7 The origins of the Budget in 1980

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Introduction

Few historians, commentators or politicians are guilty of underestimating the significance of the 1981 Budget. The risk is surely the other way, if one dare write that in a volume dedicated to the event. But it is curious that the literature on the actual framing of the Budget is so much dominated by a relatively narrow (though important) issue, namely the slugging match between No. 10 and the Treasury over the exact size of the planned public sector borrowing requirement, which took place in what was then the eleventh hour in budget-making terms, during the last days of February 1981, over sums well within the Treasury's margin of error in estimating the PSBR.[1] The purpose of this chapter is to gain a longer perspective by examining what one might call the Budget's prehistory, and drawing out some of the implications for the thinking behind it. It looks at the evolution of policy in the last half of 1980, a period of some confusion and fluidity (to put it politely), culminating in the Autumn Statement of 24 November 1980 – a much less well remembered event that came close to entering the historical record under the unhappy, and very unThatcherite, designation of a 'mini-budget'.[2]

The original focus on the final weeks of budget making largely came about because it suited the book, or books, to treat it so. As one of the

[1] The margin of error on the annual PSBR forecast at that time was around £3 billion. The cut-off for Budget decisions was supplied by the physical demands of printing and distribution. In 1981 the deadline for indirect tax decisions was lunchtime on Friday 20 February, and for direct taxes the following week (for the Budget on 10 March). By 2009 progress was such that Alistair Darling's Budget that year was safe from further tinkering by No. 10 only when he got into his car en route to the Commons to deliver it: A. M. Darling, *Back from the brink: 1,000 days at Number 11* (London, 2011), 232; R. E. G. Howe, 'Money supply, interest rates, the PSBR and the exchange rate', 7 October 1980, London, TNA, PREM 19/179, MTFW 113260.

[2] Tim Lankester's chapter in this volume addresses the detailed business of budget making, greatly clarifying the record on some crucial points. It is an exemplary reconstruction of economic policy making by a well-placed official observer, with which I have made no attempt to compete, ending my piece more or less where his begins.

small team involved in the writing of Margaret Thatcher's *The Downing Street years*, completed in the summer of 1993, I recall the uncomfortable pressure placed on us by the knowledge that her principal colleagues were racing to bring their recollections to market, with Lawson publishing his brilliant memoir *The view from No. 11* just ahead of her, and Howe serving up a *Conflict of loyalty* not long afterwards.[3] Alan Walters quietly advised us by fax, phone and visit how best to parry and return attack, with Lawson his bête noire. For many years these accounts were the only ones drawing on original documents, and, naturally enough, they shaped the literature. In this battle of the books, the making of the Budget was presented as a conflict between No. 10 and the Treasury, each claiming credit for what they took to be a turning point in economic policy and performance while denying it to the others, or at least restricting their share. But, in playing up the argument over paternity, the fallings-out during Thatcher's last government – still painfully recent when the memoirs were written – were being allowed to condition the reading of earlier times.

One should not underplay tensions within the Conservative leadership, including those between Treasury ministers themselves, but the following account places less emphasis on that aspect. The story looks a little different on a longer focus. One discovers some surprising positions on fiscal policy within government, even settled critics of the monetarist experiment, such as the Bank of England's Deputy Governor, Kit McMahon, and Permanent Secretary Sir Douglas Wass, sometimes favouring a tighter fiscal stance. On the monetary side, the situation was rather different, but, again, there is more to say than the paternity framework allowed.

