pedantic he is.

Tim wonders whether you would like him to see him instead?

C.S.

Will of course see him. Give him an hour. MT.

Can the Chancellor & K.J. also be present. It can be at a weekend MT

5 June 1980

Mr Lankester
No action
yet taken.
CS.
3/6.

KING'S HOUSE
36-37 KING STREET
LONDON EC2V 8DR
TEL. 01-606 4033

3rd June, 1980

Dear Lankester,

I enclose herewith a letter addressed to the Prime Minister and I should be most grateful if you would kindly put it before her at an opportune moment.

Yours sincerely

Miss Caroline Stephens

KING'S HOUSE
36 - 37 KING STREET
LONDON EC2V 8DR
TEL. 01-606 4033

PRIVATE AND CONFIDENTIAL

3rd June, 1980

Dear Prime Minister,

For a long time I have been considering writing to you because there are a number of aspects of economic policy about which I am considerably worried.

You know the high regard I have always had for you personally and this has been in no way diminished. As a matter of fact, I would say "regard" is probably an understatement - "admiration" would be more accurate.

When you wrote to me last time you quite rightly pointed out that it would be impossible for you to have individual private conversations as your time would simply not allow it and that I would be the first to understand - and I do.

As I have now received a letter from you, to which I shall refer in a moment, I wonder whether as an exception you could fit in half an hour as I would like to discuss one or two things with you which I do not think I should put on paper. I shall, of course, quite understand if you cannot manage it.

Amongst others, one of the points which I would like to discuss with you is the lecture which I gave at the Institute of Bankers on 1st April last under the heading "Banking through the Eyes of a Private Banker". I would like to tell you some of the background to it which prompted me to give the lecture, and which I found most disturbing. In case you have not got it to hand I enclose a further re-print of the lecture.

Other matters I would like to discuss concern the growing disquiet within private enterprise about the slowness with which various of your Ministers deal with the Acts they have to administer and which were introduced by the Socialist Government. One probably ought not to blame the Ministers concerned but rather their Civil Servants who deal with these matters and who are probably in the main the same Civil Servants as were there when the Socialist Government was in power. However, as a number of these Acts were strongly opposed by the Conservatives when they were in opposition, this tardy attitude creates considerable unrest. I would like to give you chapter and verse on these matters but it would be difficult to do so in writing.

With regard to your letter, I understand the point which you make concerning interfering with the sterling rate and there is, of course, great substance in your argument - perhaps it would be better to fall back and

let the market economy take its toll. I am not so sure I agree with the Exchange Control Act; I can quite see why the Civil Servants should advise that it be kept in being, if only because they do not want to lose any of their power.

John Baring had the Chancellor to lunch on Sunday last and I prepared for him a memorandum dealing with the subject matter. He tells me that unfortunately there was no opportunity to discuss it over lunch as the Chancellor arrived late and anyway there were others around. I feel I can do no better than send you a copy of the memorandum which sets out my views in a succinct manner.

I know that the views of the Bank of England are in no way unanimous on this point but then there is great concern in many circles about some of the things which are happening at the Bank of England and this is another subject which I would like to have the opportunity to discuss with you confidentially.

I am sorry about the length of this letter which I have tried to keep as brief as possible and as I have already said, I shall quite understand if you are unable to see me although, if course, I would very much regret it.

Yours sincerely
Walter H. Salomon

THE INSTITUTE OF BANKERS City of London Centre

ADDRESS GIVEN BY MR. WALTER H. SALOMON, FIB., CHAIRMAN OF REA BROTHERS LIMITED, PRIVATE BANKERS, AT THE CITY OF LONDON CENTRE OF THE INSTITUTE OF BANKERS ON 1st APRIL, 1980

"BANKING THROUGH THE EYES OF A PRIVATE BANKER"

Some nine years ago I had the privilege of addressing the members of the Institute at the City of London Centre on the subject: "Merchant Banking through the Eyes of a Private Banker".

I want to return today to some of the issues I discussed on that occasion, but perhaps on a wider front, under the title: "Banking through the Eyes of a Private Banker".

In particular, I want to comment on the Banking Act, 1979, which received Royal Assent on 4th April, 1979. But more about that later.

If I repeat some general observations on banking, which I have reiterated for many years, I would remind you of the words of the eminent novelist and philosopher, André Gide, who opened a lecture by noting:

> *"All this has been said before, but since nobody listened, it must be said again."*

I understand from your Chairman that he would like a questions and answers period after my talk and for this reason I will curtail my remarks and be as succinct as possible.

There are a great number of kinds of operation which in some way or other come under the heading of "Banking" including clearing banks, the investment banks, the merchant banks and the foreign banks, etc. etc. The words "Private Bank" are rarely used these days and I hope you will not mind my repeating what I said in my last address to you on 30th November, 1971, when I quoted what Walter Bagehot said in 1858 about the old private banker. He said:

> *"I can imagine nothing better in theory or more successful in practice than private banks as they were in the beginning. A man of known wealth, known integrity, and known ability is largely entrusted with the money of his neighbours. The confidence is strictly personal. His neighbours know him, and trust him because they know him. They see daily his manner of life, and judge from it that their confidence is deserved. In rural districts and in former times, it was difficult for a man to ruin himself except at the place in which he lived; for the most part he spent his money there, and speculated there if he speculated at all. Those who lived there also would soon see if he was acting in a manner to shake their confidence. Even in large cities, as cities*

then were, it was possible for most persons to ascertain with fair certainty the real position of conspicuous persons, and to learn all which was material in fixing their credit. Accordingly, the bankers who for a long series of years passed successfully this strict and continued investigation, became very wealthy and very powerful. The name 'London Banker' had especially a charmed value. He was supposed to represent, and often did represent, a certain union of pecuniary sagacity and educated refinement which was scarcely to be found in any other part of society. In a time when the trading classes were much ruder than they now are, many private bankers possessed a knowledge and a delicacy of attainment which would even now be very rare. Such a position is indeed singularly favourable. The calling is hereditary; the credit of the bank descends from father to son: this inherited wealth soon brings inherited refinement. Banking is a watchful, but not a laborious trade. A banker, even in large business, can feel pretty sure that all his transactions are sound, and yet have much spare mind. A certain part of his time, and a considerable part of his thoughts, he can readily devote to other pursuits. And a London banker can also have the most intellectual society in the world if he chooses it. There has probably very rarely ever been so happy a position as that of a London private banker; and never perhaps a happier."

Those were the days! In more recent times, starting in August, 1914, the then generally accepted private banks formed themselves into the Accepting Houses Committee and it was from that day on that the words "merchant bank" came into being. It is significant to note that of the twenty firms who joined together only two were Limited Companies. In other words, family involvement and the sense of the proprietor were their hall-marks. Even in the two firms which were Limited Companies the founder families had a substantial stake in the bank.

I have to remind you that in a private partnership each partner is fully responsible for the entire indebtedness of his firm and that in itself provides a healthy restraining influence on the decision-making.

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This development is regrettable and is largely promoted through the confiscatory nature of our tax system where either by Capital Transfer Tax, or by ordinary taxation, private partnerships are being taxed out of existence. It is worth remembering that this is not the case on the Continent where some of the leading private bankers are today still partnerships. The argument advanced was that by becoming a Limited Company it would be easier to raise fresh capital and be competitive in meeting the growing demands being made on the services of the banks.

I said in my 1971 address that a bank does not automatically improve by becoming bigger. There can be no objection to organic growth which is the natural process resulting from internal development. The danger to sound banking comes from the forced growth which is now held to be necessary for business success. I may say that some of the merchant banks which supported this philosophy have since found by experience that the truth lies somewhere else. When growth is forced and takes the firm into areas beyond its experience, the managers, called directors, can no longer be involved as individuals in the fortunes of the business.

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It was on the basis of the latter that the London market became what it was: the centre of finance and credit in the world, and the envy of other countries. Later I shall propose that the new Banking Act is a very serious assault on this philosophy. In this connection I think it is equally important to look at the central banks as they are part of the whole structure.

In most cases the central banks were owned originally by the public and had a totally independent management. Of late, most central banks are in the hands of the Government and are therefore subject to the direction of the Government (i.e. politicians). It goes without saying that their decisions are not necessarily based on sound economic banking principles but on the directions they receive from their political masters. We in this country have in the past been lucky in that the Bank of England has been able to keep in close touch with the banking sector so that usually day-to-day problems are dealt with by consent. On the other hand, I believe the inflation we are experiencing today would not have been possible if central banks had remained independent. Thus the German central bank is much more independent from government and politicians. Under German Law the Bundesbank is required to maintain the value of the mark and the monetary policy in that country is therefore traditionally much more geared towards maintaining sound money than to helping politicians manipulate the economy. Because Germany experienced hyper-inflation, her bankers certainly know what they are talking about. Hence, inflation in Germany today is minimal.

I recall that in my 1971 address to you, I suggested that the commercial banks should have a single association to represent them. I am pleased to say that since then—and let me add that I take no credit for it—the British Bankers Association, which was originally formed in 1920, has taken on a new lease of life following our entry into the E.E.C. and has made an extremely useful contribution to banking in this country.

I now turn my focus onto the Banking Act, 1979, which the present Government is currently bringing into operation. The Bill had, in fact, been prepared under the Socialists and when the present Government took office it was already on the Statute Book and was put into operation by them. On 20th November, 1979, The Rt. Hon. Lord O'Brien, President of the British Bankers Association, addressed you on the occasion of the Ernest Sykes Memorial Lecture. He spoke in his private capacity and in a very approving manner on the subject of the new Banking Act, and concluded that

> *"the Act should benefit our banking system by ensuring good order and discipline throughout the whole range of deposit-taking institutions, while not to any degree impairing that freedom to do business under the benevolent if watchful eye of our central bank".*

I hold a different view which I believe is shared by a number of other bankers. This does not imply any disrespect for Lord O'Brien as a distinguished central banker; but, of course, it is not surprising that private bankers like myself should see things differently from someone who has made his career in central banking.

There might at some time be the necessity to introduce a Banking Act in order to comply with the requirements of the European Community. However, this Banking Act was introduced as a result of the last Government's over-reaction to the secondary banking crisis of 1974—a crisis incidentally to which the introduction of Competition and Credit Control may well have been a major contributory factor as the massive expansion in the money supply certainly was. It is as if one took a sledge-hammer to crack a nut.

My misgivings are based on humanitarian grounds, libertarian grounds, and on practical consequences. In fact, the Bill cuts right across the professed philosophy of our Prime Minister to encourage smaller businesses, and to make it possible for young and aspiring people to find a place in the sun. Instead, it increases bureaucracy and can be a direct interference with the workings of the market economy.

As legislation now stands, there is little chance for young, enterprising people to start a banking business because they simply could not comply with the requirements laid down by the Act, especially the minimum requirements on capital. Had the Act been in force when Sir Sigmund Warburg was starting his business, or when we were starting ours, we would not have been able to do so. I do not apologise for quoting my personal experience because I speak as one who in the 1930s under the Nazis knew what it was to lose my liberties. That is not a matter to be taken lightly.

What the Act does is create a two-tier system which is divisive. If one is classified as "second class', it is more than difficult to cross the Rubicon. Not only must there already be hundreds whose aspirations and ambitions have been thwarted by the Act. It also creates a comfortable monopoly for those in the favoured first category, and thereby stifles competition.

The liberty for the creation of free enterprise is the most precious of all our assets and the price to be paid is great. I recall from personal experience the discretionary laws introduced at the time by the Government ruling Germany before Hitler came to power. These seemed quite reasonable if dealt with by fair-minded people, but Hitler used them to further his dictatorship. We must make sure that this cannot happen here. As John Philpott Curran, the Irish Judge said

"the price of liberty is eternal vigilance".

The Bank of England has been entrusted with the administration of the Act and its sweeping and ill-defined powers are subject to appeal only to the Chancellor of the Exchequer.

In my view the establishment, growth, licensing and recognition of young new banks will be very difficult indeed under the new legislation. The Bank of England is no doubt very conscious of these problems and has said that within the constraints of the Act it will adopt a flexible approach in its administration. However, a close study of the Act shows that the Bank has very little discretion in its interpretation and the ultimate supervisory powers of the Bank of England are vested in the hands of a few senior officials under one of the Executive Directors. Such a set-up in the wrong hands could be a recipe for bureaucracy or worse.

Already, the Banking Supervisory Division has shown signs of interpreting the Act fairly rigidly. Its Hand-book of Banking Supervision, if anything, makes more stringent demands than the Act itself. There are numerous examples of this but just to mention one, I would point out that certain criteria required by licensed deposit-takers under the Act have been applied to banks in general. Also the Handbook requires licensed and recognised institutions to consult the Bank in advance about, *inter alia*, "the establishment or disposal of subsidiaries", or the acquisition or disposal of "any material interest in other companies". This gives the Bank substantial control over the development of the business and is a further extension of bureaucracy. It prevents banks from making speedy decisions on proposals which require immediate action without waiting for approval from the supervisory authority. Part C of the Handbook "Principles of Supervision" has not yet been issued and appears likely to contain a series of arithmetical "prudential" formulae, none of which are mentioned in the Act. As IBRO, the London clearing banks research organisation has pointed out, the bureaucrats are likely to

> *"fossilise market procedures. It is a vicious circle; the Bank calculates a gearing ratio because it believes the market is relying on a gearing ratio and the market will continue to calculate a gearing ratio because it knows that the Bank is calculating one".*

Many years ago in a speech entitled "The Price of Liberty", I said

> *"Liberty is not taken away in one lump; it is being taken away in little bits and pieces. 'One little bit', you may say, 'why worry?'. But little bits put together make a big lump and if we are not watchful our liberty is gone."*

I understood the philosophy of the present Government to be based upon what Dean Alfange, the American lawyer once wrote:

> *"I do not wish to be a kept citizen, humbled and dulled by having the State look after me".*

Under the Act banks are required to submit certain forms to the Bank of England. In fact, the banks have provided a great deal of information in this way for many years, but in a more or less informal way and by consensus. Now, by direction of the supervisory body of the Bank of England we are, for instance, required to give information on the personal background of the officers of our banks for scrutiny by the officials. (Annex C). This is a lengthy form requiring details of directors and requests information for instance regarding the nationality of a director or manager. I cannot see what this has to do with whether he is a suitable person to be appointed a director or manager of a bank. Furthermore, I fail to see the relevance of how his nationality was acquired. In addition, the form requests information for instance on any offences committed, however trivial, which could even extend to certain categories of motoring offences.

