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THE GOVERNOR

Copies to The Deputy Governor o/r
Mr Loehnis
Mr Dawkins

CHANCELLER

CC Chief Secretary
See 119.30
14.10.80
Mr Byrne
Mr Dudgeon
Mr Hamish
Mr Middleton
Mr Lavelle
Mr Pevsley
Mr Rogers
Mr Allan

THE EXCHANGE RATE

In the course of a conversation I had this morning with Roger Lavelle, he passed on one or two thoughts on a minute by the Financial Secretary to the Chancellor. (The minute, which we had not previously seen, has been sent across by the Treasury this morning and is attached.) The substance of what Lavelle had to say was that the Financial Secretary seemed quite likely to put some emphasis at this afternoon's meeting on the arguments against intervention; and at the same time, to suggest that there seemed no reason for the Financial Secretary's assumptions about the necessary symmetry of intervention on the way up and on the way down to hold in practice.

Deputy Governor's Secretariat
6 October 1980

T A Clark (4498)

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CHANCELLOR

CC Chief Secretary
 Sir D Wase CB
 Sir K Cawson CB
 Mr Dyrie
 Mr Burns
 Mr Hancock
 Mr Middleton
 Mr Lavelle
 Mr Peretz
 Mr Hodges
 Mr Allan
 Mr M L Williams
 Mr Ridley
 Mr Cropper

REDUCING THE EXCHANGE RATE: INFLOW CONTROLS AND OTHER OPTIONS

I have read very carefully ^{the paper} prepared by EF and sent under *CONF* of Mr Lavelle's minute of 26 September. I understand that a copy was sent across to Washington last week; and have noted Mr Lavelle's suggestion that you may wish to discuss it *on your* return, prior to the Prime Minister's meeting on 13 October.

On intervention, I recall that in an earlier paper, inflow controls were rejected above all on the grounds (which I believe to be mistaken) that they would necessarily lead to intervention and the establishment of an explicit exchange rate policy. *Then* in this paper intervention is suddenly presented in a much more favourable light. I note of course, that, of the four options outlined in paragraph 21, three - (b) (c) and (d) - are rightly rejected out of hand. But I would equally wish to see (a) *as* in practice, it would be bound to lead to increasing intervention on the way up, which would not only inflate the money supply at a time when we can least afford it, but also would be clearly *seen* by the market and seen - most damagingly - as a fundamental *of* policy; and all to no useful effect. Of course let there *be* intervention on the way down; but let there be none on the way *up* either: I very much doubt whether the intervention here has *any*

practice kept sterling lower than it would otherwise have been: on a sustained basis, since freak rises would soon have been corrected by the market itself. On "talking down", this seems to me in general a most unwise course to pursue, with far more to lose than to gain. Again, I note that, of the four options identified in paragraph 17, two - numbers (iii) and (iv) - are quite rightly rejected. But I am not happy with the acceptance of (i) and (ii) either. In particular, (i) is surely out of the question. Ministers are repeatedly attacked, both inside and outside the country, over the damage done by a strong pound: they are bound to continue to defend themselves by pointing out that a strong pound has its good points too. As to (ii), this is I suppose a starter, but will need very careful drafting indeed if it is to be noticed and yet not interpreted as a change of policy. Clearly, no decision should be taken until a specific draft has been attempted and carefully examined. And even if it does pass muster, there is always the danger that it will lead to musing of a less conservative kind. In any event, this prescription seems to me to miss the point: it is hardly likely to provide the political cover which is inherent in the notion of inflow controls.

Which brings me to inflow controls. It is a pity that officials have been able to come up with so little. Perhaps the way forward might be to look at it again (whether in the context of overseas purchases of gilts or in a wider context) as a tax matter, designed to produce a new source of revenue. The advantage of this approach is that we could pronounce ourselves satisfied so far as any additional tax revenue was produced: this should greatly reduce the administrative paraphernalia needed to make thoroughgoing inflow controls effective, would not require any justification in terms of an actual fall in the exchange rate, would be easier presentationally and would provide greater political cover (and fewer risks) than the "talking down" option.

NIGEL LAWSON
29 September 1980