Overshooting monetary targets in the summer of 1980

Over the summer of 1980 it became ever harder to fit economic and monetary developments within the framework of policy. The Medium-Term Financial Strategy had been announced as recently as March, targeting £M3 growth at 7 to 11 per cent for 1980/81. Following the removal of 'the corset', Minimum Lending Rate was cut by one percentage point on 3 July on the premise that £M3 figures were improving, but when the numbers appeared in early August they showed a 5 per cent increase *over the month*. Meeting Howe on 4 August, the Bank's Governor, Gordon Richardson, admitted '£M3 had grown grotesquely', attributing

[3] Thatcher, *The Downing Street years*; Lawson, *The view from No. 11*, republished in abridged form as N. Lawson, *Memoirs of a Tory radical* (London, 2010), edited by me; Howe, *Conflict of loyalty*.

only one-third of the increase to the unwinding of corset distortions.[4] Nigel Lawson 'thought the rate of monetary growth too high but saw no reason to believe that a sudden upturn was at hand'.[5] In fact, the increase in August itself was 3 per cent, with the annualised growth rate over the previous six months reaching 26 per cent, making the £M3 target practically unachievable less than halfway through the financial year.

On a monthly basis the PSBR was also overshooting the MTFS projection of £8.5 billion by a very significant amount. There were hopes that later months would undershoot, but in the event they did not. The outturn was a painful £13 billion. Meanwhile, untargeted and unprojected, but far from unwatched, sterling reached the $2.40s in early September, finally peaking at $2.4495 on Friday 24 October.[6]

Holidaying in Switzerland in late August, the Prime Minister lunched with Professor Karl Brunner, who told her that her monetary policy was right but implementation woeful, casting the Bank as chief villain. Thatcher returned to No. 10 in hanging mood. Apprised of the August money figures, she summoned Richardson and castigated the Bank for becoming a 'lender of first resort' (Brunner's exact phrase) and being 'simply unwilling to implement Government strategy'.[7] In her eyes the clearers were just as guilty, if not more so, because she saw them as natural allies who were letting her down: 'The clearing banks did not seem to be deeply attached to the Government strategy. Indeed they were shovelling money out... She felt that the centre-piece of Government strategy was being undermined by her own supporters.'[8] There were a series of such

[4] Richardson will have been quoting here an early estimate by Charles Goodhart. Goodhart now thinks two-thirds would be more accurate (personal communication with C. A. E. Goodhart). Like Lawson, the Bank's Eddie George was hopeful about the horrible July figure, calling it 'not in itself unhelpful, since it gets it out of the way', and adding: 'We have no grounds for complaining to the clearing banks about it since they did provide us with the opening to ask them to stagger reintermediation, which we chose not to do.' E. A. J. George, 'Sir Jeremy Morse's call on the Governor', 22 July 1980, London, BOE, G1/552, MTFW 128603; R. I. Tolkien, 'Note of a meeting held at 11 Downing Street on Monday 4 August 1980 at 5.30 pm', 7 August 1980, BOE, 7A133/2, MTFW 113132.

[5] Tolkien, 'Note of a meeting...4 August 1980 at 5.30 pm'.

[6] Sterling in fact went as high as $2.4645 during the day, so that the peak is sometimes quoted as $2.47; the rate at *closure* was $2.4495. For a definitive account, see Bank of England, 'Foreign exchange and gold market report', 24 October 1980, BOE, C8/52, MTFW 129305.

[7] [? M. A. Pattison], 'Summary record of a meeting held at 10 Downing Street at 1800 hours on 3 September 1980', 3 September 1980, TNA, PREM 19/178, MTFW 115636. A much briefer version of this record was circulated around Whitehall: 'M. A. Pattison to A. J. Wiggins', 3 September 1980, BOE, 7A133/2, MTFW 113137.

[8] [? Pattison], 'Summary record of a meeting...3 September 1980', MTFW 115636.

meetings, long remembered by bruised senior staff at the Bank.[9] Following the one on 18 September, Richardson was sufficiently aggrieved at his treatment to raise it with No. 10 on the phone, and he planned to discuss it with the Cabinet Secretary too.[10] Only with difficulty did Howe dissuade the Prime Minister from summoning the clearers.