This is a serious matter and I consider the question whether a person is suitable for appointment as a director or manager of a bank should be left to the Board of the bank and, as far as directors are concerned, if necessary to the shareholders, who are best qualified to decide.

There are two subsidiary objections to the administration of the Act. Firstly, a new bureaucracy is being built up. After forty years we have only just got rid of foreign exchange control. It must have been an extremely expensive department to run. In this connection, the only matter still outstanding is the abolition of the 1947 Exchange Control Act. As I have already said bureaucracies are expensive and this is certainly not in line with the declared policy of the Government to reduce public expenditure. At present, the Bank of England supervises approximately 100 banks and 60 other deposit-taking institutions which is a substantial increase compared with 1974. It is thought that with this Act the numbers may increase to 250 banks and between 200 and 300 licensed institutions. This increase is of course largely due to the ever-continuing inflow of foreign banks into London. Secondly, and most seriously, there is no provision for independent appeal. The only appeal is to the Chancellor of the Exchequer who cannot be considered independent because he is the politician to whom the Bank of England is in any case responsible and to whose ultimate authority its affairs are subject.

There is a subsidiary but still important criticism. The Act clearly confers on the Bank considerable powers not only if an institution fails to comply with any obligation imposed by the Act but also if in its opinion the conduct of any institution threatens the interests of its depositors. In these circumstances the Bank may give directions prohibiting *inter alia* the institution from disposing of its assets. For example, any future administration could take the view that it would be in the interests of depositors for the dividend of any bank to be blocked. As a matter of commonsense, it might be argued that it is very difficult ever to justify paying dividends to shareholders if the interest of depositors must be protected over everyone else. But, those who drafted this Act are not bankers. They do not understand that banks are not merely there to allow people to deposit money safely; the Government can always offer safer savings media—with the involuntary support of taxpayers' money. There has to be a balance in private banking between the safety of deposits, the maximising of profits and the financing of productive enterprise.

Now notice the subtle wording of the Act. Even if the stated criteria for recognition as a bank are fulfilled the Bank is not bound to grant a licence, but only "may" do so. (Sec. 3 para. 1). Furthermore, paragraph 6 of Schedule 2 gives the Bank absolute authority to determine whether resources are, in the Bank's view, "commensurate with the scale of operations". This clause means that the Bank can specify what any bank does, e.g. the size of loans, balance sheet totals, exposure to certain countries or types of business. Even worse, the Bank is given wide powers (Sec. 19 para. 6) to disclose confidential banking information to foreign central banks. This power may rightly inhibit foreigners from placing banking business in this country.

Supposing we had a less understanding government than we now have, how could such powers be used? In Chile we had a glaring example of just what happens in such a case. The Communist take-over by Allende began with the confiscation of businesses. The approach, however, was subtle. Allende announced a 50 per cent reduction in interest rates. Debtors were exultant. On the Stock Exchange, the price of bank shares came tumbling down. Then the Government offered to buy the shares at the old price on condition that Communist officials had seats on the Board. The next step was to cut off credits to private industry. Production schedules were disrupted, labour disputes developed. From then on it was a simple matter for Marxist labour leaders in alliance with the new Board officials and Government officers to cause conflicts which provided an excuse for expropriation, nationalisation or plain theft of industrial enterprise.

One favourite tactic was to claim that a particular company had failed to maintain production. Then a government inspector would be sent in to present the management with a list of impossible demands. He might, as happened in the case of a domestic appliance manufacturer, demand to be shown up-to-date records of all business transactions within 24 hours. If the company management failed to meet his demands, he could then obtain an order for the firm to be "requisitioned". You say, "this would not happen here. The U.K. is not Chile". But, have I not explained that the Act gives just the sort of powers as were used in Chile to control dividends, lending, acquisitions, balance sheets ratios and so on. Perhaps you think it is unlikely that a British Government would seek to manipulate the value of companies on nationalisation, but I ask you to recall The Aircraft and Shipbuilding Nationalisation Act. This legislation provided for the acquisition by the state of companies in 1977 with compensation based in most cases on imaginary stock market prices in the winter of 1973–74—the time of the three-day week and one of the bleakest periods in stock market history. The result of all this has been that most compensation claims remain unsettled, even now. A number of the stockholders' representatives are considering going to the Court of Human Rights in Strasburg and the present Conservative administration seems to be bound by the legislation put through Parliament by Mr. Benn. Do you still think it can never happen here?

I do not think it will be necessary for a new Act to be introduced to nationalise the banks. This Act, administered by other than well-meaning officials under the direction of a government of a different complexion, could be a back-door route to nationalisation.

Another glaring example of unsatisfactory legislation is the Consumer Credit Act which was intended to rationalise and regulate the hire purchase and second mortgage business. In practice it has meant imposing yet another licencing procedure on the whole banking system with the usual proliferation of forms, notices and bureaucrats. It also sought to change the basis on which all banks gave credit to the ordinary private borrower although Parliament in its wisdom did not see fit to mention the word "bank" or "overdraft" in any of the Act's 170 odd clauses. The Act is regarded by those unfortunate enought to have to live with it as one of the most impractical pieces of legislation ever to see the light of day and such is the confusion it has caused that nearly six years later much of it has still not been brought into effect. I believe that they should repeal the whole Act and start again with new legislation using a practical rather than an academic approach. It is just another case of the sledge-hammer being used to crack a nut. The saddest aspect is that the Act must raise costs and so increase the charge for credit to the consumer, whilst inevitably failing to stamp out the extortionate charges made by fringe operators to borrowers who cannot obtain finance from any other source.

The amount of delegated legislation that is already effectively law is far too great. Government officials direct our actions in almost every area of life by way of statutory instrument. This is something against which I have always campaigned and written at length.

Discretionary powers cannot today be challenged in law. What we really need is a Court of Administration—on the continental model—through which these powers can be challenged.

I promised to allow adequate time for questions at the end and so I bring my remarks to a close by appealing to every banker in this country. Let us stand up and ask for the repeal of the banking law as it stands or, at least, for its substantial amendment. Let me again quote John Philpott Curran, the Irish Judge, who said

> *"It is the common fate of the indolent to see their rights become a prey to the active".*

Let's become active for a change. In this respect, I am glad to learn that at the last meeting of the Accepting Houses Committee it was agreed that a working party should be formed by the Chairman and Director-General to examine what changes were required in the provisions of the Act and the manner in which it was being implemented and to advise on whether Members wished to seek outright repeal or amendment of the Act or to find ways of operating the Act in a self-regulatory manner.

I hope the British Bankers Association will follow this example as well as any other interested party and that in the end their efforts will be co-ordinated. The banking industry should consider this matter a first priority.

Thank you for having listened to me so patiently.

Printed by Harrison & Sons (London) Ltd. 06464

MEMORANDUM

FOREIGN EXCHANGE CONTROL ACT, 1947

1. On 16th May, 1980, in a written question, Mr. Cockeram, M.P., asked the Chancellor of the Exchequer if he had completed his review of the future of the Exchange Control Act, 1947, and whether he would make a statement. In a written answer the Chancellor replied as follows:

> "Yes. The House was told on 6th November last that, "following my decision, announced in October, to abolish "exchange controls, I would be reviewing the future of the "Exchange Control Act, 1947. I have now decided that, at "least for the time being, the present Act should be retained.
>
> "I regard the 1947 Act as unsatisfactory in a number of ways, "notably in the wide extent of its powers and in his bias, "natural enough when it was introduced, towards the control "of outflows. I see no prospect of time being made available "in the legislative programme for the early replacement or "substantive amendment of the Act; and simple repeal would "not be compatible with our Treaty obligations.
>
> "I do however envisage that ultimately, and probably most "conveniently in several stages, changes in the law will be "sought with the objectives of making the powers available in this "area less draconian and more symmetrical as between control "of outflows and of inflows.
>
> "In the meantime, the Act needs to be kept in being because the "United Kingdom Government are required, under the European "Community Council Directive 72/156 of 21st March, 1972, to "have available certain instruments for effective regulation of "international capital flows and for neutralising those effects of "such flows on domestic liquidity which are considered undesirable. "The Directive also requires that these instruments may be able, "where necessary, to be put into operation without further enabling "measures. The Exchange Control Act, 1947, is the only current "legislative authority in the United Kingdom under which the "Government could take such action."

2. It will be seen from the above reply that the Chancellor agreed that he regarded the 1947 Act as unsatisfactory in a number of ways "notably in the wide extent of its powers and in its bias". He then went on to say that the Act needed to be kept in being "because the "United Kingdom Government are required, under the European "Community Council Directive 72/156 of 21st March, 1972, to have "available certain instruments for effective regulation of international "capital flows and for neutralising those effects of such flows on "domestic liquidity which are considered undesirable. The Directive "also requires that these instruments may be able, where necessary, "to be put into operation without further enabling measures". I have carefully perused the Directive mentioned above and a copy is attached hereto.

3. It seems odd to me that other countries can comply with the Directive without having an Exchange Control Act on their Statute Books and I refer in particular to Germany. I would have thought it a very simple matter, via the Bank of England authority, to achieve the desired aim of the Directive. To use this Directive as an excuse to retain the Exchange Control Act is, in my opinion, unwarranted.

4. In a lecture which I gave at The Institute of Bankers on 1st April, 1980 I called for the repeal of the 1947 Act; I attach a re-print of my lecture in which I have marked the appropriate passage. The removal of any possibility of the re-imposition of Exchange Control, without legislation but by the mere fiat of Treasury officials, would be the best possible protection for the British public from over regulation of the banking industry. Knowing the Chancellor as I do, I am quite sure he would sympathise with these sentiments, as would the Prime Minister.

5. In dealing with these matters the Chancellor must, of course, rely on the advice given him by his Civil Servants and the removal of any controls might be against their direct personal interest as it would take power out of their hands.

6. I am, in the meantime, making enquiries of other E. E. C. countries to ascertain what measures they have taken in order to deal with the Directive.

WHS/MB
30th May, 1980

cc HMT vb

CF to note

10 DOWNING STREET

THE PRIME MINISTER

2 June 1980

Dear Mr. Salomon

Thank you for your two letters of 28 April about the Exchange Control Act and the value of sterling.

With regard to the Exchange Control Act, the future of this legislation involves other factors besides the temporary need to retain powers while exchange controls had to continue (till 13 December last) in relation to Rhodesia. In particular, repealing the Act would not be compatible with our Treaty obligations in the European Community since the Council Directive 72/156 requires us to have available, without further enabling measures, certain instruments for the regulating of capital flows. The 1947 Act provides the only current legislative authority. While we do envisage ultimately seeking some changes in the law on exchange control, there is no prospect of finding time in the legislative programme for the early replacement or substantive amendment of the present Act. You may have seen that the Chancellor of the Exchequer recently made a statement in Parliament to this effect.

In your other letter you suggested that we should sell sterling to reduce the value of the pound, at the same time offsetting the domestic monetary impact by cancelling a corresponding amount of debt; I assume that you have in mind repayment of debt to overseas. (If we were to re-pay a corresponding amount of debt held in the UK, this would simply add to the money supply).

It is our policy to reduce substantially the burden of our foreign currency borrowing during the lifetime of this Parliament. But this policy does not offer a solution to the problem that I posed in the House. The monetary effect of intervention depends on

/its scale and

its scale and how it is financed. Any net inflow to the private sector would not be offset if we then used the additional reserves to repay overseas debt. Such repayments have no impact on domestic conditions at all; no private sector transactions are involved. Sooner or later, as I said, any attempt to hold down the exchange rate by intervention would jeopardise monetary control.

Even if we sought to offset the domestic monetary impact by, say, selling additional gilts there might well be little lasting impact on the exchange rate, although interest rates would need to be higher to achieve the necessary gilt sales. Mobility of international capital limits the extent to which intervention can effect the exchange rate, other than in the very short term. And if we succeeded in holding down the exchange rate, we would have to balance the advantage to exporters against the cost - some of which would be borne by exporters - of the higher level of domestic interest rates. We would also lose the beneficial effects of a higher exchange rate on inflation and monetary control.

signed

MT

W.H. Salomon, Esq.

PRIME MINISTER

I think we agreed at the meeting with the Chancellor this afternoon that Walter Salomon must mean re-payment of debt to overseas when he says "cancellation of the national debt". If he were to mean re-payment of domestic debt without any corresponding new borrowing from the non-bank private sector, this would simply add to the money supply. I have added a sentence in parenthesis to the Treasury draft just to clarify this point.

28 May 1980

3

Tim

Yours -

MS

to ~~pass~~ take on

10 DOWNING STREET

PRIME MINISTER

Attached is a draft reply provided by the Treasury to two recent letters from Mr. W. Salomon.

TL

21 May 1980

I would have thought Walter meant cancel those securities which the bank means reserve assets. His point is that then sterling in = sterling cancelled.

