

Copy in inflows 200



NOTE OF A MEETING HELD IN THE CHANCELLOR OF THE EXCHEQUER'S ROOM,  
H.M. TREASURY, AT 4.45 P.M. ON TUESDAY, 16 SEPTEMBER 1980

Present:

Chancellor of the Exchequer	Governor of the Bank of England
Sir Kenneth Couzens	Deputy Governor
Mr. Barratt	Mr. D.A. Dawkins
Mr. Britton	
Mr. Lavelle	
Mr. Hodges	
Mr. Peretz	
Mr. Allan	
Mr. R. Armitage (T. Sol.)	
Mr. J.R. Ibbs (CPRS)	

*Copy also to  
Mr Lockin  
Mr Denny  
Mr Heltan  
2 JSP, JSPD,  
ENSG, CPSC*

*on 19/9*

-----  
INFLOW CONTROLS

The meeting had before it Mr. Lavelle's minute of 15 September and the Treasury paper attached to it.

2. The Chancellor invited the Bank representatives to express their views. The Deputy Governor said that he had begun with a bias towards action to restrict inflows, as a possible means of alleviating the difficulties industry was facing as a result of the present high exchange rate. The fact that Germany and Switzerland had imposed such controls was a further point in their favour. However, further examination suggested that the imposition of controls would present very serious difficulties. Experience following the abolition of the corset emphasised the extent of the problem of the commercial bill leak, which could only be blocked by new primary legislation; and the fact that the controls were likely to result in an increase in the sterling M3 statistic could not be ignored. Nor would it be easy to negotiate the special deposit arrangements with the banks (although in the UK situation as compared with the Swiss, a zero rather than a negative rate of interest on overseas deposits would probably be adequate). Any scheme of controls would



inevitably be rather rough and ready, and could not last for very long. Nor was it possible to foresee what the effects of the controls on the exchange rate were likely to be; all that could be said was that the effects on market sentiment were likely to dwarf any more direct effects. If the market took the introduction of controls as implying that the Government were now regarding the exchange rate as a policy variable, the effect could be a significant reduction in confidence in sterling; but if the controls were perceived as a holding operation until such time as the domestic situation permitted a reduction in interest rates, the result might be upward pressure on the rate. The markets would certainly be surprised by the imposition of inflow controls, which would seem to them inconsistent with the Government's general stance in removing controls from all areas of economic activity; and inflow controls would certainly look very odd against the background of the recent abolition of outward exchange controls and the corset.

3. Sir Kenneth Couzens saw the imposition of inflow controls as a leap in the dark; the removal of one distortion - the corset - was now causing considerable problems in interpreting the monetary statistics, and the experience with the corset showed how hard it was to know in advance which of the loopholes would prove to be the most serious. Similar uncertainties applied to inflow controls, which - if they were to remain effective for any significant period of time - would need to be reinforced by further measures to block the major loopholes of which the authorities became aware. But even then there would be no assurance that this further action was proving effective. Moreover the imposition of inward controls would surely be a big stimulus to the development of the euro-sterling market, and this would be most undesirable. Nor did the German and Swiss experience constitute a strong argument for the controls - that experience suggested that they might have some modest effect for a limited period, but in the end both countries had been obliged to give them up. Sir Kenneth Couzens thought inflow



controls might make sense in a situation (e.g. a new Middle East war) in which there was a collapse of confidence in the dollar and perhaps other currencies also; but in an uncertain domestic situation which fell short of a crisis, the risks from introducing them seemed far to outweigh any possible benefits.

4. Mr. Ibbs emphasised that his main concern was the damage to manufacturing industry as a result of the present high exchange rate; he would accept any reasonable way of bringing the exchange rate down, and had no particular liking for inflow controls in themselves. However, if the probability was that the imposition of controls would produce a reduction in the exchange rate, then this step deserved serious consideration. Mr. Ibbs saw inflow controls as in some sense an alternative to a reduction in interest rates, which he thought potentially more dangerous - through its possible impact on future inflation - in present uncertain circumstances. Some action was essential to help industry during the interval before public spending and borrowing could be got under sufficient control for interest rates to be reduced consistently with prudence. Meanwhile the present pressures on the economy were tending to improve the attitudes of unions and management and increase their willingness to accept necessary change; more general measures of relief would tend to reduce these salutary pressures across the board, whereas action to reduce the exchange rate would concentrate the help where the pain was greatest.

5. The Governor pointed out that Germany and Switzerland, when they introduced inflow controls, had had objectives for the exchange rate, and had been willing to do whatever was necessary to achieve them. The Swiss had a clear view of the exchange rate/price level trade off they were aiming at, and had expressly abandoned their short run monetary objective. And during the years 1971-73 when inflow controls had been a major element in German policy, the Bundesbank had bought \$16 billion in intervention. It was not at all clear what the comparable UK



objective would be in introducing inflow controls, if we were uncertain even of the direction in which the exchange rate might move. Reducing interest rates would be a surer way of getting the sterling exchange rate down, but unless the reduction were justified by the underlying economic situation, the resulting monetary situation could be very difficult for the authorities to control.

6. In further discussion it was pointed out that the problem faced by UK manufacturing industry (and indeed by all UK producers of tradeable goods and services) was not a temporary one until public spending and borrowing could be got under control; it reflected the appreciation in real exchange rate which was an inevitable consequence of North Sea oil production, and UK industry faced a difficult structural adjustment to accommodate itself to this situation. If inflow controls were to be introduced, it might then prove extremely difficult to take them off again, whether or not they were having any significant effect, since their removal would be seen as a blow to manufacturing industry. Moreover while they were in force the monetary statistics would be distorted and it would be the more difficult to use them as a guide to monetary policy decisions.

7. It was noted that another possible device for reducing the exchange rate would be to use the tax system to discourage foreigners from portfolio investments in the UK. The difficulty here was that the widespread network of Double Tax Agreements made it impossible for the UK to impose a withholding tax on bank interest or on interest and dividend flows (and a large proportion of gilt-edged securities had tax exemption for non-residents as a condition of their issue). Moreover, even if there were not these other difficulties in the way, attempts to discourage inflows through the tax system would have the undesirable consequence that non-residents would instead hold euro-sterling beyond the reach of the Inland Revenue.



Conclusion

8. The Chancellor, summing up the discussion, said that he shared the view expressed by the Governor and by Treasury officials that the balance of advantage was decisively against the introduction of inflow controls. He would make this clear in the covering minute he would send to the Prime Minister together with the paper prepared by the Treasury. He felt that the paper, in seeking to be fair to inflow controls, had not made sufficiently clear the practical and presentational difficulties to which their introduction gave rise; but he thought at the same time that the paper should make clear the problems associated with the present high exchange rate. He invited the EF group to revise the paper to take account of these points, and to prepare a short draft minute for him to send to the Prime Minister on 17 September.

JW

(A.J. WIGGINS)

17 September 1980

Distribution

Those present  
Financial Secretary  
Sir Douglas Wass  
Mr. Middleton  
Mrs. Lomax  
Mr. Ridley