The Bank of England's response

The records show that, alongside the monetary overrun, the focus of Thatcher's angst was the high level of sterling. This was a topic on which she and the Bank found some agreement. Scouting a way ahead for the Governor after the 18 September meeting, McMahon rejected the notion that the affronted Bank should offer an *apologia* for its conduct of monetary policy (as Charles Goodhart and Christopher Dow had suggested), and instead proposed building on the common ground:

> Here we now have a good starting point in that in response to your explicit question the Prime Minister has told us that she would like to have the exchange rate lower than it is so long as (a) it was consonant with continuance of the existing monetary policy and (b) it did not involve a plunge. Specifically, she indicated that she felt \$2.20 would be low enough. She did not want this achieved through intervention. I also noted, though it is perhaps not immediately relevant, that she did not join Lawson's strong rebuttal of the idea of joining the EMS.[11]

At the meeting the Prime Minister had pressed strongly for inflow controls, in the form of differential interest rates, for which she believed there to be a Swiss precedent. McMahon firmly rejected these, as subject to 'enormous loopholes', perverse effects arising from resulting expectations that high interest rates would persist, and the fact that they had not

[9] Thatcher was greatly displeased by John Fforde and Eddie George standing in for Richardson and McMahon, who were both abroad when the August £M3 figures were discussed on 8 September, 'T. P. Lankester to A. J. Wiggins', 9 September 1980, BOE, 7A133/2, MTFW 113138.

[10] Richardson had taken it all much more lightly when others were on the receiving end, using an off-colour phrase to characterise Thatcher's famously confrontational dinner with Permanent Secretaries earlier in the year ('the reverse of a gang bang'): G. Hacche and C. Taylor (eds.), *Inside the Bank of England: memoirs of Christopher Dow, chief economist 1973–84* (Basingstoke, 2013), 153; 'T. P. Lankester to A. J. Wiggins', 18 September 1980, BOE, 7A133/2, MTFW 113143; R. C. W. Mayes, 'Note for the record', 19 September 1980, BOE, 7A133/2, MTFW 114080.

[11] Goodhart believes that McMahon was right in this judgement (personal communication with C. A. E. Goodhart); C. W. McMahon, 'The Bank's position on monetary policy', 18 September 1980, BOE, G3/380, MTFW 128593. No. 10's record of the meeting has the Prime Minister saying that 'a rate of between \$2.20 and \$2.30 would be desirable; anything below \$2.20 would jeopardise the fight against inflation': 'T. P. Lankester to A. J. Wiggins', 18 September 1980, BOE, 7A 133/2, MTFW 113143.

been successfully operated 'except to defend or achieve an explicit exchange rate target and then only as an ancillary to massive intervention':

> This leads then to fundamentals. What is really preventing the achievement of the [£M3] target is the development of the PSBR; and what is really wanted by industry both for its own sake and because of its effect on the exchange rate is lower interest rates. There may not in the end prove to be a need to reduce the PSBR: it *may* not be much above target and come right down in the last months of the financial year. But no-one can predict this with confidence and the risks are severe. Thus, there is a case for cutting it significantly on its own merits. If a significant cut were made it then might be possible to lower interest rates by enough to make a dint [sic] on the exchange rate.[12]

The Treasury's response

There were strong echoes of this thinking in parts of the Treasury. Inflow controls were generally rejected, with the head of the Overseas Finance Division, Sir Kenneth Couzens, describing them as 'a leap in the dark', using arguments similar to McMahon's, and Howe concluding that 'the balance of advantage was decisively against'.[13] As papers were prepared for a Downing Street meeting on the topic, an approach not so different from that sketched by McMahon began to take flesh among officials. On Monday 22 September Sir Douglas Wass, Second Permanent Secretary Bill Ryrie and the Chief Economic Adviser, Terry Burns, met with ministers on the basis of a submission by Wass designed (as he put it) 'to pave the way for contingency work if the money and PSBR figures did not come right in the coming weeks and months. We could not now rely on things going right; and if they did not, the credibility of the Government's policy – which was fundamental to the success of that policy – would be at risk.'[14]

Ministers may well have felt officials were trying to bounce them; the record certainly suggests tension between the two. From the ministerial side, Lawson rebutted Wass lengthily and with force:

> *The Financial Secretary* saw no immediate problem of credibility. Financial markets were strong, and the PSBR would undoubtedly turn round (although a question

[12] McMahon, 'The Bank's position on monetary policy', MTFW 128593 [emphasis in original].