?

10 DOWNING STREET

THE PRIME MINISTER

Thank you for your two letters of 28 April about the Exchange Control Act and the value of sterling.

With regard to the Exchange Control Act, the future of this legislation involves other factors besides the temporary need to retain powers while exchange controls had to continue (till 13th December last) in relation to Rhodesia. In particular, repealing the Act would not be compatible with our Treaty obligations in the European Community since the Council Directive 72/156 requires us to have available, without further enabling measures, certain instruments for the regulating of capital flows. The 1947 Act provides the only current legislative authority. While we do envisage ultimately seeking some changes in the law on exchange control, there is no prospect of finding time in the legislative programme for the early replacement or substantive amendment of the present Act. You may have seen that the Chancellor of the Exchequer recently made a statement in Parliament to this effect.

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It is our policy to reduce substantially the burden of our foreign currency borrowing during the lifetime of this Parliament. But this policy does not offer a solution to the problem that I posed in the House. The monetary effect of intervention depends on

/ its scale and



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

19 May 1980

T P Lankester Esq
Private Secretary to the
Prime Minister
No 10 Downing Street

Dear Tim,

... I attach a draft reply to the second of Mr Salomon's letters of 28 April, for which you asked in your letter of 30 April.

Yours

John

J WIGGINS
Private Secretary

DRAFT LETTER FROM PRIME MINISTER TO:

Pse type

Walter Salomon Esq
Chairman
Rea Brothers Limited
King's House
36-37 King Street
London EC2V 8TR

~~You wrote on 28 April~~ suggesting that we should sell sterling to reduce the value of the pound, at the same time offsetting the domestic monetary impact by cancelling a corresponding amount of debt; I assume that you have in mind repayment of debt to overseas.

It is our policy to reduce substantially the burden of our foreign currency borrowing during the lifetime of this Parliament. But this policy does not offer a solution to the problem that I posed in the House. The monetary effect of intervention depends on its scale and how it is financed. Any net inflow to the private sector would not be offset if we then used the additional reserves to repay overseas debt. Such repayments have no impact on domestic conditions at all; no private sector transactions are involved. Sooner or later, as I said, any attempt to hold down the exchange rate by intervention would jeopardise monetary control.

Even if we sought to offset the domestic monetary impact by, say, selling additional gilts there might well be little lasting impact on the exchange rate, although interest rates would need to be higher to achieve the necessary gilt sales. Mobility of international capital limits the extent to which intervention can effect

/the exchange rate,

the exchange rate, other than in the very short term. And if we succeeded in holding down the exchange rate, we would have to balance the advantage to exporters against the cost - some of which would be borne by exporters - of the higher level of domestic interest rates. We would also lose the beneficial effects of a higher exchange rate on inflation and monetary control.

G/R.

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

16th May 1980

T.P. Lankester, Esq.,
No.10, Downing Street

Dear Tim,

With your letter to me of 30th April you enclosed a copy of a letter to the Prime Minister of 28th April from Mr. Walter Salomon about the Exchange Control Act 1947. I enclose a suggested draft reply for sending after the statement to be made by Written Answer on 16th May (about which I have written to you separately).

Yours

John

A.J. WIGGINS

DRAFT LETTER FROM: PRIME MINISTER

TO: Walter H. Salomon, Esq.,
Chairman,
Rea Brothers Ltd.,
King's House,
36-37, King Street,
London. EC2V 8DR

~~You wrote to me on 28th April about the Exchange Control Act 1947.~~ The future of this legislation involves other factors besides the temporary need to retain powers while exchange controls had to continue (till 13th December last) in relation to Rhodesia. In particular, repealing the Act would not be compatible with our Treaty obligations in the European Community since the Council Directive 72/156 requires us to have available, without further enabling measures, certain instruments for the regulating of capital flows. The 1947 Act provides the only current legislative authority. While we do envisage ultimately seeking some changes in the law on exchange control, there is no prospect of finding time in the legislative programme for the early replacement or substantive amendment of the present Act. You may have seen that the Chancellor of the Exchequer recently made a statement in Parliament to this effect.

FILE RH

R. W SALOMON

9/5

30 April 1980

We spoke about the enclosed letters which the Prime Minister has received from Mr Walter Salomon. I would be grateful if you could provide me with a draft reply for the Prime Minister to send. (There is no need to include an explanatory covering note: a simple draft will do in this case.)

T. P. LANKESTER

A J Wiggins, Esq
HM Treasury

PRIME MINISTER

Here are two letters from Walter Salomon - the first asking that the Exchange Control Act be repealed, the second querying the answer you gave in the House last week on the monetary effects of intervening to hold down sterling.

On the first point, the Chancellor intends to retain the Exchange Control Act in order to provide the possibility of control on inflows. He is reviewing the Act with a view to putting through improved legislation when the Parliamentary timetable allows it. He will be announcing this before long.

Mr. Salomon's point about the money supply is incomprehensible. He says that if intervention to keep sterling down were to be matched by cancellation of the national debt, the money supply would not go up. By cancellation, he presumably means buying up the national debt: this would inject even more sterling into the system, and increase the money supply further.

Do you want to reply? Or shall we ask the Chancellor?

Wilson

29 April 1980

FILE

RH

29 April 1980

Thank you for your note of 28 April and I shall ensure that the Prime Minister sees your two letters at the first possible opportunity.

CS

W H Salomon, Esq

KING'S HOUSE
36 - 37 KING STREET
LONDON EC2V 8DR
TEL. 01-606 4033

28th April, 1980

Dear Caroline

I enclose herewith a letter addressed to the Prime Minister. I should be most grateful if you would kindly put it before her at an opportune moment.

Warmest regards

James Prior

Miss Caroline Stephens

WALTER SALOMON
HANS

P. S. Actually, the envelope contains two letters.

KING'S HOUSE
36 - 37 KING STREET
LONDON EC2V 8DR
TEL. 01-606 4033

28th April, 1980

Dear Prime Minister,

When you took the courageous step of abolishing foreign exchange restrictions, for technical reasons, the Exchange Control Act, 1947, had to be left unchanged. I understand this had to do with our situation vis-a-vis Rhodesia and that until Rhodesia was independent the Act could not be changed.

Now that Rhodesia is independent I think it highly desirable to repeal the 1947 Exchange Control Act. To do so would, in my opinion, make a great psychological impact, both at home and abroad, and in fact it is totally in line with the policies to which I understand you subscribe.

Yours sincerely,

WALTER SALOMON.

[check T: He]

KING'S HOUSE
36-37 KING STREET
LONDON EC2V 8DR
TEL. 01-606 4033

28th April, 1980

Dear Prime Minister,

According to Hansard, during Questions and Answers in the House on 24th April, Mr. Robert Sheldon put the following question regarding the rise in the value of the pound: "..... When will she (the Prime Minister) instruct the Governor of the Bank of England to sell sterling and reduce the value of the pound?". Your reply was as follows: "If I were to instruct the Governor of the Bank of England to sell sterling, to go on and on selling it and to resist the market, the money supply would go through the roof and we should be laying the foundations for the next round of inflation".

May I suggest that this would only be correct if the proceeds were to go into the money supply. However, it would not be the case if a corresponding amount of the National Debt were to be cancelled.

You probably already know this but in case you had overlooked it I thought I would take the liberty of drawing your attention to it.

Yours sincerely

Martin Shaloun

file

ds

8 April 1980

The Prime Minister has asked me to thank you for your letter of 2 April and for the re-print of the speech to The Institute of Bankers which you kindly enclosed with it.

CAROLINE STEPHENS

Walter H. Salomon, Esq., F.I.B.

TCR

pio

KING'S HOUSE
36 - 37 KING STREET
LONDON EC2V 8DR
TEL. 01-606 4033

2nd April, 1980

Dear Caroline,

I enclose herewith a re-print of a speech which I gave last evening at The Institute of Bankers. I think the Prime Minister would be interested to see it and I should be most grateful if you would kindly put it before her at an opportune moment.

Warmest regards
Yours sincerely
Ernest Saloman

Miss Caroline Stephens

This copy of speech removed. Additional copy behind letter of 3/6/80 with PM's underlinings. CAW. 25/8/15

2 - APR 1980



vb

5 March 1980

Thank you very much for your note of 5 March. I will ensure that your enclosure is placed before the Prime Minister at the earliest opportunity.

C.S.

Walter Salomon, Esq.

DSS

KING'S HOUSE
36 - 37 KING STREET
LONDON EC2V 8DR
TEL. 01-606 4033

5th March, 1980

Dear Caroline

I enclose herewith a letter addressed to the Prime Minister. I would appreciate it if you would put it before her at an opportune moment.

Yours sincerely

WALTER SALOMON

Miss Caroline Stephens

5 MAR 1980



With

Mr. Walter H. Salomon's

Compliments

FOR INFORMATION ONLY

King's House,
36-37, King Street,
EC2V 8DR

THE REFORM CLUB

5th March, 1980

Dear Col. Stanley

I am writing to you today with regard to the short interview which you gave on the "Man Alive" programme (24th January), a transcript of which I enclose herewith.

I, too, have been an athlete and I vividly remember the 1936 Berlin Olympiad which was used by the Nazi Party in Germany as a huge propaganda operation. I am therefore writing to you today to enquire how you can reconcile your statement that "in 1936 all Hitler had done as far as the rest of the world were concerned, was organise his Nazi Party, which had slightly comic connotations. He'd marched into Rhineland which was part of Germany and he had done nothing comparable to what has happened in Afghanistan". I think I can do no better than enclose a copy of a letter which appeared in The Economist (16th February) which sharply contradicts your assessment of the situation.

I think on reflection, you might revise your views as expressed in the BBC interview - and make them known publicly.

If the 1980 Olympic Games were to be allowed to take place unchallenged, it would give a similar opportunity to the Red Nazis, i. e. the Communist regime in Russia, to create tremendous propaganda for the "well-run peaceful" Soviet regime.

You will probably recall that when in 1936 everyone attended the Berlin Olympics, Hitler was supposed to have thrown his arms into the air with joy, exclaiming "and they all came!

I am sending a copy of this letter to the "Man Alive" programme.

Walter H. Salomon

Col. G. Rampling
27 Gleneagles,
Gordon Avenue,
Stanmore,
Middlesex

ROSS: Colonel Rampling, had we had this programme what, forty four years ago you might have been sat up on the back row there. You took part in the 1936 Berlin Olympics. You won a Gold. Are you pleased in retrospect that you went, it was obviously a highlight of your life.

RAMPLING: Yes, yes very.

ROSS: You're pleased you went and you have no qualms about it.

RAMPLING: I have no qualms about it because I don't think the two things are parrallel at all. I mean in, in 1936 - umm - all Hitler had done as far as the rest of the world were concerned, was organise his - umm - Nazi Party which had slightly comic conotations. He'd marched into the Rhineland which was part of Germany and he - umm - had done nothing comparable to what has hapened in Afghanistan.

ROSS: You mean people weren't aware that he was doing comparable things?

RAMPLING: Well in fact he wasn't, I mean he hadn't got into Czechoslovakia. He hadn't raped a, a soverign country, he'd merely taken back a bit of what the Times called 'his back garden'.

ROSS: Do you think the Soviet invasion of Afghanistan is much more serious than what Hitler was doing in 1936?

RAMPLING: I think it's much more serious than what Hitler had done at that stage.

ROSS: So would you, or would you not go to Moscow?

RAMPLING: I would not go to Moscow. I think this question of going to Moscow, it has a political angle and to use an old-fashioned and unpopular word a 'moral' angle.

THE ECONOMIST - 16th February, 1980

LETTERS

Olympics

SIR—I would like to endorse your stand on the Olympics (February 2nd). In 1936 the Olympic games were held in Germany. Dedicated athletes, imbued with only one thought, to win in sports, competed in great facilities provided by Nazi Germany.

They did not see the human misery behind it, the concentration camps, the persecution of the Jews, the murder of innocent people, the refugees. They did not see the ruthlessness of a powerful state determined to eliminate all opposition. Adolf Hitler refused to shake hands with Jesse Owens, because of the colour of his skin, but even that did not leave a lasting impression. Germany, however, gained prestige and respectability because of the participation of those young people.

Came 1938—the annexation of Austria and subsequently the dismemberment of Czechoslovakia and then the invasion of Poland and the second world war. Only 44 years ago and the same thing is about to happen again except that the counterpart of Czechoslovakia has already occurred—Afghanistan.

I still hope that the young athletes will recognise that by not going to Russia they may assist in eliminating undeserved prestige for the Soviet government and show the Russian people that the world has come to the conclusion that their government has gone too far.

If the athletes go, it may well happen that their pride in having competed, or having won, will by matched only by their shame to have taken part in the greatest cover-up of aggression in this century.

Caulfield South
Australia PETER FRANKEL

MFJ

19 February 1980

Many thanks for your note and enclosure for the Prime Minister. I will ensure that she sees this as soon as possible.

CAROLINE STEPHENS

W.H. Salomon, Esq.

KING'S HOUSE
36-37 KING STREET
LONDON EC2V 8DR
TEL. 01-606 4033

19th February, 1980

Dear Caroline,

I enclose herewith a letter addressed to the Prime Minister. I should be most grateful if you would kindly put it before her at an opportune moment.

With kindest regards.

Yours sincerely

Miss Caroline Stephens

Prime Minister.

I have acknowledged. CP. 19/2

807

KING'S HOUSE
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19th February, 1980

Dear Prime Minister,

Thank you for your letter dated 18th February.

