Econ Pol

MR BRIGGS

CONTROL OF THE MONEY SUPPLY UNDER MR HEALEY

You suggested that the Prime Minister may wish to reiterate the comments which the Chancellor made on Mr Healey's record of controlling the money supply, during last week's Industry debate. I attach a draft speaking note which was provided for the Chancellor on that occasion and which the PM could use. The paragraph was provided to refute Mr Healey's earlier assertion that money supply growth in the last year of his Chancellorship was lower than in the first year of the present Government. I presume you will attach a copy of the relevant extract from last week's Hansard.

Dinis Lennon

T LENNON
15 July 1980

LIST OF PARTICIPANTS (EXCLUDING BANK OF ENGLAND AND HM TREASURY)

PM

Participant	Organisation
Professor R Alford	LSE
Professor Artis	Manchester University
J Atkins	Citibank
Professor A Bain	University of Strathclyde
Professor W Buiter	Bristol University
A Courakis	Oxford University
D Currie	London University
T Congdon	Leeds University
G E Gilchrist	Union Discount
D Gowland	York University
Professor B Griffiths	City University
M Hall	Loughborough University
C Johnson	Lloyds Bank
D Kern	National Westminster Bank
T Laugharne	Grieveson, Grant
S Lewis	Phillips & Drew
Professor C Foster	Coopers & Lybrand Assoc Ltd
Professor M Miller	University of Warwick
Professor P Minford	Liverpool University
Professor V Morgan	Reading University
I Morison	Inter-Bank Research Organisation
Professor W Newlyn	Leeds University
G Pepper	Greenwells
R J Petherbridge	Union Discount
G C Powell	Jersey, States Office
B Riley	Guernsey, States Office
Professor H B Rose	Barclays Bank
Professor T Rybzynski	Lazard Bros
D Savage	NIESR
Professor J R Sargent	Midland Bank
A Smithers	Warburgs
M Stewart	University College London
Professor B Tew	Nottingham University
P Turner	James Capel
B Williamson	Gerrard & National Discount
H Wills	LSE
G Wood	City University
P Wood	Barclays International Bank
G. Brook	Morgan Grenfell

DRAFT SPEAKING NOTE

The problem with the last Government was that the Rt. Hon. Gentleman completely lost control of the money supply in the last two years of his administration. Then the money supply was running at an annual rate approaching 14% compared with a more modest 7½% for the preceding two years. It was this legacy of an accelerating money supply that the Rt. Hon. Gentleman left us. Even so, in our first year we have managed to bring down the rate of increase from that we inherited. This improving trend has continued; and over the last 6 months £M3 growth at an annual rate has been within the 7-11% target range.

Sir G. Howe: The right hon. Gentleman, much more recently, in a debate in January last year, told the House:

"The Government are determined to maintain the monetary policy to which they have pledged themselves and the fiscal policy implied by the monetary policies."—[*Official Report*, 25 January 1979; Vol. 961, col. 755.]

The trouble is that he was not so prepared, but we are. I hope that we may continue to count on his support. Unlike some of his hon. Friends, the right hon. Gentleman——

Mr. Healey: I must point out to the right hon. and learned Gentleman, as I have done in every debate since the election, that a monetary target of 8 per cent. to 12 per cent. with inflation running at under 10 per cent. is perfectly consistent with the growth of British industry, and was so. A monetary policy which sets a target which is well under half the rate of inflation created by the Government is one with which industry and Government cannot live.

Sir G. Howe: We shall examine in a moment the responsibility for the present rate of inflation. The right hon. Gentleman will not find himself easily acquitted.

The link between monetary policy and inflation is crucial. The right hon. Gentleman understands that. At any given time, one may identify one or more temporary factors affecting inflation. Recently, as I have remarked, there was the rise in world commodity prices, not unconnected with the doubling of world oil prices. In the United Kingdom, wholesale input prices, dominated by imports, including oil, increased by nearly a quarter over last year. By contrast, they were falling in the last year of the previous Administration. There are the price increases that follow from the necessary reduction in subsidies and financial support for the nationalised industries. In the period before the election, increases in rates and nationalised industry prices had not matched the impact of cost increases. That unsound price structure had to be corrected. There are the short run consequences in the change of the burden of taxation from direct to indirect taxation.

I remind the House that the effect on the year-on-year inflation rate of the changes made in my first Budget will pass out of the retail price index when the index is published in August.

The last but not the least of the short-term influences on the rate of inflation has been the backlash from the previous Government's pay policy. The disintegration of that policy led to immediate and accelerating pay increases far greater than the country could afford and bequeathed an inheritance of large and disruptive catch-up awards in the public sector stretching well over a year ahead. The clutch of staged comparability awards is estimated to have cost almost £3,000 million in a full year. Of that total almost a half falls on the local authorities' pay bill, with inevitable consequences for the rates.

Those are the short-term factors that have been at work, but, as the right hon. Gentleman reminded the House, the real and underlying causes of inflation usually lie in the past. The past year is no exception. The rise in prices over the the last 12 months reflects primarily the acceleration of monetary growth and fiscal expansion during the last two years of the right hon. Gentleman's stewardship at the Treasury. Whereas sterling M3 rose at an annual rate of 7 per cent. between mid-1975 and mid-1977, it increased at more than twice that rate between mid-1977 and mid-1979. That acceleration was associated with a major change in the budgetary stance with increased public spending and tax cuts that he embarked upon in autumn 1977.

Mr. Jack Straw (Blackburn) *rose*——

Sir G. Howe: I shall give way in a second.

In our first year, we have managed to curb the money supply increase that we inherited. Over the last six months, sterling M3 growth, at an annual rate, has been within the 7 to 11 per cent. target range. We have not shrunk from the painful and other fiscal measures that were necessary. I stress that the high rate of inflation with which we are currently grappling was largely caused by the right hon. Gentleman's failure to exercise sufficient control of monetary and fiscal policy.

Mr. Straw: If it is correct that the rate of money supply in the previous two years caused the present level of inflation,