[13] A. J. Wiggins, 'Note of a meeting held in the Chancellor of the Exchequer's room, HM Treasury, at 4.45 pm on Tuesday, 16 September 1980', BOE, 7A/133/2, MTFW 113141. Lawson was absent from this meeting.

[14] A. J. Wiggins, 'Note of a meeting held in the Chancellor of the Exchequer's room, HM Treasury at 9.30 am on Monday, 22 September 1980', TNA, T386/544, MTFW 128330. Wass had prepared the ground for this meeting in a minute to Howe ten days earlier: D. W. G. Wass, 'Monetary and fiscal policy', 12 September 1980, TNA, T386/544, MTFW 133715.

remained how small it would be in the first quarter of 1981). Difficulties remained over public expenditure, but although the policy might appear to be in poor condition, the Government's determination to stick to that policy despite the difficulties faced by industry was not in doubt; and the longer the Government persisted in this stance, the more credible the policy would be. The Financial Secretary saw no prospect of achieving significant changes in public expenditure or tax receipts during the current financial year, other than through public services pay; and he saw no reason for tax increases now to reduce the 1980–81 PSBR. There was undoubtedly an imbalance between the personal and corporate sectors, and for this reason he favoured attracting more funds into national savings, even at the cost of a higher mortgage rate, together with restraints on consumer credit. He noted that it might be necessary to increase taxes in the 1981 Budget; but at that stage more options would be open, and it would be undesirable for the Government to take hasty and perhaps inappropriate action now.[15]

Officials struck back:

Mr Ryrie emphasised the strong political and industrial pressures for lower interest rates; but could interest rates be reduced consistently with the Government's strategy without some other action as well? He therefore suggested the possibility of a package of measures as a cover for a reduction in interest rates, and accepted that the measures would have to be primarily aimed at 1981–82. . . Nevertheless an early announcement could give a substantial boost to confidence.[16]

Summing up, Howe withheld explicit authority to plan for a package, although Burns was to prepare a paper on the 'medium-term fiscal stance', in connection with which Howe noted: 'The 1981 Budget was fundamental to the Government's success.'[17]

Meeting without officials a few days beforehand, at Treasury prayers, ministers and advisers had spoken more frankly and in some contrast.[18] In 'extended discussion', there was hope that the 1980/81 PSBR might yet come right, but realisation that it might not, and that significant public expenditure reductions would not be achieved within the current financial

[15] Wiggins, 'Note of a meeting held . . . 22 September 1980', MTFW 128330 [emphasis in original].

[16] Ibid.

[17] Ibid. The Bank received orders that day from the Treasury 'to prepare as quickly as possible contingency plans to restrict non-resident acquisition of BGS [gilts]'. The commissioning of such a scheme was no small thing, given the possibility of a leak. That gilts were initially the focus suggests the Treasury was aiming for the minimum it could get away with. By 14 November 1980 much more extensive controls had been prepared, covering the ability of non-residents to bring new funds into the United Kingdom 'for the purpose of interest-bearing investment'. Bank of England notices were printed in proof: D. A. C. Nendick, 'Contingency plans for inflows controls', 14 November 1980, BOE, 11A56/11, MTFW 128445 (proofs included); D. A. Dawkins, 'Inflow controls', 22 September 1980, BOE, 11A56/11, MTFW 128444.