I thought I would draw your attention to an article which appeared in today's Herald Tribune in which Professor Hayek explains forcefully that gradualism is unacceptable and, furthermore, that inflation has to be stopped quickly. I have referred to this subject on a number of occasions, both in writing and in our personal conversations going back over a number of years. In case you have not already seen it, I am enclosing a copy of the article herewith.

Yours sincerely,

HERALD TRIBUNE

Gradualism Unacceptable

Stop Inflation Quickly: Hayek

By James Flanigan

PALM SPRINGS, Calif. (LAT) — Friedrich Hayek, whose outlook is as gloomy as his disposition is sunny, believes the United States will have a depression before it can end the terrible inflation gripping the economy.

On the other hand, Mr. Hayek, an 80-year-old Nobel Prize-winning economist, believes that if inflation gets to a 20-percent annual rate — it hit 13.3 percent last year — the government will step in with wage and price controls. "Instead of an open inflation which you can read by looking at the price index, we'll have a repressed inflation which is even worse," he said.

"Instead of prices restricting consumption, it is shortages which operate." In other words, you cannot buy a thing, not because its price is too high but because it isn't there.

And he sees some price controls as imminent. President Carter will have to impose controls on key consumer products soon, Mr. Hayek said, if he is to have any chance of telling the voters that he has reduced inflation. "There won't be a word of truth in it, of course, but it will serve the purpose of the election," he said.

Mr. Hayek, even more than fellow Nobel Laureate Milton Friedman, is the philosopher of the free market. An economy, he believes, is neither controllable nor predictable but rather "a process which brings millions of events into coordination, which coordination never could be achieved deliberately."

No coordinator, not even a government with a computer, can know all the millions of economic decisions that comprise an economy. Thus, to Mr. Hayek, all ideas of centrally planned economies appear "sheer nonsense."

Philosophically a descendant of Adam Smith, capitalism's first theorist, Mr. Hayek has a reverence for the marketplace that transcends the usual ideas of economics as a dismal science. "In the hunting and gathering society," he explained, "all our efforts were directed to the known needs of known people. But we took up civilization instead, where we were able to feed so many by following abstract signals of prices in terms of which we were told how we could keep more lives going.

"It is the market which enabled us to serve the needs of people whom we do not know and to keep alive 400 times as many people as we could under the hunting and gathering economy — from 10 million to 4 billion."

The trouble with inflation, or with government intervention to guide the economy, Mr. Hayek said, is that artificial prices and therefore false signals result. Society gets carried off in wrong directions.

A monetarist, he believes that inflation comes only from government expanding the money supply. "There is no such thing as cost-push inflation," he declared recently. "A rise in costs can cause inflation only in the roundabout way of people clamoring for more money to pay the higher prices and government giving into this.

"As the price of gasoline goes up, either you have to buy less gasoline or buy less of everything else. If you look to the government for help for the time being, it makes you not to see what your real problem is."



UPI

Friedrich Hayek

Make no mistake, he warned, stopping inflation hurts. "The immediate effect will be very extensive unemployment and an expansion of bankruptcies. Once this is over, we will start on a normal development."

Yes, Mr. Hayek said, and "the fears of the politicians to stabilize are perfectly justified because the man who stabilizes gets all the blame for the unpleasant consequences."

It is for this reason — that politicians end inflation at their peril — that Mr. Hayek said he opted for a swift and radical strategy: stop money supply growth, wring out the economy, and do it within six months.

"There are many people whom I greatly respect, including my friend Milton Friedman, who plead for a gradual decrease. I've seen Miltor Friedman argue that in the course of five or six years we might bring down the rate of inflation to zero."

But, Mr. Hayek said, reducing inflation causes such suffering and misery that no government could stand to pursue such a policy over a long run.

TMP

file

10 DOWNING STREET

THE PRIME MINISTER

18 February 1980

Dear Mr. Salomon,

Many thanks for your letter of 15 February and for letting me have a translated version of the interview between Professor Hayek and the Die Welt reporter. I have found this most interesting and encouraging. I must look up some of the old books to which Professor Hayek refers.

Milton Friedman is coming here soon and I am very much looking forward to meeting him.

Yours sincerely,

Margaret Thatcher

W.H. Salomon, Esq.

BK

KING'S HOUSE
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15th February, 1980

Dear Professor Kristol

Thank you very much for your letter dated 13th February.

Whilst I do regret that it is not possible for us to have the occasional little tete à tete as we did in the old days, I more than understand.

I enclose herewith, as promised, a translated version of the interview between Professor Hayek and a Die Welt reporter.

With kind personal regards.

Yours sincerely

Friedrich Hayek

WA!

Nobel Prizewinner Friedrich A. von Hayek: Schmidt no Socialist, Strauss is the only liberal German politician

"Socialism destroys personal freedom"

by Wilfried Hertz-Eichenrode

DIE WELT: Franz Josef Strauss has named you as originator of the CDU-CSU election slogan "Freedom instead of/or Socialism". Do you agree?

von Hayek: Certainly. That is my view, and I have put it forward more systematically than anybody else has ever done. But it was not a new discovery. Strauss was evidently referring to my book "The Way to Bondage", in which I deal, in Chapter 12, in detail with the socialist roots of National Socialism.

WELT: How did you arrive at this view?

von Hayek: I found it necessary to emphasize this connection because there existed in England the erroneous notion that the national socialist movement in Germany was a "capitalist" reaction against the social tendencies of the Weimar Republic. In reality it was a further development of Socialism which came when Socialism divested itself of democratic and liberal ideas. This is dealt with in my book "The Way to Bondage" published in 1944.

WELT: Professor, you are an economic scientist, and yet the question arises: Are you politically a conservative?

von Hayek: I once made a lengthy lecture on the subject: "Why I am not a conservative". But today one can only support the Conservative parties, for all other parties are

more or less socialist. I consider Socialism such a danger that in England I consider myself a conservative, although I never had the occasion to take part in active politics.

WELT: You have described yourself as a radical anti-socialist. Why? For reasons of national economy or because of politics?

von Hayek: Entirely for reasons of national economy, from insight into social contexts. In the book I am writing at present I treat Socialism as a reactionary movement.

WELT: Many people consider Socialism progressive. You say it is reactionary. How do you argue that?

von Hayek: Socialism mobilises the primitive instincts of the small group, instincts originating in times when people still lived in small hordes. In our modern "open society" the adherence to the rules of the game has long taken the place of group action under a common leadership. This is the only way that a process became possible which made widely scattered information available to a growing number of people as signals which we call market prices. This was the only way we could create modern economy.

WELT: What is your central objection to Socialism from the standpoint of personal freedom?

von Hayek: That, as the Socialists themselves admit, it cannot restrict power to enforcing the rules of the game but must tell people what they have to do. Socialism must suppress the basic principle of freedom, namely,

that everyone can use his knowledge in order to pursue his own aims. It must order the people to do what is necessary for the purposes of the state. Pursued to its logical conclusion that is a complete destruction of personal freedom.

WELT: That is, totalitarianism?

von Hayek: Yes, Socialism is a form of totalitarianism.

WELT: Do you mean by that orthodox Socialism with its centralised economy or "democratic socialism" as well - for instance that of the Godesberg Programme - which represents nationalisation no longer as a dogma, but as a means among other means of economic policy?

von Hayek: Naturally only "hot" Socialism, as I have called it, is immediately dangerous. The consequences are really unavoidable only under classical Socialism, and most of the western socialist parties have turned away from this in their programmes. Yet I do fear that the expression "democratic socialism" is misleading. Also, what these Socialists intend, a completely different distribution of the national product, cannot be carried through democratically. They will be compelled to bring back much which they have shied away from in the past because otherwise the distribution dictated from above under the so called principle of justice is not possible. Enforcement of social justice or of what is so called leads inevitably to totalitarian socialism.

WELT: Did you not seek the roots of "democratic socialism" in the democratic currents of the 1848 revolution? According to this, is the Social Democratic party in

the Federal Republic of Germany, for instance, right in calling itself a freedom party?

von Hayek: No. And it was not quite as you have just now said. The date when socialism and democracy appear is about the time of the 48 revolution. In itself socialism is originally emphatically anti-democratic. Only at that time did it discover that it would have to behave democratically if it was to gain adherents. Then there were periods at the turn of the century when convinced Socialists spoke very contemptuously of democracy. But the experience of Communism in Russia and of the fascist regimes in Europe frightened them off and makes them wish - honestly wish, I admit - to preserve democracy. Only I believe they cannot do it if they want really to fulfil their decisive standpoint on justice.

WELT: In the Federal Republic we have had a social-liberal coalition since 1969. The ex-Minister for the Interior, Mayhofer, and Willy Brandt traced the SPD-FDP alliance back to 1848, even described it as "historic". Have the Liberals and the "democratic socialists" the same notion of freedom?

von Hayek: If one conceives the term "liberal" in the classical meaning of English-19th-century-Liberalism, then Liberalism and Socialism are the most extreme possible opposites. On the Continent they saw it somewhat differently. In contrast to the classical Liberalism in England, the Liberals on the Continent came to an alliance with Socialism in great part because Socialism was anticlerical. With few exceptions continental Liberalism - unlike the English form - was an anticlerical movement.

WELT: In the Federal Republic the Liberal party, the FDP, is clearly stamped with the example set by Friedrich Naumann. Do you count Naumann among the great Liberal thinkers?

von Hayek: Quite the contrary. It is proof positive that the Liberal party is actually a socialist party. In any case no party which keeps a socialist government in power has the right to call itself liberal. Friedrich Naumann was originally a Marxist, and then later he developed ideas during the First World War which were quite rightly described in detail by one of our English historians, R. Butler, in his book "The Roots of National Socialism" (London 1941) as being at the foundation of the ideas of National Socialism. That is now largely forgotten.

WELT: Can you document this judgement on Naumann?

von Hayek: Friedrich Naumann was even the creator of the word Nationalsocialism. In 1896 he founded a party, the "National Social Union", in 1900 he published the book "Democracy and Empire". Its last chapter, "National Socialism", summarised this thesis: "We want to show that nationalism and socialism can be fused together as a political unity."

In 1915, while the war was still on, Naumann wrote the highly influential book "Mitteleuropa" carrying those statements about the future steering of the economy by the state which have caused this English historian to describe him as a founder of national socialist ideas. I consider the coice of Naumann as a party saint as proof that the FDP has no right to call itself a liberal party.

WELT: Professor, you have repeatedly ascribed "credulity" to the "democratic socialists" when they promise simultaneously a just social distribution and personal freedom. But you deny that both can be had at the same time. So are the "democratic socialists" Helmut Schmidt, Willy Brandt und Herbert Wehner in magnificent error?

von Hayek: Yes, I am not convinced that Helmut Schmidt, who is very intelligent and understands things, really believes that one can do much more than guide the market economy a little in the direction of greater justice. Against that the other two really believe in a state-directed economy which apportions to each what he earns. The present-day "democratic socialists" hope in vain that the steering of production can play a smaller role and that "social justice" can be installed by taxation and redistribution from tax funds. Only slowly do they realise that this does not lead very far. Excessive taxation only paralyses the economy without achieving much greater justice. They are thrown back on their earlier plans of straight re-direction of economic means, as Naumann proposed for the period after the first war: We demand, after the experiences of the war, a controlled economy, the control of production from the point of view of necessity of the state. Hitler followed that.

WELT: Do you consider Chancellor Schmidt a guarantor of the economic order which you, Professor, describe as "play of the market"?

von Hayek: I regard it as a happy event in German history that the German socialist party has a Chancellor who is clearly not a socialist. Against this Messrs. Brandt and Wehner are rather emphatically socialists who, I believe, only reluctantly submit to any moderation.

WELT: Which German politicians are in your opinion convinced champions of the market economy?

von Hayek: The only real market economist and the only leading German politician whom from my standpoint I would describe as a liberal is Franz Josef Strauss. He is the only liberal politician of great stature in Germany fighting against socialist parties.

WELT: Professor, you have defined anti-socialism as "opposition to all state interventions in the market, no matter whose interests they are intended to serve". Can you maintain this fundamental opposition even when you think of the oil crisis, of worldwide inflation, of the destruction of the environment by mass technology?

von Hayek: In the first two cases the state has so obviously made things worse instead of better that my arguments are strengthened. But I would like to be more precise. It depends on what we mean by intervention. Without doubt we need a legal framework which delimits property rights in an appropriate way, and although there is more wisdom in our property laws than people ever consciously put into them, we are certainly not yet at the end of our wisdom. Changes in the legal framework I would not call intervention. What I call intervention - and that is the strict term which my teacher Ludwig von Mises used - are only specific ordinances and prohibitions not expressed in the form of general rules applying to everybody but in the form of direct orders and prohibitions. These I absolutely reject.

WELT: I want to take up another of your expressions, the term "cold" Socialism. What does it mean?

von Hayek: It is the attempt to arrive at the goal of Socialism without direct steering of the economy through the device of taxation and distribution of state funds.

WELT: In the Federal Republic the state has acquired 47 per cent of the gross national product. Is that "cold" Socialism in your definition?

von Hayek: Yes.

WELT: What part does the collaboration between the governing SPD and the trade unions in politics and social policy play in this connection?

von Hayek: That is a complex phenomenon, and perhaps I am somewhat prejudiced because in England the trade unions have played such a disastrous part. I admit that after the war in Germany the relative reasonableness of the unions contributed very strongly to the great economic upswing. In itself a socialist regime cannot tolerate trade unions. The present collaboration of socialist idealists and trade union realists will not survive. This partnership cannot maintain itself if Socialism as such makes advances. We know there are practically no trade unions in the East Bloc countries. Trade unions are an institution of capitalist systems, an advance to Socialism must lead to the abolition of the unions.

