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Patron of the Pound

Bank of England Plays Wide-Ranging Role, Gets Wide Criticism

It Angered Mrs. Thatcher
Over Its Monetary Policy
But Rescues Sick Firms

Aiding the Hostages in Iran

By LAURA WALLACE

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LONDON—At one end of the chandelier-lit room where the directors of the Bank of England meet each week, a golden pointer traces small arcs on the wall. It's hooked up to a rooftop weather vane, a remnant of the imperial days when London's merchants and bankers needed to know which way the wind was blowing.

A favorable wind would speed the arrival of tea-laden ships from India. If money to pay for cargoes was scarce, the "Old Lady of Threadneedle Street" could expect a call from the financial district for credit.

The central bank's 16 directors still need to know which way the financial winds are blowing, though they don't rely on archaic pointers anymore. But critics — including Prime Minister Margaret Thatcher — aren't so sure that there has been much progress. Over much of the past 2½ years, the bank has allowed the money supply to swell far more than Mrs. Thatcher's Conservative Party government wanted. This has been a distressing setback for a government that preaches the monetarist virtues of throttling inflation by slowly curbing growth in the money supply.

Attack on Competence

In fact, Mrs. Thatcher was so upset last year that she questioned not only the bank's commitment to her tough monetarist policies but also its overall competence — and infuriated bank officials. "We may be less than enthusiastic" about her economic prescriptions, says one, with an edge of irritation, "but active sabotage — that's ludicrous."

It wasn't a mere technical squabble. It was a serious clash between a publicly owned central bank unable to accept a government's policy and a government surprised by a central bank's lack of enthusiasm.

"Monetarism is a theology," says John Florde, the bank's executive director, "and central banks aren't theological places. At least, this one isn't."

It wasn't history's most serious confrontation between the Old Lady and the government of the day, and it wasn't the loudest. Not one unkind word was exchanged publicly. But much backbiting went on behind the scenes, and it was a surprising run-in between two power centers whose historic conservatism had led observers to expect greater compatibility. "It took us longer to understand this government than previous governments," one bank official says.

Tumultuous Years

For Gordon Richardson — the urbane lawyer, industrialist and merchant banker who has been governor of the bank since 1973 — this monetary tangle capped tumultuous years that forced the bank to deal with oil shocks, stubborn inflation, severe recessions, wild foreign-exchange swings, banking crises and the dramatic growth of the Euromarkets. The 66-year-old governor's second five-year term expires in 1983.

It isn't surprising, though, that the bank should have been so much in the thick of things. Its duties are unusually wide, far wider than those of the Federal Reserve Board or other European central banks. It supervises British and foreign banks in Britain, manages the country's foreign-exchange reserves, oversees domestic money markets, advises the government on monetary policy and carries out that policy, issues and markets bonds for the treasury, and holds the main banking accounts of the government, the banking system and some institutions. (In contrast, the Fed shares commercial-bank regulation with the Comptroller of the Currency, the Federal Deposit Insurance Corp. and state commissions, and the U.S. Treasury conducts its own debt auctions.)

Sitting in the middle of London's financial district, the Bank of England is surrounded by a massive windowless wall as much as 14 feet thick in places. It is guarded by gatekeepers with black top-hats, pink coattails and red vests. Hand-laid mosaic floors lead to spacious, antique-filled rooms hugging an inner garden. In the fortress's belly lies the gold. All in all, the bank is a comfortable place to work. It even has a staff sports club in Roehampton, south of London, where the Wimbledon qualifying tennis matches are held.

Rescue Missions

Such trappings befit a conservative institution. But Assistant Director David Walker says "proper caution" is balanced by "adaptability," as evidenced by the bank's efforts to limit unnecessary industrial bankruptcies during Britain's current, worst recession since World War II.

"The government has no industrial strategy, believing in giving greater play to market forces," Mr. Walker explains, but sometimes the free market needs lubrication. Over the past year, the bank has overseen meetings of creditors of some three dozen companies to make sure that basically sound concerns didn't sink because of temporary cash-flow problems. Most of these companies have won a respite, and the bank has won praise for its enterprise and fairness. At Continental Bank's London office, Roy Degenhardt, a vice president, says, "We've had our arm twisted from time to time, but not excessively so."

Knowing how to persuade bankers is old hat for the Bank of England. It was founded in 1694 by William Paterson, a Scottish entrepreneur, to help a cash-strapped William of Orange. The privileged private bank

Patron of the Pound: Bank of England Plays Big Role And Gets Much Criticism, Even From Mrs. Thatcher.

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gradually emerged as the more or less official guardian of the money supply as well as of the government's financial concerns. As the British Empire grew, the bank took a leading role in central banking.

Then, in 1946, the Labor Party government, moving toward wider public ownership of many enterprises, decided to curb the bank's influence. The government bought out the private shareholders and made the nationalized bank answerable to the Chancellor of the Exchequer.

"Of all institutions concerned with economics, none has for so long enjoyed such prestige," writes John Kenneth Galbraith, the American economist. "It is, in all respects, to money as St. Peter's is to the faith. And the reputation is deserved, for most of the art as well as much of the mystery associated with the management of money originated there."

Although the sun has set on the British Empire, the international community still holds the bank in high esteem. Its close links with the large, sophisticated and innovative London financial center make it perhaps the best-informed central bank on the intricacies of the Euromarkets, which deal in currencies outside their country of origin.

A real tribute to its expertise came last January when the U.S. asked the Bank of England to act as a go-between during the final hours of the negotiations for release of the hostages in Iran. With 52 lives hanging in the balance, the bank in less than a day moved \$8 billion of gold, securities and deposits into an Algerian escrow account for Iran at the bank.