[18] G. S. Cardona, 'Chancellor's meeting, 17 September 1980', Churchill, Adam Ridley MSS, 'Prayers' file 4, MTFW 113274.

year. It was concluded that, while there was 'a reasonable chance that fiscal measures would not be required before the budget', they *might* be necessary and contingency planning *should* take place.[19] Equally, it is obvious that there was great political discomfort about a step so reminiscent of Healey – the kind of makeshift many of those present had damned and double-damned in recent memory. A large political element entered into the thinking, the meeting agreeing in principle that if a package was required it had best take place before the party conference, then barely a fortnight away, although it was pointed out that such a timetable was 'operationally out of the question'.[20] It was noted also: 'If there were a fiscal package, it would probably be sensible to include some action on consumer credit.'[21] Contingency plans for such action had been drawn up earlier in the year at the bidding of No. 10, Lawson pushing hard to devise a scheme against Treasury resistance. And, on the subject of inflow controls Lawson broke ranks with the general Treasury view, openly colliding with Howe:

> The Chancellor found the argument that, once imposed, such controls would be difficult to remove a persuasive one. The Financial Secretary was less persuaded of the difficulty of removing controls: other countries (e.g. the Swiss) had abolished them. However he was uncertain of the monetary consequences of inflow controls. The Chancellor concluded that the underlying monetary and fiscal situation was what mattered.[22]

One almost has the sense of entering a looking-glass world, transported by MTFS magic. The monetarists ponder direct controls, the Keynesians hanker for emergency action to cut the PSBR. The Keynesians would have preferred to scrap the MTFS outright, naturally enough, and those monetarists who had placed faith in £M3 as the target aggregate (by no means all, of course) were thinking again.[23] Yet few doubted that the government had at least to pretend to live within the strategy for the time being. In this sense, if not in others, MTFS was working as intended.[24]

[19] Ibid. [20] Ibid. [21] Ibid. [22] Ibid.

[23] A pregnant footnote to the MTFS table setting out the £M3 targets stated that 'the way in which the money supply is defined for target purposes may need to be adjusted from time to time as circumstances change'. But, of course, that was more easily said than done. Much political capital had been sunk in £M3, not least by the Prime Minister. *FSBR 1980–81*, 16.

[24] McMahon is an exception, his position evolving as sterling rose. Three days before it peaked against the dollar he suggested abandoning MTFS targets in favour of an explicit focus on the exchange rate, backed by 'a substantial visible intervention onslaught'. But even he felt the need to add: 'There can be no question of reversing the broad thrust of the strategy: that would give us the worst of all worlds.' C. W. McMahon, 'The roll-over and policy generally: tomorrow's meeting with the Chancellor', 21 October 1980, BOE, G3/380, MTFW 128440. He included no such proviso in C. W. McMahon, 'Policy and the exchange rate', 27 October 1980, BOE, G3/380, MTFW 128441 (a document handled with the tightest security within the Bank).

It is surprising at first sight that Lawson should have shown any interest in inflow controls. He had been the Treasury minister most ready to defend the counter-inflationary merits of a high pound. He had been the strongest advocate of the early abolition of exchange control and the most eloquent exponent of Thatcherism as a free market creed. But one should examine the context, which supplied many unpalatable options and not much else. At the end of the month Lawson sent Howe his views of a draft Treasury paper entitled 'Inflow controls and other options for reducing the exchange rate'.[25] The paper had been triggered by pressure on the topic from No. 10; its very existence was significant and probably unwelcome to him. Lawson paid it the closest attention. He detected in the paper, and warned against, a weakening of previous Treasury opposition to intervention in the foreign exchange markets and rejected also various suggested approaches to 'talking down' the currency. His objection to talking down was partly that it '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'.[26] He expressed disappointment that 'officials have been able to come up with so little' on the latter and suggested they be looked at again, as a revenue measure:

> The advantage of this approach is that we could pronounce ourselves satisfied so long as 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 flaw in the exchange rate, would be easier presentationally, and would provide greater political cover (and fewer risks) than the 'talking down' option.[27]