WELT: The market economy is getting into ever greater difficulties in the international field. What can the Federal Republic contribute to avert these dangers?

von Hayek: The Federal Republic has made an immense contribution with its relatively reasonable monetary policy. We would otherwise be in a much worse position. I hope the Federal Republic will continue in this. It cannot do much more than prove how successful the market economy can be. In this sense the Federal Republic's example has had great influence in the right direction.

WELT: We are in an election year. Many people, particularly intellectuals, in our country are convinced that the association of "democratic socialism" with Liberalism is progressive. How do you explain that?

von Hayek: It is without doubt a very great error, but one must explain the thing historically and through the history of ideas. Through the past hundred years what I might almost call a philosophical current has come to rule for which I have introduced the term "Constructivism", which is now spreading. Constructivism contains the belief that man in the past consciously built up his culture thanks to his intelligence, that he also has unlimited power in addition to the ability to improve this power at will. It would contradict this world view which dominates European thinking if men were to realise that - as I expressed it in a recent work - man was civilised very much against his will and that only discipline and a morality which is not at all to his taste enable him to create prosperity as enjoyed by present-day humanity. We are under the rule of a destructive philosophy. The title of my book, "Die übermächtige Einbildung des heutigen Intellektuellen" ("The supreme

conceit of the present-day intellectual") characterises the problem of our age. In the long term we can only change the political tendency if we change the intellectual development. Though I am very pessimistic for the near future I believe that subsequently the prospects are very good, provided the politicians do not destroy the world in the next twenty years.

WELT: What should be better after twenty years?

von Hayek: A young generation is coming up throughout the world who I believe see things properly. If we are still free to vote in twenty years, then an intellectually much more reasonable youth will be at the rudder and will quit the destructive ways we have followed in the past hundred years. But in the meantime it will be a very exciting struggle to see whether we can preserve the elements of a free culture or whether the politicians - caught in the prejudices of our age - will try to combat every difficulty through new controls and thus stifle both our free economy and our possibilities for development.

WELT: What do you fear concretely in the next two decades?

von Hayek: Inflation, which leads to price controls, and a dammed up inflation is worse than an open one. I fear a growing dissatisfaction with the economy; and an economy which fails to work will produce ever greater unemployment. Then the state will be compelled to fight this unemployment with more and more false measures, so that we will have a

permanent economic crisis. It will tend in the next ten or fifteen years to grow more acute, interrupted by inflationistic explosions and the subsequent crises of stabilisation.

WELT: Is that not too black a picture?

von Hayek: For the near future the outlook is not good, if you look at the world. Still, in Germany, Switzerland or Japan one can feel: Perhaps I am in a lifeboat.

LPO

10 DOWNING STREET

THE PRIME MINISTER

13 February 1980

Dear Mr. Salomon.

Thank you for your letter of 11 February and I look forward to receiving the interview which appeared in Die Welt between Professor Hayek and a Die Welt reporter.

You mentioned the possibility of coming to see me between 3 and 12 March. As you know, I always enjoy our conversations but now I am Prime Minister my Governmental duties are so enormous that it is no longer possible for me to see all my old friends. I know you will be the first to understand and do please write whenever you wish.

Yours sincerely

Margaret Thatcher

W. H. Salomon, Esq.

BK.

KING'S HOUSE
36 - 37 KING STREET
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TEL. 01-606 4033

11th February, 1980

Dear Caroline,

I should be most grateful if at an appropriate moment you would put the enclosed letter before the Prime Minister.

Kind regards

Yours sincerely

Miss Caroline Stephens

KING'S HOUSE
36-37 KING STREET
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TEL. 01-606 4033

11th February, 1980

Dear Prime Minister,

I don't know whether you will recall during our discussion about Professor Hayek and his book, "The Constitution of Liberty", I drew your attention to the fact that he had headed his last paragraph "Why I am not a Conservative". You said at the time that one would have to make him change this heading.

You have, in the meantime, met the Professor many times but you may not have seen the article which appeared in Die Welt (Axel Springer) on 28th January last. It was an interview which took place between the Professor and Die Welt reporter, Mr. Wilfried Hertz-Eichenrode, in which the reporter asked:

> "Herr Professor, you are an Economist, and yet may I ask: are your political views conservative?"

The Professor replied:

> "I once gave a long lecture on the topic "Why I am not a Conservative". However, in the present-day climate it is only possible to support the conservative parties

because all others are more or less socialist parties. I personally see in Socialism such a great danger that in England I would consider myself to be a Conservative, even though I have not had an opportunity to participate actively in politics."

I am having the article translated and as soon as it is ready I shall send you the full text. I thought you might like to know about it in the meantime because it should give you great personal satisfaction.

After the luncheon which I attended at Downing Street on 12th December last I sent you a short memorandum which I hope has reached you safely.

I am going abroad this week and will not be back before 3rd March. If between 3rd and 12th March it would be possible for me to have half an hour of your time I should greatly appreciate it; there are a number of matters with which I want to acquaint you and which might be of interest to you.

Warmest regards
Yours sincerely
Winston S. Churchill

H8

22 October 1979

Dear Mr. Salomon,

Thank you very much indeed for your letter and this is just to let you know that we shall be taking decisions on this matter soon.

With all best wishes.

Warm regards,

Yours sincerely,

(signed) M.T.

Walter Salomon, Esq.

TMW

10 DOWNING STREET

PRIME MINISTER

This correspondence comes from Walter Salomon. Do you wish any action to be taken?

17 October 1979

HS

16 October 1979

Thank you for your letter of 15 October and I will ensure that this is placed before the Prime Minister at the earliest opportunity.

CAROLINE STEPHENS

Walter Salomon, Esq.

VLR

KING'S HOUSE
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TEL. 01-606 4033

15th October, 1979

Dear Caroline,

I am in a little difficulty because I am not quite sure that I should be doing what I am, in fact, doing. However, I am prompted to go ahead because I am very concerned, as are a number of my friends, over a little note which appeared in yesterday's Observer, a copy of which I enclose.

I wrote to Sir Keith Joseph on 12th October as per copy letter also enclosed. It is on this point that I find myself in difficulty because I would not normally have sent a copy of the Observer note to you but would have left it to Sir Keith to discuss it with the Prime Minister. However as, according to the Observer, a decision is going to be made in Cabinet this week, I thought Sir Keith might not have an opportunity to see the Prime Minister beforehand - hence my indiscretion.

Whitehall (the Civil Service) will always find a reason for not loosening the strings of their power and unless they are made to do so the market economy will never develop fully and have the affect in which the Prime Minister and I believe.

Quite apart from that, neither I nor my friends are sure whether the vulnerability of the pound as mentioned in The Observer would really take place and in this connection one could say he who never dares, never wins. However, if it were to happen it might well be to the benefit of the economy as it would mean a lower pound and from the point of view of our exports this would not be a bad thing. (Perhaps one of the opposing Treasury mandarins (by an indiscretion) simply wants to throw a spanner into the works).

I should be most grateful if you would find an early opportunity to put this letter before the Prime Minister.

Kind regards

Yours sincerely

Rudolf Peierls

STRICTLY PRIVATE
AND CONFIDENTIAL

12th October, 1979

I spoke to you on the telephone the other day and mentioned briefly my concern over the fact that the Exchange Control Act has not yet been totally abolished.

The following is one of the points I made in my general observations made at our Annual General Meeting on 11th April last:

> "Exchange Control was introduced almost forty years ago and has nowadays come to be accepted as a natural abuse of personal liberty. It has cloaked some of the misdoings of Government, slowed down our effectiveness in international trade, and created a vast and totally unnecessary bureaucracy".

Under normal circumstances, I should have thought an interview with the Prime Minister would be appropriate in order to express these thoughts to her, but I am hesitant to seek an interview because I know she must be totally over-committed with many important issues. However, knowing

as I do, that you and I share similar ideas on the question of the freedom of the individual, freedom of choice and the minimum interference by government in our daily lives. I thought that sooner or later you might find a quiet moment in which to impress on our Prime Minister that the total dismantling of Foreign Exchange Control will have a tremendous psychological affect, not only nationally but also internationally.

It is quite possible that the longer one waits the more difficult it will become to pursue this course as the pressures are building up and what is done is done. There is an old saying: strike while the iron is hot.

I know that this point is shared by some very eminent and practical people with whom I have discussed the matter - people whom I hold in the highest esteem. I know too that both you and our Prime Minister are persons of great moral courage and for this you are both greatly admired. Here is a splendid opportunity and it would be very sad were it to be missed.

The Rt. Hon. Sir Keith Joseph. Bt. MP.

THE OBSERVER - 14.10.1979

Doubts on controls

THE decision on the next stage of relaxation of UK exchange controls is expected to be made by the Cabinet this week, in time for an announcement when Parliament reassembles on 22 October.

Despite hints by the Chancellor at Blackpool that the promised relaxations are on the way, there are signs of growing nervousness in Whitehall about the wisdom of going ahead.

The first stage of relaxations, on capital movements within the EEC, produced a dramatic outflow.

The sudden worry is that, after average earnings increases of 17 per cent in the past 12 months (against 4½ per cent in Germany), and another winter of discontent brewing up, the pound could suddenly be vulnerable to strong speculative pressure.

FILE

DSG

10 DOWNING STREET

8 October 1979

From the Private Secretary

Thank you so much for sending for the Prime Minister a copy of the speech made by Dr. Burn in Belgrade.

The Prime Minister had in fact already seen this and found it extremely interesting, but she is most grateful to you for having taken the trouble to send it to her.

CAROLINE STEPHENS

W. H. Salomon, Esq.

TWC

KING'S HOUSE
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TEL. 01-606 4033

5th October, 1979

Dear Lawrence,

I have just returned from the World Bank Meeting which this year took place in Belgrade. I cannot say it was a very encouraging affair.

At the meeting, Dr. Burn, former Head of the Federal Reserve, gave a first-class talk under the auspices of the Per Jacobsson Foundation. I enclose herewith a copy of his speech. If the Prime Minister can find a moment in which to read it I think she will find it rewarding.

I also enclose a copy of a letter which I have today written to Geoffrey Rippon. I think utterances such as those which in today's Daily Telegraph he is reported to have made are not very helpful in the present climate. Perhaps you could put this correspondence before the Prime Minister at an opportune moment.

Kind regards
Yours sincerely
Walter Salomon

KING'S HOUSE
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5th October, 1979

Dear Mr. Thorpe,

I have just seen your remarks as reported in today's Daily Telegraph. I hope you will permit me to say that I totally disagree with your views as does, I think, the majority of informed opinion.

I have just returned from the World Bank Meeting in Belgrade where I spoke to a number of distinguished bankers. Perhaps you did not see the article by Samuel Brittan in the Financial Times of 20th September or the one in yesterday's Financial Times by Anthony Harris. I enclose copies of these, together with a copy of a letter of mine which was published in the Financial Times on 24th September. I am sending all these to you because I thought that you, as a broad-minded member of the Conservative Party would like to hear the other side as well.

Yours sincerely,

Walter H. Salomon

DAILY TELEGRAPH - 5.10.1979

RIPPON CALLS FOR RETURN TO GOLD

A former Conservative Cabinet Minister called last night for the return of gold to a central role in the world's monetary system in an effort to tackle "inflation and chronic currency instability."

Mr Geoffrey Rippon, M P for Hexham, said that omens from the International Monetary Fund meeting in Belgrade bore out his forecast that "an utter collapse of the international paper dollar standard" was on the way.

"The United States administration should stop their insane gold sales forthwith," Mr Rippon told the annual dinner of the Company of Builders at the Guildhall. "They only serve to knock the dollar further down while pushring up the price of gold."

THE 1979 PER JACOBSSON LECTURE

THE ANGUISH OF CENTRAL BANKING

ARTHUR BURNS

FOR RELEASE
September 30, 1979
2:30 p.m.
Belgrade-Time

The Ballroom-East
Beograd Inter-Continental Hotel
SAVA Centar Complex
Belgrade, Yugoslavia

Sunday, September 30, 1979
2:30 p.m.

THE ANGUISH OF CENTRAL BANKING

Arthur F. Burns

When I was invited several months ago to deliver this year's Per Jacobsson Lecture, I found it easy to give my consent. Per Jacobsson was a financial statesman whose efforts in behalf of world economic order deserve to be remembered by this distinguished audience. I feel I can honor his memory best by presenting on this occasion some straightforward thoughts on central banking.

The international monetary system, which has been in almost constant turmoil during this decade, has benefited recently from several developments. Under the amended Articles of Agreement, the International Monetary Fund can exercise firm surveillance over the exchange rate policies of its members, and is therefore now in a position to move the nations of the world toward a rule of law in international monetary affairs. Another promising development is the establishment of the European Monetary System with the aim of maintaining relatively stable exchange rates within the Common Market.

A third positive development is recognition by the United States that the persisting deficits in its international current account must be eliminated, and that in the meantime decisive intervention to protect the external value of the dollar may well be needed. The conventional theory that a depreciating currency is beneficial to a nation's foreign trade and to its over-all economic activity has lost its appeal within the American government. The officials concerned with economic policy have learned that whatever merit may in some circumstances attach to this theory, it is a dangerous guide for a country whose currency is still the centerpiece of the international monetary system. "Benign neglect" of the external value of the dollar came to an end dramatically, and I would hope irrevocably, last November.