Deputy Governor Christopher McMahon, who handled the operation, says he felt both excitement and tremendous relief as he stood on the Algiers airport runway watching the hostages walk to freedom. The negotiations had been especially tense, he says, because "one of the difficulties of operating at such a distance from the principals was that one never knew whether they were negotiating in good faith." Ironically, it was the bank's refusal, to join in an earlier American proposal for a general Western freeze on all Iranian assets that convinced Iran of the bank's impartiality and enabled the bank to help the U.S. in the negotiations.

The bank's smooth handling of the Iranian situation bolstered staff morale; the Old Lady had been getting her share of barbs for some time. In the mid-1970s, critics accused her of failing to take advantage of borrowing opportunities in the U.S. and thereby forcing Britain to accede to the International Monetary Fund's restrictions to get an IMF loan.

And although the bank won praise for its handling of a domestic banking crisis in 1973, it was criticized for having allowed the situation to develop. The bank quickly realized that its informal contacts with British banks and financial institutions weren't suf-

ficient. Parliament gave the bank its first legal supervisory powers in 1979, the number of bank supervisors was increased, and banks were urged to adopt tougher requirements on liquidity, capital and vulnerability to foreign-exchange fluctuations.

But the Old Lady still hopes to carry some sway just by a shake of her head. That's why officials were so upset when Hongkong & Shanghai Banking Corp. persisted in a takeover bid that the Bank of England disliked. The target company, Royal Bank of Scotland, had already accepted an offer from Standard Chartered Bank, with the Bank of England's blessing. The battle between Standard Chartered and Hongkong & Shanghai awaits a ruling from the government's Anti-Monopoly Commission, and it would be unprecedented for the British trade secretary to disagree.

"What concerns us," Mr. McMahon says, "is that the existing structure of agreements has been challenged. Obviously, the bank is worried that its authority is called into question." If the commission rules in Hongkong & Shanghai's favor, the Old Lady must decide whether her informal guidelines on bank takeovers by foreign and British institutions need more teeth. One option suggested by the central bank—turning the guidelines into legislation—was rejected last week by the government for fear of foreign retaliation and loss of Far Eastern trade.

But the most serious challenge to the bank's prestige has come on the monetary front. In the summer of 1980, the money supply seemed to explode—and so did Mrs. Thatcher. Her monetary-growth target of 7% to 11% for February 1980 to April 1981 was threatened (the actual increase was 18.6%). Dissatisfied with the bank's and the treasury's explanations, she turned to outsiders, including Fritz Leutwiler, the chief of the Swiss national bank, and Karl Brunner, a well-known professor at the University of Rochester. They reassured her that her policy was right, and they blamed the way it was being carried out.

No. 10 Downing St. then commissioned Juerg Niehans, a University of Bern professor, to investigate further. He concluded last December that Britain was undergoing an unnecessarily severe recession. Forget trying to control the money supply by manipulating interest rates, he suggested, and instead manipulate the deposits held by banks at the central bank—which is what the Americans and the Swiss do. On the strength of this and similar advice from others, Mrs. Thatcher started urging the bank to begin concentrating on commercial-bank reserves.

Prof. Niehans also argued that the government had tightened the monetary screws too much because it was watching a misleading measure of the money supply. Sterling M3, the broad measure in question, is like a distorting mirror in a fun house, he says: "You see yourself getting fatter and

fatter, so you diet and diet, but in reality you're losing weight and dying of anorexia."

The Bank of England gave the Niehans study a mixed review. It doubted that abandoning interest rates as a tool—and manipulating banks' reserve deposits instead—was the answer. But it welcomed the support for its contention that monetary conditions were truly tight, regardless of how sterling M3 looked. Mrs. Thatcher's stress on money-supply targets was "traumatic" for the bank, a bank official says.

The upshot: a compromise of sorts. Happy that inflation was easing, Mrs. Thatcher stopped pressuring the bank to change overnight to a system of manipulating reserve deposits. Forestalling the switch was the bank's "strongest rear-guard action," says Tim Congdon, a monetarist economist at L. Messel & Co., a London brokerage firm. But the bank did make technical changes in reserve requirements to facilitate such a switch eventually.

In addition, Mrs. Thatcher and her chancellor stopped harping on the overriding need to hit money-supply targets, and the bank indicated that it would try harder to hit those targets.

Tensions have eased this year. The anti-bank sniping from No. 10 has died down, and bank officials hope that the two power centers finally understand each other better.

But the long-running battle did raise a critical question: Would the bank have greater influence if it was more independent, like the Fed and the West German Bundesbank? Bank officials think not. Executive Director George Blunden says, "Government is more likely to be persuaded in private than by shouting from the rooftops."

Anyhow, bank officials say, they do speak up publicly now more than before. They testify before a parliamentary committee. The bank's quarterly bulletin, some say, is downright subversive, despite pre-publication review at the treasury; they complain that astute observers, reading between the lines, can discern that the bank's positions on major policy issues often differ sharply from those of the government. The bank's first press officer in the 1940s was told to keep the bank out of the press and the press out of the bank; now, the press officers try to be helpful.

"Whatever else we are," sums up one bank official, "we aren't supine." Clearly, the government agrees, and if Mrs. Thatcher's economic policies fail, the bank doesn't expect to escape blame. "Part of a central bank's function is to be a useful whipping boy," a senior bank economist says. "Whatever happens, I'm sure it will be our fault."

But like governments, fads in economic theory come and go, and at least one bank official expects monetarism eventually to fold its tent. "Life will go on when some of the nostrums have died," he says.

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