Lawson makes no mention of inflow controls in *The view from No. 11* (nor do Thatcher or Howe in their books), but he does concede that sterling offered 'a clear example of overshooting' at the end of 1980 and the beginning of 1981.[28] And surely he was registering the strength of the political wind blowing from No. 10, which had reached storm force by this point. Options within the existing policy were diminishing to the degree that radical departures were rendered thinkable, however unattractive. By late November the Bank had prepared a scheme on forty-eight-hour readiness, and a wide circle knew of it, with all the risks involved.

[25] N. Lawson, 'Reducing the exchange rate: inflow controls and other options', 29 September 1980, BOE, 7A134/16, MTFW 113083; R. Lavelle, 'Inflow controls and other options for reducing the exchange rate', 23 September 1980, BOE, 11A56/11, MTFW 128443. Dow understandably drew attention to the paper, but, as the citation shows, he is wrong to think that the Bank 'was not consulted and did not hear about [it] till later': Hacche and Taylor, *Inside the Bank of England*, 172.

[26] Lawson, 'Reducing the exchange rate', MTFW 113083. [27] Ibid.

[28] Lawson, *The view from No. 11*, 63.

October–November 1980: planning the Autumn Statement

Tension and uncertainty as to the next steps in policy only deepened as autumn ran on. There was a long and unhappy Downing Street 'monetary policy seminar' on Monday 13 October showing a general movement towards fiscal tightening on all sides – No. 10, Treasury and Bank – albeit with action in the spending round and the next budget in view, rather than an announcement of new taxes in the Autumn Statement.[29] There was significantly less agreement on monetary policy – indeed, signs that it was difficult even to discuss. And there was almost a despairing tone to some of Howe's interventions, for example on inflow controls, when he commented that Treasury analysis had convinced him they would not work, 'though he would not rule out altogether some inflow control measure if only for presentational reasons'.[30] He used a similar formula on interest rates, almost as if inviting people – perhaps one person in particular – to force his hand:

> The Chancellor said that he doubted whether an MLR reduction could be justified on monetary grounds. But it might be necessary – on political grounds and in order to persuade colleagues to further cut public expenditure – to take the risk.[31]

The record suggests that the Prime Minister did not directly respond. In fact, she seems deliberately to have avoided opening up the question of interest rates and sterling at this meeting: having demanded work on inflow controls, she showed no inclination to discuss currency matters in any depth, quite possibly fearing leaks from a group as large, and as miserable, as this one. Instead she closed discussion with the words 'it would be necessary to think further about the possibility of pushing the exchange rate down'.[32] The pound was eleven days short of its peak against the dollar.

A week later, on 20 October, the Chairman of ICI visited the Prime Minister to warn her that the company was about to declare its first ever quarterly loss. Howe was in Luxembourg, and Thatcher summoned Wass

[29] Dow felt that the Treasury had arranged for the Bank to carry the can, again, at this meeting: 'The Chancellor's aim must have been, by confessing error and declaring repentance himself, and expecting us to stand up for ourselves, to deflect the wrath of his Goddess onto the Bank.' At the end of the meeting cake was served, which the Prime Minister pressed on everyone; it was a birthday gift to her from a school in Finchley. Goodhart recalls Eddie George whispering that he was not sure he would be able to choke it down (personal communication with C. A. E. Goodhart); Hacche and Taylor, *Inside the Bank of England*, 169; 'T. P. Lankester to A. J. Wiggins', 14 October 1980, TNA, PREM 19/179, MTFW 113264.