This and other constructive developments suggested earlier this year that a closer approach to international equilibrium was under way and calm returned for a while to foreign exchange markets. But uneasiness about the monetary system, particularly about the future of the dollar, has continued and in fact intensified

this summer. There have been ample reasons for concern--among them, the political convulsions in Iran, the enormous new increases in oil prices by OPEC, the narrowing at times of interest-rate differentials between New York and foreign money-market centers, and the limited progress in developing an effective energy policy in the United States. While all these factors contributed to nervousness, what has been most disturbing to foreign exchange markets in recent months is the reacceleration of inflation in the United States and in much of the rest of the world. Even Germany and Switzerland no longer qualify as islands of stability.

This unhappy development is one more indication, if any were needed, that the current instability in international finance is largely a consequence of the chronic inflation of our times and that stability will not return to the international monetary system until reasonably good control over inflationary forces has been achieved in the major industrial nations--and especially in the United States. This critical consideration at once raises serious questions: Why is the world-wide disease of inflation proving so stubborn? Why

is it not yielding to the various efforts of the affected nations, including some determined efforts, to bring it to an end? Why, in particular, have central bankers, whose main business one might suppose is to fight inflation, been so ineffective in dealing with this world-wide problem?

To me, as a former central banker, the last of these questions is especially intriguing. One of the time-honored functions of a central bank is to protect the integrity of its nation's currency, both domestically and internationally. In monetary policy central bankers have a potent means for fostering stability of the general price level. By training, if not also by temperament, they are inclined to lay great stress on price stability, and their abhorrence of inflation is continually reinforced by contacts with one another and with like-minded members of the private financial community. And yet, despite their antipathy to inflation and the powerful weapons they could wield against it, central bankers have failed so utterly in this mission in recent years. In this paradox lies the anguish of central banking.

My aim today is to consider the causes of this paradox and its implications for the future.

Much of what I say will inevitably reflect lessons that I learned during my service as Chairman of the Federal Reserve Board over an eight-year period that ended about eighteen months ago. This may be a good time to reflect on that experience; a year ago I was probably too close to it to have the necessary perspective, and a year from now the sharpness of my impressions may have begun to fade.

I shall focus mainly, although not exclusively, on the United States. That is the area that I know best, and I also believe the American experience--despite some unique aspects--is fairly representative of that of other industrial countries. The developing nations have their own characteristic sources and patterns of inflation. Nevertheless, in our interdependent world, economic conditions in the United States and other industrial countries are bound to have a significant bearing on the fortunes of developing countries.

By way of introduction, I might note that during much of the period since the end of World War II, over-all economic developments were, in the main, satisfactory. By prewar standards, recessions were brief and mild through the mid-1960's, both in the United States and in other industrial countries;

world trade expanded rapidly under a beneficent regime of stable exchange rates; and living standards rose impressively throughout the developed world. In most industrial countries inflationary pressures were troublesome from time to time--as in the immediate postwar years, during the Korean hostilities, and for a couple of years after the mid-1950's. These pressures were more substantial in some countries than in the United States, but in none did inflation appear to be out of control.

From 1958 through 1964, the United States enjoyed a remarkable degree of price stability. During that stretch of six years, the wholesale price index remained virtually unchanged and the consumer price index rose at an annual rate of only a little more than one percent. And then the inflation that has ever since been plaguing the American economy got under way. Average wholesale prices rose at an annual rate of 2 percent from 1964 to 1968, 4 percent from 1968 to 1972, and 10 percent from 1972 to 1978. This pattern of accelerating price increases is found in other countries also, although rates of increase have varied widely, and in most industrial nations the acceleration began later--typically in 1969 or 1970.

Analyses of the inflation that the United States has experienced over the past fifteen years

frequently proceed in three stages. First are considered the factors that launched inflation in the mid-1960's, particularly the governmental fine tuning inspired by the New Economics and the loose financing of the war in Vietnam. Next are considered the factors that led to subsequent strengthening of inflationary forces, including further policy errors, the devaluations of the dollar in 1971 and 1973, the world-wide economic boom of 1972-73, the crop failures and resulting surge in world food prices in 1973-74, the extraordinary increases in oil prices that became effective in 1974, and the sharp deceleration of productivity growth from the late 1960's onward. Finally, attention is turned to the process whereby protracted experience with inflation has led to widespread expectations that it will continue in the future, so that inflation has acquired a momentum of its own.

I have no quarrel with analyses of this type. They are distinctly helpful in explaining the American inflation and, with changes here and there, that in other nations also. At the same time, I believe that such analyses overlook a more fundamental factor: the persistent inflationary bias that has emerged from the philosophic and

political currents that have been transforming economic life in the United States and elsewhere since the 1930's. The essence of the unique inflation of our times and the reason central bankers have been ineffective in dealing with it can be understood only in terms of those currents of thought and the political environment they have created.

Historically, Americans have had deep faith in the concept of progress--in the idea that it was realistic to expect to better one's own lot and that of one's family in the course of a lifetime. During the greater part of America's history, government intervention in economic life was only peripheral. Personal progress was generally viewed as a reward for personal effort--assisted, perhaps, by good fortune. Provision for bad times or other contingencies of life was deemed prudent, but that was a private responsibility. The American's way through life lay along the road of self-reliance; only in extremity did he look to government or his neighbors for economic assistance.

This tradition of individualism was shattered by the cataclysmic events of the 1930's and 1940's. The breakdown of economic order during the Great Depression was unprecedented in its scale and scope,

and it strained the precept of self-reliance beyond the breaking point. With one-quarter of the labor force unemployed, personal courage and moral stamina could guarantee neither a job nor a livelihood. Succor finally came through a political idea that was novel to a majority of the American people but compelling nonetheless--namely, that the Federal government had a far larger responsibility in the economic sphere than it had hitherto assumed.

Under the New Deal the Federal government undertook extensive projects of public construction and offered work relief as well. It gave direct relief to the needy--a function previously performed only by local authorities or private charity. It established unemployment insurance and old-age pensions. It took steps to raise wages and prices with a view to fostering economic recovery. And beyond these innovative actions, the Federal government greatly extended the range of its regulatory activities. It intervened massively in the securities market, in banking, in the public utilities industry, in the housing market, and in the farm sector; and it gave labor unions broad new rights and powers. Together, these and other New Deal measures laid the foundations of an

activist government--a government responsible not only for relieving suffering and insuring against economic adversity, but also for limiting "harmful" competition, subsidizing "worthwhile" activities, and redressing unequal balances of market power. In less than a decade the government became a leading actor on the economic stage.

Just as Americans were persuaded during the depression that the Federal government should help the unemployed, so they were taught by the experience of World War II to look to government to prevent unemployment in the first place. Under the compulsions of war, the government had demonstrated that it could assure gainful employment for every willing hand. It therefore seemed reasonable, and not only to the followers of Keynes, to expect government to do the same in a time of peace. In 1944, when President Roosevelt set forth the basis of his postwar domestic program in an "Economic Bill of Rights", he put "the right to a useful and remunerative job" at the head of the list. With the war ended, the Employment Act of 1946 explicitly proclaimed the Federal government's responsibility to promote "maximum employment", and this came to mean "full employment" as a matter of law as well as popular usage.

Armed with the Employment Act, the government sought to demonstrate that it could combat unemployment with preventive as well as curative measures. In fact, the period from World War II to the mid-1960's was marked not only by a dampening of the business cycle but also by persistent increases in the prosperity of American families. On the one side, rising incomes, reflecting substantial gains in labor productivity, made possible rising consumption, greater leisure, and better provision for retirement. On the other side, a steady stream of new and often improved consumer goods tended to sustain the growth of aggregate demand. The extensive development of consumer credit institutions made it easier for people to acquire automobiles, household appliances, and other goods and services, the desire for which was continually being whetted by alluring advertisements and the illustrations of potential life styles broadcast by television and the movies. The seemingly inexorable rise in living standards for the bulk of the population was reflected in upward trends in the proportion of families that owned their own home, that owned a summer home, that possessed one, two and even three automobiles, that had telephones, that owned television sets, clothes washers, and

food freezers; also in the proportion of the population that had graduated from high school and from college, that traveled abroad, that owned corporate stock, that carried life insurance, and so on.

This experience of economic progress strengthened the public's expectations of progress. What had once been a quiet personal feeling that the long future would be better than the past, particularly for one's children, was transformed during the postwar years into an articulate and widespread expectation of steady improvement in living standards--indeed, to a feeling of entitlement to annual increases in real income.

But the rapid rise in national affluence did not create a mood of contentment. On the contrary, the 1960's were years of social turmoil in the United States, as they were in other industrial democracies. In part, the unrest reflected discontent by blacks and other minorities with prevailing conditions of social discrimination and economic deprivation--a discontent that erupted during the "hot summers" of the middle 1960's in burning and looting. In part, the social unrest reflected growing feelings of injustice by

or on behalf of other groups--the poor, the aged, the physically handicapped, ethnics, farmers, blue collar workers, women, and so forth. In part, the unrest reflected a growing rejection by middle-class youth of prevailing institutions and cultural values. In part, it reflected the more or less sudden recognition by broad segments of the population that the economic reforms of the New Deal and the more recent rise in national affluence had left untouched problems in various areas of American life--social, political, economic, and environmental. And interacting with all these sources of social disturbance were the heightening tensions associated with the Vietnam War.

In the innocence of the day, many Americans came to believe that all of the new or newly discovered ills of society should be addressed promptly by the Federal government. And in the innocence of the day, the administration in office attempted to respond to the growing demands for social and economic reform while waging war in Vietnam on a rising scale. Under the rubric of the New Economics, a more activist policy was adopted for the purpose of increasing the rate of economic growth and reducing the level of

unemployment. Under the rubrics of the New Frontier and the Great Society, broad-scale efforts were made to stitch up open seams in the fabric of affluence--inadequate or unequal education, housing, medical care, nutrition. Under the rubrics of civil rights and citizen participation, minorities and other disadvantaged groups were given political weapons to maintain, consolidate, and extend their gains.

The interplay of governmental action and private demands had an internal dynamic that led to their concurrent escalation. When the government undertook in the mid-1960's to address such "unfinished tasks" as reducing frictional unemployment, eliminating poverty, widening the benefits of prosperity, and improving the quality of life, it awakened new ranges of expectation and demand. Once it was established that the key function of government was to solve problems and relieve hardships--not only for society at large but also for troubled industries, regions, occupations, or social groups--a great and growing body of problems and hardships became candidates for governmental solution. New techniques for bringing pressure on Congress--and also on the State legislatures

and other elected officials--were developed, refined, and exploited. Congress responded by pouring out a broad stream of measures that involved government spending, special tax relief, or regulations mandating private spending. Every demonstration of a successful tactic in securing rights, establishing entitlements, or extracting other benefits from government led to new applications of that tactic. Various groups found a powerful ally in the Federal courts, which repeatedly struck down legislative or administrative limitations on access to government benefits. Even government employees, particularly at the state and municipal levels, discovered the pecuniary rewards of shedding genteel notions of public service and pressing economic demands with a strident militancy.

Many results of this interaction of government and citizen activism proved wholesome. Their cumulative effect, however, was to impart a strong inflationary bias to the American economy. The proliferation of government programs led to progressively higher tax burdens on both individuals and corporations. Even so, the willingness of government to levy taxes fell distinctly short of its propensity to spend. Since 1950 the Federal

budget has been in balance in only five years. Since 1970 a deficit has occurred in every year. Not only that, but the deficits have been mounting in size. Budget deficits have thus become a chronic condition of Federal finance; they have been incurred when business conditions were poor and also when business was booming. But when the government runs a budget deficit, it pumps more money into the pocketbooks of people than it withdraws from their pocketbooks; the demand for goods and services therefore tends to increase all around. That is the way the inflation that has been raging since the mid-1960's first got started and later kept being nourished.

The pursuit of costly social reforms often went hand in hand with the pursuit of full employment. In fact, much of the expanding range of government spending was prompted by the commitment to full employment. Inflation came to be widely viewed as a temporary phenomenon--or, provided it remained mild, as an acceptable condition. "Maximum" or "full" employment, after all, had become the nation's major economic goal--not stability of the price level. That inflation

ultimately brings on recession and otherwise nullifies many of the benefits sought through social legislation was largely ignored. Even conservative politicians and businessmen began echoing Keynesian teachings. It therefore seemed only natural to Federal officials charged with economic responsibilities to respond quickly to any slackening of economic activity--at times, in fact, as in the early days of 1977, to sheer illusions of such slackening--but to proceed very slowly and cautiously in responding to evidence of increasing pressure on the nation's resources of labor and capital. Fear of immediate unemployment--rather than fear of current or eventual inflation--thus came to dominate economic policy making.

This weighting of the scales of government policy inevitably gave an inflationary twist to the economy, and so too did the expanding role of government regulation. Traditional ways of protecting particular groups against competition--such as raising farm price supports, increasing minimum wages, and imposing import quotas--did not lose their appeal as inflation kept soaring. On the contrary, all these devices of raising costs

and prices were liberally employed even in the face of accelerating inflation during 1977 and 1978. Also troublesome were the newer social regulations--those concerned with health, safety, and the environment--that kept multiplying during the 1970's. However laudable in purpose, much of this regulatory apparatus was conceived in haste and with little regard to the costs being imposed on producers. Substantial amounts of capital that might have gone into productivity-enhancing investments by private industry were thus diverted into uses mandated by the regulators. Improvements in productivity were also slowed by the discouragement of business investment that resulted from the increasing burden of income and capital-gains taxes. Progress in equipping the work force with new plant and equipment proceeded much less rapidly during the 1970's than during the 1950's or 1960's, and this shortfall contributed to the productivity slump and thus to the escalation of costs and prices.

