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CENTER FOR RESEARCH IN
GOVERNMENT POLICY & BUSINESS

GRADUATE SCHOOL OF MANAGEMENT
UNIVERSITY OF ROCHESTER, ROCHESTER, NEW YORK 14627

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September 10, 1980

The Right Honorable Mrs. Thatcher,
Prime Minister
10 Downing Street
London
England

Dear Prime Minister:

After returning to my mountain village after the visit with you on Lake Zug I thought further about the issues raised in our discussion on August 20. It occurred to me to formulate my ideas and also examine ways of mobilizing some help among competent professionals.

With respect to the Bank of England's monetary policy the following two conditions are crucial for any reliable and effective anti-inflationary policy.

The Bank needs to develop an implementation procedure adjusted for the purpose of controlling monetary growth. Such implementation is not a mystery and can be instituted in England as in other countries. The Swiss National Bank has successfully attended to this requirement. The Shadow Open Market Committee in the USA discussed this issue since its inception in 1973. A general procedure was developed and has been checked over the past three years in order to assure that it could be usefully applied. We seriously contend that the procedure which involves a refinement of the Swiss technique could be used as a design for control over monetary growth. It is certainly not perfect, but it should yield over one year a monetary growth within a target band of two percentage points. This procedure could also be applied by the Bank of England. The inherited procedures customarily cultivated by the Bank are not designed for purposes of monetary control.

The institutional arrangements of the British monetary system need be reexamined and adjusted for the purposes of an effective monetary control. These arrangements actually obstruct at the moment an effective monetary control. I mention specifically the reserve arrangements for commercial banks and the operation of the Bank's discount window. The first item, introduced with the new law in the early 1970's seriously undermines any attempt at effective monetary control. And a propos the second item: the

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Bank should abandon its lender of first resort attitude and concentrate on controlling the monetary base.

These recommendations would hardly be greeted with any enthusiasm at the Treasury or the Bank of England. The supply of excuses has been in my experience the best developed activity of many Central Banks. I noticed that you did hear an objection emphasizing that "the Swiss National Bank" failed in its attempt to control monetary growth. As I had many discussions with the staff and President Leutwiler I can assure you that this is simply not true. They deliberately abandoned for about six months the control procedure developed and replaced it with a procedure addressed to the pegging of the DM. They knew perfectly well what they were doing and that they risked an inflationary surge - which indeed they got in 1979/80. But they returned, just as deliberately, to the control procedure in the spring of 1979.

I had an opportunity to ask this summer an official of the Bank of England about their attitudes and procedure. I inquired in particular why the Green Book essentially attempted to sell the traditional procedures and customs under the pretense of a monetary control policy. The answer I obtained emphasized that the announcement of a monetary control policy was really sufficient and any adjustments of external institutions or internal procedures would have "confused" the financial markets. This is in my judgment just a camouflage justifying an essentially rhetorical attention to monetary control. It is noteworthy in this context that the Green Book on Monetary Control thoroughly failed to address the central issues and crucial requirements for an effective monetary control. I find this particularly distressing as some members of the Bank's staff, at the request of the Governor, engaged in regular discussions with the Swiss National Bank bearing on these issues.

Whatever observations I may have on the behavior of Central Banks suggest that we cannot expect a change in attitudes or procedures developed by an entrenched bureaucracy without substantial outside pressure. I find it difficult to believe that the Bank of England will on its own initiative attend to the two recommendations made above. Let me suggest therefore the useful function of an academic group attending to these problems. They could examine both internal and external aspects in detail and articulate these issues possibly in public. There are three excellent English professionals in the USA and in Canada: Allan Walters, Michael Parkin and David Laidler. I talked recently with Brian Griffiths concerning this matter. Perhaps Brian could act as informal organizer arranging visits in regular intervals by this group in England. These visits should be used for intense professional attention to the issues noted above and possibly other issues in fiscal policy. I am sure that some (non-English) colleagues of these gentlemen mentioned could also be relied upon to offer technical advice on the basis of their accumulated work. As a matter of fact, my friend and long time collaborator

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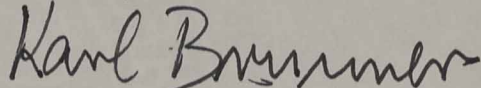
Allan H. Meltzer (Professor at Carnegie-Mellon University) will visit London by the end of September or early October in order to attend a Conference organized by Brian Griffith. We have worked closely on these issues over 20 years and he would certainly be most willing to discuss with you issues affecting monetary and fiscal policy.

*Give
to NAP /*

You will receive by separate mail some material from the Shadow Open Market Committee, two opening statements from last year's Congressional Hearings on monetary policy and two pieces attending to my increasing interest in political and social aspects of our world.

You should realize that there are many academics in this country who understand and appreciate what you want to do. If I can be of service in any particular way, please let me know.

Sincerely,



Karl Brunner

Fred H. Gowen Professor of Economics

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This material is mailed in accordance with a discussion held with the Prime Minister on August 20, 1980. Please submit the material to the Prime Minister.

Material in wallet attached to file.

Karl Brunner

Karl Brunner
Fred H. Gowen Professor of Economics

Enclosures

1. The Perception of Man and Justice and the Conception of Political Institutions
2. Reflections on the Political Economy of Government: The Persistent Growth of Government
3. Reflections on the State of International Monetary Policy
4. The Choice and Implementation of Monetary Policy, Statement Dec. 4, 1980
5. Statement Prepared for Hearing on Conduct of Monetary Policy U.S. House of Representatives, February 22, 1979
6. Shadow Open Market Committee Policy Statement and Position Papers, September 16-17, 1979
7. Shadow Open Market Committee Policy Statement and Position Papers, February 3-4, 1980