[30] Ibid. [31] Ibid. [32] Ibid.

for comment. They met for a little over an hour at the end of the working day.[33] Wass later took pains to remind Howe:

> The Prime Minister expressed a very strong wish that I should explore ways of mitigating the adverse conditions in which British industry is operating, so that good and viable companies like ICI should not be driven to the wall. You yourself endorsed this wish and authorised me to submit some options to you.[34]

It is impossible to know quite what Thatcher asked or expected Wass to do, but he surely made the most of whatever authority she gave him.[35] He consulted with Ryrie and others 'on a strict "need to know" basis', a group resembling that which had approached ministers in late September, and produced a paper blandly entitled 'Policy options', which Howe forwarded to No. 10. The Governor was told about it 'in general terms'.

This was an unusual initiative, and the document matches it. Wass based his case for a change of policy on the unexpectedly high level of sterling, much as McMahon had pegged that territory as the most hopeful one for the Bank to occupy after its roasting in September. He laid out six options, 'listed in descending order of compatibility with the Government's present strategy of gearing down inflation through strict control of the money supply', namely:

[33] 'MT engagement diary', 20 October 1980 ('1845–2000 Sir Douglas Wass'), MTFW 113609. See also D. W. G. Wass, 'The exchange rate', 21 October 1980, TNA, T386/545, MTFW 133716, which recounts part of the discussion. On Wass's initiative officials met separately on 24 October 'to consider the possibilities for action if the exchange rate continued to move upward': J. M. G. Taylor, 'Note of a meeting', 24 October 1980, TNA, T386/545, MTFW 133719.

[34] D. W. G. Wass, 'Policy options', 5 November 1980, TNA, PREM 19/174, MTFW 113271.

[35] An intriguing contemporary document suggests that senior officials felt Wass was sometimes inclined to push ministers harder than was wise. At a regular meeting of Permanent Secretaries in economic departments, plus Sir Robert Armstrong, Terry Burns and Christopher Dow, Wass asked: 'Should they seek to make Ministers take stock of the political dangers facing them – not just a ½ hr discussion in Cabinet, but a ½ day at Chequers? Robert Armstrong took up someone's remark that there would be a clear "kickback" if civil servants started to try to tell Ministers about politics – "Kickback is just the word". No political taking stock would take place unless the PM desired it, which she did not.'

But this response to Wass did not imply confidence in the policy on the part of those present. Dow also noted: 'The to and fro of discussion after some time produced recognition that action to ameliorate the recession – whether via reduction of the exchange rate or by significant aid to industry – could not be done within the present economic strategy. Douglas Wass allowed this conclusion to emerge, while himself maintaining a white mantle of orthodoxy. . . But the general feeling was quite clearly despairing worry at the developing recession and the growing unemployment. The mood seemed to me very clear and unanimous with no difference between Terry Burns and the rest. . . [Armstrong] evidently thinks quite strongly of lowering the exchange rate by any means possible, and of joining EMS.' J. C. R. Dow, 'Short term economic policy group (STEP)', 15 January 1981, BOE, 7A173/8, MTFW 128043.

(1) inflow controls and some minor measures intended to reduce the exchange rate;
(2) a modest cut in interest rates;
(3) a large reduction in interest rates;
(4) an explicit exchange rate policy;
(5) a significant tax switch to the benefit of companies; or
(6) a pay freeze.[36]

That inflow controls were considered the most compatible policy is startling. Wass, like Howe, made a sceptic's case for them, on presentational grounds, offering perhaps 'short-term gains'.[37] Having initially rejected controls, the Treasury and the Bank seem to have reconciled themselves to the possibility that they might be forced to live with them, and were aiming now to minimise the damage. If the Prime Minister wanted them, she could have them, fully informed of the risks, embarrassments and complications. McMahon had similarly switched to advising the governor to take the line that the Bank was not 'doctrinaire' on the question, that such controls might be worth going for 'on a strictly temporary rough and ready basis', although 'very much against the spirit of present policies'.[38]

By a modest cut in interest rates Wass meant two points off MLR 'at most'. He went on, in words that echo Ryrie's remarks, in the 22 September meeting:

> There would be some presentational difficulties with a modest interest rate cut, particularly following the October monetary figures. These could be mitigated if the move were linked to some apparent strengthening of fiscal policy – e.g. an announcement of the outcome of the public expenditure review (though this does not now look a promising piece of cover), or of the new taxes that have been under discussion, or the outcome of our consideration of monetary base control.[39]

Cover again. Thatcher annotated the document: 'Preliminary view: options (iii), (iv), (v) and (vi) are NOT ON. The long-term damage would be too great.'[40] Her reaction was immediately relayed to the Treasury.