Additional forces on the side of supply contributed to the inflationary bias. As the income maintenance programs established by government were liberalized, incentives to work tended to diminish. Some individuals, both young and old,

found it agreeable to live much of the time off unemployment insurance, food stamps, and welfare checks--perhaps supplemented by intermittent jobs in an expanding underground economy. Even enterprising and ambitious individuals who sought permanent jobs could be more leisurely or more discriminating in their search when the government, besides pursuing a full employment policy, provided a protective income umbrella during jobless periods. In such an environment, employed workers could demand and often achieve longer vacations with pay and more frequent holidays and sick leave, besides enjoying coffee breaks and other social rites on the job. In such an environment, they could afford to reject a pay cut or a small wage increase when their employer pleaded serious financial difficulties. Thus the number of individuals counted as unemployed could rise even at times when job vacancies, wages, and the consumer price level were rising.

The philosophic and political currents that transformed economic life and brought on secular inflation in the United States have run strong also in other industrial countries. Rising economic expectations of people, wider citizen

participation in the political arena, governmental commitments to full employment, liberal income maintenance programs, expanding governmental regulations, and increasingly pressing demands on government for the solution of economic and social problems--all these became common features of the industrial democracies. And just as the rapid expansion of government activities in the United States was accompanied by persistent budget deficits and inflation, that too happened in other industrial countries. Indeed, other countries have often practiced loose governmental finance and inflation on a more intensive scale than has the United States.

And so I finally come to the role of central bankers in the inflationary process. The world-wide philosophic and political trends on which I have been dwelling inevitably affected their attitudes and actions. In most countries, the central bank is an instrumentality of the executive branch of government--carrying out monetary policy according to the wishes of the head of government or the ministry of finance. Some industrial democracies, to be sure, have substantially independent central banks and that is

certainly the case in the United States. Viewed in the abstract, the Federal Reserve System had the power to abort the inflation at its incipient stage fifteen years ago or at any later point, and it has the power to end it today. At any time within that period, it could have restricted the money supply and created sufficient strains in financial and industrial markets to terminate inflation with little delay. It did not do so because the Federal Reserve was itself caught up in the philosophic and political currents that were transforming American life and culture.

The Employment Act prescribes that "it is the continuing policy and responsibility of the Federal government to....utilize all its plans, functions, and resources....to promote maximum employment". The Federal Reserve is subject to this provision of law, and that has limited its practical scope for restrictive actions--quite apart from the fact that some members of the Federal Reserve family had themselves been touched by the allurements of the New Economics. Every time the government moved to enlarge the flow of benefits to the population at large, or to this or that group, the assumption was implicit that

monetary policy would somehow accommodate the action. A similar tacit assumption was embodied in every pricing decision or wage bargain arranged by private parties or the government. The fact that such actions could in combination be wholly incompatible with moderate rates of monetary expansion was seldom considered by those who initiated them, despite the frequent warnings by the Federal Reserve that new fires of inflation were being ignited. If the Federal Reserve then sought to create a monetary environment that fell seriously short of accommodating the upward pressures on prices that were being released or reinforced by governmental action, severe difficulties could be quickly produced in the economy. Not only that, the Federal Reserve would be frustrating the will of Congress to which it was responsible--a Congress that was intent on providing additional services to the electorate and on assuring that jobs and incomes were maintained, particularly in the short run.

Facing these political realities, the Federal Reserve was still willing to step hard on the monetary brake at times--as in 1966, 1969, and 1974--but its restrictive stance was not maintained long enough to end inflation. By and large, monetary policy came to be governed by the principle of under-nourishing the inflationary process while still

accommodating a good part of the pressures in the marketplace. The central banks of other industrial countries, functioning as they did in a basically similar political environment, appear to have behaved in much the same fashion.

In describing as I just have the anguish of central banking in a modern democracy, I do not mean to suggest that central bankers are free from responsibility for the inflation that is our common inheritance. After all, every central bank has some room for discretion, and the range is considerable in the more independent central banks. As the Federal Reserve, for example, kept testing and probing the limits of its freedom to undernourish the inflation, it repeatedly evoked violent criticism from both the Executive establishment and the Congress and therefore had to devote much of its energy to warding off legislation that could destroy any hope of ending inflation. This testing process necessarily involved political judgments, and the Federal Reserve may at times have overestimated the risks attaching to additional monetary restraint.

Any such errors of political judgment are extremely hard to identify; but I believe, in any event, that errors of economic or financial judgment have in practice been far more significant. In a rapidly changing world the opportunities for

making mistakes are legion. Even facts about current conditions are often subject to misinterpretation. Statistics on unemployment in the United States provide a good example. Even before World War II ended, some economists were trying to determine how much frictional and structural unemployment would exist when the demand for labor and the supply of labor were in balance; in other words, the rate of unemployment that would reflect a state of full employment. Before long, a broad consensus developed that an unemployment rate of about 4 percent corresponded to a practical condition of full employment, and that figure became enshrined in economic writing and policy making. Conditions in labor markets, however, did not stand still. A huge influx of women and young people into the labor force, the liberalization of unemployment insurance, the spread of welfare programs, the progressive lifting of statutory minimum wages, the increasing proportion of families having more than one worker, and the increase of national affluence itself--all these changes in the economic and social environment served to render the conventional 4 percent figure obsolete. The unemployment rate corresponding to full employment is now widely believed to be about 5½ or 6 percent, and this year's report of the

Council of Economic Advisers appears to concur in that judgment. But governmental policy makers, while generally aware of what was happening in the labor market, were slow to recognize the changing meaning of unemployment statistics, whether viewed as a measure of economic performance or as a measure of hardship. The Federal Reserve did not escape this lag of recognition and, once again, I believe that other central banks at times have made similar mistakes.

While misinterpretations of unemployment statistics or other current information have consequences for all public policy making, there are other problems of interpretation to which the central banker's calling is peculiarly subject. Monetary theory is a controversial area. It does not provide central bankers with decision rules that are at once firm and dependable. To be sure, every central banker has learned from the world's experience that an expanding economy requires expanding supplies of money and credit, that excessive creation of money will over the longer run cause or validate inflation, and that declining interest rates will tend to stimulate economic expansion while rising interest rates will tend to restrict it; but this knowledge stops short of mathematical precision.

Partly as a result of the chronic inflation of our times, central bankers have been giving closer attention to the money supply than did their predecessors; but they continue to be seriously concerned with the behavior of interest rates. They face difficult questions about the relative weight to be given to measures of money and interest rates in the short run and long run; about the concept or concepts of money that are most significant for policy purposes; about the interpretation of such developments as the growth of Eurocurrency deposits and credits; about the length and regularity of the lags with which changes in monetary growth rates influence business activity and prices; about the likely changes in monetary velocity as a consequence of institutional innovations and business-cycle developments; and so on and on--as any student of central banking and monetary theory well knows. And there are more fundamental problems about potential conflicts between domestic and international objectives, about the appropriate response to exceptional events not encompassed by theory, and about the precise relevance of any theory based on past experience to a world where behavioral patterns are continually evolving.

It is clear, therefore, that central bankers can make errors--or encounter surprises--at practically every stage of the process of making monetary policy. In some respects, their capacity to err has become larger in our age of inflation. They are accustomed, as are students of finance generally, to think of high and rising market interest rates as a restraining force on economic expansion. That rule of experience, however, tends to break down once expectations of inflation become widespread in a country. At such a time, lenders expect to be paid back in cheaper currency, and they are therefore apt to demand higher interest rates. Since borrowers have similar expectations, they are willing to comply. An "inflation premium" thus gets built into nominal interest rates. In principle, no matter how high the nominal interest rate may be, as long as it stays below or only slightly above the inflation rate, it very likely will have perverse effects on the economy; that is, it will run up costs of doing business but do little or nothing to restrain overall spending. In practice, since inflationary expectations, and therefore the real interest rates implied by any given nominal rate, vary among individuals, central bankers cannot be sure of the

magnitude of the inflation premium that is built into nominal rates. In many countries, however, these rates have at times in recent years been so clearly below the ongoing inflation rate that one can hardly escape the impression that, however high or outrageous the nominal rates may appear to observers accustomed to judging them by a historical yardstick, they have utterly failed to accomplish the restraint that central bankers sought to achieve. In other words, inflation has often taken the sting out of interest rates--especially, as in the United States, where interest payments can be deducted for income tax purposes.

In addition to these direct effects of inflation, there are other effects that raise doubts about the meaning of particular growth rates of the monetary aggregates. I have in mind changes in financial practices that evolved in the United States during the 1960's--particularly during the bouts with tight money in 1966 and 1969--and that culminated in an explosion of financial innovations in the 1970's.

Many of these changes were facilitated by regulatory actions or the development of new computer technology. But the driving force behind them was the incentive that sharply rising market

interest rates gave to financial institutions and their customers to change their ways of doing business. Commercial banks responded to rising rates by economizing on non-interest-bearing reserves, and their customers responded by economizing on non-interest-bearing demand deposits. Both banks and large corporations developed new sources of funds in the Euro-dollar market and the domestic commercial paper market. Banks developed new techniques of liability management by exploiting these sources as well as the vast potential of the Federal funds market and the market for negotiable certificates of deposit. Other financial institutions--including savings banks, savings and loan associations, credit unions, and money market mutual funds--developed new transactions services in connection with customer accounts on which they paid interest. Banks fought this competition for transactions balances by offering large depositors special services that reduced the average level of balances they had to carry and by employing various ingenious means to pay interest on balances that were held in large part for transactions purposes.

Developments of these kinds have had profound consequences for the environment in which American monetary policy operates. Not long ago, the thrust of

monetary restraint was conveyed more by reductions in the availability of credit--particularly residential mortgage credit--than by rising interest rates; at present, rising interest rates are the primary channel of restraint. This means that a higher level of interest rates is required to achieve any given degree of restraint--quite apart from the effects of inflation premiums that I discussed earlier. But how much higher is not clear; only time will tell. Not long ago, changes in M-1, the familiar monetary aggregate confined to currency and demand deposits, reflected reasonably well changes in the aggregate volume of transactions balances; at present, with new alternatives to bank demand deposits emerging all the time, a lower rate of growth in M-1 is required to achieve any given degree of restraint. But how much lower is not clear; only time will tell. Nor is it clear what other monetary aggregate, if any, would be more serviceable than the traditional M-1 as a monetary indicator. As a result of these effects of inflation, central banking has not only lost its moorings in interest rates; that has happened to a large extent also in the case of the monetary aggregates--certainly in the United States and perhaps in other countries as well.

There is no need to expand further on the opportunities for misjudgment that in recent years have surrounded policy making at central banks. Some uncertainty, of course, has always characterized monetary policy, just as it has characterized policy decisions generally, whether in public or private life. It should be noted, however, that lags in recognizing some of the developments I have been discussing--with respect to unemployment rates, interest rates, and growth rates of the monetary aggregates--would tend to bias policy toward monetary ease. Moreover, the emergence of an inflationary psychology in industrial countries has imparted an asymmetry to the consequences of monetary errors, even if the errors themselves occurred as often in one direction as the other.

There is a profound difference between the effects of mistaken judgments by a central bank in our age of inflation and the effects of such judgments a generation or two ago. In earlier times, when a central bank permitted excessive creation of money and credit in times of prosperity, the price level would indeed tend to rise. But the resulting inflation was confined to the expansion phase of the business cycle; it did not persist or gather force beyond that phase. Therefore, people generally took it for granted that

the advance of prices would be followed by a decline once a business recession got under way. That is no longer the case.

Nowadays, businessmen, farmers, bankers, trade union leaders, factory workers, and housewives generally proceed on the expectation that inflation will continue in the future, whether economic activity is booming or receding. Once such a psychology has become dominant in a country, the influence of a central bank error that intensifies inflation may stretch out over years, even after a business recession has set in. For in our modern environment, any rise in the general price level tends to develop a momentum of its own. It stimulates higher wage demands which are accommodated by employers who feel they can recover the additional costs through higher prices; it results in labor agreements in key industries that call for substantial wage increases in later years without regard to the state of business then; and through the use of indexing formulas, it leads to automatic increases in other wages as well as in social security payments, various other pensions, welfare benefits, also in rents on many properties and in the prices of many commodities acquired under long-term contracts. On the other hand, unintended central bank effects of a restrictive type do not ramify in similar fashion.

To develop any significant momentum in unwinding inflation, they would need to be both large and repetitive--a combination that can hardly occur under prevailing conditions in the industrial democracies.

If my analysis of central banking in the modern environment is anywhere near the mark, two conclusions immediately follow. First, central banks have indeed been participants in the inflationary process in which the industrial countries have been enmeshed, but their role has been subsidiary. Second, while the making of monetary policy requires continuing scrutiny and can stand considerable improvement, it is vain to look to technical reforms as a way of eliminating the inflationary bias of industrial countries. What is unique about our inflation is its stubborn persistence, not the behavior of central bankers. This persistence reflects the fundamental forces on which I dwelt earlier in this address--namely, the philosophic and political currents of thought that have impinged on economic life since the Great Depression and particularly since the mid-1960's.

My conclusion that it is illusory to expect central banks to put an end to the inflation that now afflicts the industrial democracies does not mean that central banks are incapable of stabilizing actions; it simply means that their practical capacity for

curbing an inflation that is continually driven by political forces is very limited. Historically, central banks have helped to slow down the pace of economic activity at certain times and to stimulate economic activity at other times. They have also contributed to economic stability by serving as lenders of last resort or even going beyond that traditional function. During this decade alone, the Federal Reserve moved on at least two occasions to prevent financial crises that otherwise could easily have occurred. I have in mind particularly the failure of the Penn Central Transportation Company in June 1970 and the failure of the Franklin National Bank in October 1974. In the former case the inability of Penn Central to refinance its outstanding commercial paper caused consternation among holders of commercial paper generally. To prevent a financial panic the Federal Reserve put aside its monetary targets for a while, opened the discount window wide, and changed its regulations so that commercial banks could raise funds in the open market to finance firms unable to renew their maturing commercial paper. In the Franklin National case, the Federal Reserve loaned to that troubled international bank almost 2 billion dollars; and while these advances were outstanding it was possible to arrange a takeover by another bank that

protected the interests of Franklin's depositors and customers. These actions were influenced by a feeling of responsibility for the financial system as a whole--international as well as domestic. The central banks of some other countries, notably the Bank of England, have likewise discharged constructively the function of serving as lenders of last resort, and the entire concept of central bank responsibility has been both widened and clarified through discussions in recent years at the Bank for International Settlements.

All this and much more deserves to be noted about central banks--especially their tireless efforts to awaken the citizens of their respective countries to the economic and social dangers posed by inflation. But whatever the virtues or shortcomings of central banks may be, the fact remains that they alone will be able to cope only marginally with the inflation of our times. The persistent inflation that plagues the industrial democracies will not be vanquished--or even substantially curbed--until new currents of thought create a political environment in which the difficult adjustments required to end inflation can be undertaken.

There are some signs, as yet tenuous and inconclusive, that such a change in the intellectual

and political climate of the democracies is getting under way. One of the characteristic features of a democracy is that it encourages learning from experience. Recent disturbing trends in economic and social life, particularly the persistence and acceleration of inflation, have led to much soul-searching by leaders of thought and opinion. Among economists, the Keynesian school has lost much of its erstwhile vigor, self-confidence, and influence. Economists are no longer focusing so exclusively on unemployment and governmental management of aggregate demand. They are paying more attention to the management of aggregate supply--to the need to strengthen incentives to work and innovate, to ways of stimulating saving and investment, to the importance of eliminating barriers to competition, to ways of reducing the regulatory burdens imposed on industry, and to other means of bolstering business confidence. Many economists now recognize that much of reported unemployment is voluntary, that curbing inflation and reducing involuntary unemployment are complementary rather than competitive goals, that persistent governmental deficits and excessive creation of money tend to feed the fires of inflation, that the high savings rate that usually prevails in the early stages of inflation

is eventually succeeded by minimal savings, and that when this stage is reached it becomes very much harder to bring inflation under control.

The intellectual ferment in the world's democracies is having its influence not only on businessmen and investors, but also on politicians, trade union leaders, and even housewives; for all of them have been learning from experience and from one another. In the United States, for example, people have come to feel in increasing numbers that much of the government spending sanctioned by their compassion and altruism was falling short of its objectives; that urban blight was continuing, that the quality of public schools was deteriorating, that crime and violence were increasing, that welfare cheating was still widespread, that collecting unemployment insurance was becoming a way of life for far too many--in short, that the relentless increases of government spending were not producing the social benefits expected from them and yet were adding to the taxes of hard-working people and to the already high prices they had to pay at the grocery store and everywhere else. In my judgment, such feelings of resentment and frustration are largely responsible for the conservative political trend that has developed of late in the United States.

And I gather from the results of recent elections elsewhere that concern about inflation and disenchantment with socialist solutions are increasing also in other industrial countries. Fighting inflation is therefore being accorded a higher priority by policy makers in Europe and in much of the rest of the world.

In the United States a great majority of the public now regard inflation as the Number One problem facing the country, and this judgment is accepted by both the Congress and the Executive establishment. Some steps have therefore been taken within the past year to check the rapid rise of Federal spending, to lower certain taxes in the interest of encouraging business investment, and yet bring down the still large budget deficit. Pressures to augment the privileges of trade unions have been resisted by the Congress. Some government regulations--as in the case of airlines and crude oil--have been eased. And even restrictive moves by the Federal Reserve, which not long ago would have stirred anger and anxiety in government circles, have been accepted with equanimity. Symbolic of the changed political atmosphere was the announcement of an increase in the Federal Reserve discount rate on the very day this July when a sizable decline of the nation's over-all

production was being reported for the spring quarter.

The present widespread concern about inflation in the United States is an encouraging development, but no one can yet be sure how far it will go or how lasting it will prove. The changes that have thus far occurred in fiscal, monetary, and structural policies have been marginal adjustments. American policy makers tend to see merit in a gradualist approach because it promises a return to general price stability--perhaps with a delay of five or more years but without requiring significant sacrifices on the part of workers or their employers. But the very caution that leads politically to a policy of gradualism may well lead also to its premature suspension or abandonment in actual practice. Economic life is subject to all sorts of surprises and disturbances--business recessions, labor unrest, foreign troubles, monopolistic shocks, elections, and governmental upsets. One or another such development, especially a business recession, could readily overwhelm and topple a gradualist timetable for curbing inflation. That has happened in the past and it may happen again.

If the United States and other industrial countries are to make real headway in the fight

against inflation it will first be necessary to rout inflationary psychology--that is, to make people feel that inflation can be, and probably will be, brought under control. Such a change in national psychology is not likely to be accomplished by marginal adjustments of public policy. In view of the strong and widespread expectations of inflation that prevail at present, I have therefore reluctantly come to believe that fairly drastic therapy will be needed to turn inflationary psychology around.

The precise therapy that can serve a nation best is not easy to identify, and what will work well in one country may work poorly in another. In the case of the American inflation, which has become a major threat to the well-being of much of the world as well as of the American people, it would seem wise to me at this juncture of history for the government to adopt a basic program consisting of four parts. The first of these would be a legislative revision of the Federal budgetary process that would make it more difficult to run budget deficits and that would serve as the initial step toward a constitutional amendment directed to the same end. The second part would be a commitment to a comprehensive plan for dismantling regulations that have been impeding the competitive

process and for modifying others that have been running up costs and prices unnecessarily. The third part would be a binding endorsement of restrictive monetary policies until the rate of inflation has become substantially lower. And the fourth part would consist of legislation scheduling reductions of business taxes in each of the next five years--the reduction to be quite small in the first two years but to become substantial in later years. This sort of tax legislation would release powerful forces to improve the nation's productivity and thereby exert downward pressure on prices; and it would also help in the more immediate future to ease the difficult adjustments forced on many businesses and their employees by the adoption of the first three parts of the suggested program.

I wish I could close this long address by expressing confidence that a program along the lines I have just sketched, or any other constructive and forceful program for dealing with inflation, will be undertaken in the near future in the United States or elsewhere. That I cannot do today. I am not even sure that many of the central bankers of the world, having by now become immured to gradualism, would be willing to risk

the painful economic adjustments that I fear are ultimately unavoidable. I would therefore not be surprised if the return to reasonable price stability in the industrial democracies and thereby to an orderly international monetary system is postponed by more false starts. But if political patience in individual countries is severely tested as that happens, the learning process will also be speeded. The conservative trend that now appears to be under way in many of the industrial democracies will then gather strength; and unless political leadership falls into irresponsible hands, the inflationary bias that has been sapping the economic and moral vitality of the democracies can finally be routed.

10 DOWNING STREET

From the Private Secretary

2 October 1979

Thank you for your letter of 25 September. I shall certainly see that the paper you enclosed is passed to the Prime Minister at the first opportunity.

C.S.

Walter Salomon, Esq.

2

KING'S HOUSE
36 - 37 KING STREET
LONDON EC2V 8DR
TEL. 01-606 4033

25th September, 1979

Dear Caroline,

I enclose herewith a copy of a letter which I have today written to Sir Keith Joseph and which I thought the Prime Minister would like to see. Perhaps you would put it before her at an opportune moment.

Yours sincerely

Rupert

name?

WALTER SALOMON

MT

C.S.
Acknowledge?
AP 2/10

25 SEP 1979

KING'S HOUSE
36-37 KING STREET
LONDON EC2V 8DR
TEL. 01-606 4033

PRIVATE AND CONFIDENTIAL

25th September, 1979

I am really writing this letter with tongue in cheek. When we spoke on the telephone the other day you suggested that we might meet and have a little talk together. I have not heard from you since but, of course, I do understand that you must be inundated with the daily problems of your office.

As you are well aware, I am in full agreement with the proposition that inflation is Public Enemy No. 1, and that the measures which are now being pursued by the Government are absolutely essential if we want to succeed. On the other hand, one must realise that the Opposition will do everything within its power to denigrate every effort in this respect and will, in particular, use for its own ulterior motives the temporary hardship which is being caused in an effort to bring inflation to an end.

I have had experience from time to time in making speeches and writing articles. I do not want to compare myself with you from an intellectual point of view but I just want to say that before I made a speech or wrote anything I

always made quite sure that it was understood by my wife and if she did not understand it I tried to re-write it in such a way that she did.

The present policies of the Government are widely misunderstood by many. The last political broadcast by the Labour Party made full use of this misunderstanding. Has the time not now arrived when the Government should seek the help and assistance of experienced public relations experts who could, in simple terms, explain to the man and woman in the street what it is all about and in that way get their cooperation.

It is this matter that I would really like to discuss with you and if I can be of any help or assistance you can, of course, count on me.

I am going to Belgrade on Saturday to attend the World Bank Meeting and will be back on the 6th October.

I am looking forward to hearing from you.

The Rt. Hon. Sir Keith Joseph, Bt. MP.

KING'S HOUSE
36 - 37 KING STREET
LONDON EC2V 8DR
TEL. 01-606 4033

2

PRIME MINISTER

MS

24th September, 1979

Dear Caroline

I enclose herewith a copy of a letter of mine which was published in the Financial Times today and which the Prime Minister might be interested to see.

Kind regards

Yours sincerely

Richard Marsh

Financial Times Monday September 24 1979

Utopian view of gold

From the Chairman,
Rea Brothers

Sir,—I agree with Sam Brittan's Economic Viewpoint article (September 20) when he writes that if the central banks had had the courage of their convictions in 1970 they would have dumped their own gold stocks on a falling market.

According to the figures published by the IMF as at September 30, 1978, gold in the hands of the central banks together with that of the IMF itself but excluding China, Soviet Russia, etc., total 39,325 tons, which at today's bullion price of $375 per ounce amounts to approximately $474bn.

Sir Thomas More once wrote: "They wonder much to hear that gold, which in itself is so useless a thing, should be everywhere so much esteemed." UTOPIA.

If the central banks could dispose of their gold at the ruling market price, which, of course, they cannot, and use the proceeds to redeem government indebtedness (by repurchasing government bonds), it would put an end to the ridiculous speculation in gold that is currently taking place and, at the same time, have a considerable anti-inflationary effect. The central banks should be more realistic and should not try to live in their own Utopia.

Walter H. Salomon.
36-37, King Street, EC2.

FILE VLB

10 DOWNING STREET

From the Private Secretary

18 May 1979

Many thanks for your note of 16 May and I will of course pass on a cutting from an American newspaper to the Prime Minister.

It was kind of you to send it.

CS

Walter Salomon, Esq.

DSG

KING'S HOUSE
36 - 37 KING STREET
LONDON EC2V 8DR
TEL. 01-606 4033

16th May, 1979

Dear Lawrence,

I enclose herewith a cutting from an American newspaper which Mrs. Thatcher might be interested to see. Perhaps you would put it before her at an opportune moment.

Yours sincerely,

Malcolm Muggeridge

BUCKLEY

Thatcher's Win Is Socialism's Loss

New York—Not that I am prejudiced. Though the day before the election I wired the lady: "I and what's left of the free world rooting for you, love."

From now on, inasmuch as Margaret Thatcher is prime minister, I shall have to address her more formally. I am practicing. It has narrowed to two choices. "Command, madam, your devoted servant" or "*Perseverate proelari*, Margareta," roughly translated as "Keep swinging, Maggie."

Here is why the British experience is important to all of us. For over a generation we have been assaulted—castrated, is probably closer to the right word—by the notion that socialism is the wave of the future. That explanation is given us, sometimes patiently, sometimes impatiently, in those accents of ineluctability that tend to drown out dissent.

We had in Great Britain a government which had turned over effective power to a few militants who dominated a single institution, the trade unions.

A handful of men constructed a theology around the paramount rights of labor unions. Under their aegis, the mother of parliaments began to surrender what had been the distinctive feature of political life since the Glorious Revolution of the 17th Century: the supremacy of Parliament.

The British had reached the point where all conventional nostrums of socialism had been explored. All relevant industries had been nationalized, producing enduring discontent within those industries. A respect for the immutable rights of individuals was eroding. The cultivation of envy had become institutionalized in bills of attainder against ingenuity, industry and husbandry.

The only way to go, had James Callaghan won, would have been gradually to yield power to those arrantly disposed to use it for the sake of transmuting society toward one of those ideological visions that have pockmarked the century in Germany, Russia, China.

There is nothing demagogic about the victory of Margaret Thatcher.

She has to deal with tacky little things like the secondary boycotts, repealing sclerotic tax laws, bringing order to jurisdictional disputes, controlling inflation, acknowledging that Leonid Brezhnev is a greater threat than Ian Smith.

But behind it all is a commitment to an idea. Here is how she put it on one occasion: "It seems to me that our Christian tradition has bequeathed to politics two great and permanently important ideas, and that almost the whole of political wisdom consists in getting these two ideas into the right relationship with each other.

"The first is defined as the notion that we are all members one of another, and from it the importance of interdependence is learned; the second and equally important Christian contribution to political thinking is that the individual is an end in himself, a responsible moral being endowed with the ability to choose between good and evil."

Evelyn Waugh complained that the trouble with our century is that we never succeeded in turning the clock back a single second. The voters may now have proved him wrong.

William F. Buckley Jr. is editor of National Review.

NEWSDAY, TUESDAY, MAY 8, 1979


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