Thatcher, Howe and Wass met at No. 10 for ninety minutes on 12 November to discuss the paper, Howe arriving fifteen minutes ahead for a preliminary chat. The Bank was not represented at the meeting, and,

[36] Wass, 'Policy options', MTFW 113271. [37] Ibid.

[38] Lukewarm official embrace was probably better calculated to kill off prime ministerial interest in inflow controls than outright opposition, but it might be over-subtle to suggest that was the intention: C. W. McMahon, 'Inflow controls: possible line to take', 16 September 1980, BOE, G3/380, MTFW 128594.

[39] Wass, 'Policy options', MTFW 113271.

[40] Wass, 'Policy options' (annotation by M. H. Thatcher), MTFW 113271 [emphasis in original].

although a full retinue from No. 10 was there, Thatcher asked them not to speak.[41] Discussion focused entirely on Wass's options (1) and (2). Howe now sought, and was given, the authority to cut MLR by two percentage points and 'to demonstrate that the Government was not abandoning the monetary strategy' by announcing 'a credible package of measures', which would require the preannouncement of some of his intentions on tax for 1981/82.[42] He firmly rejected inflow controls, an option that Thatcher seems to have relinquished only with reluctance, looking to bargain them away: 'The Prime Minister said that she hoped that, even if option 1 were not adopted, the Treasury would consider switching Bank "customers'" transactions off market again.'[43]

Howe entered a caveat: it would all involve 'a considerable element of risk; questions would be raised as to whether the Government was doing enough to get the fiscal balance right, and this might mean that the next budget would have to be even more restrictive; alternatively, it might conceivably be necessary to put MLR up again'.[44]

Significance of these events for the Budget

Thus the Thatcher government decided to introduce something that looked very much like a 'mini-Budget' and adopted the stratagem of tightening fiscal policy to give cover for loosening the monetary side. The measures were seen and presented as pointing the way for the 1981 Budget. The initiative largely originated with officials unsympathetic to the fundamentals of policy, who overcome understandable political reluctance because the government was acting *faute de mieux*, the policy climate having become sufficiently hostile to tempt even the Prime Minister to reverse a totemic reform by reintroducing an element of exchange control. The result was that, only six weeks after Thatcher had declared herself 'not for turning', the government was making an MLR cut impossible to fit within the framework of the MTFS – a departure publicly unstated, of course, but privately acknowledged, and all but impossible

[41] 'MT engagement diary', 12 November 1980 ('1445 Chancellor of the Exchequer', '1500–1630 Chancellor of the Exchequer and Sir Douglas Wass'), Churchill, THCR 6/1/2/2, MTFW 113632; Hoskyns, *Just in time*, 244, MTFW 113374.

[42] 'T. P. Lankester to A. J. Wiggins', 13 November 1980, TNA, PREM 19/180, MTFW 113270.

[43] Ibid. The Treasury went through the motions of examining Thatcher's suggestion, then turned it down after a diplomatic delay.

[44] Ibid. It is likely that Lawson also had reservations about the November package: see N. Lawson, 'Bank lending', 1 December 1980, BOE, 7A133/3, MTFW 127435.

to disguise from those who understood the policy.[45] If indeed the November measures pointed the way to the 1981 Budget, from a Thatcherite point of view it had a far from promising origin.

Should one accept, then, that the origin of the Budget strategy lay in the Autumn Statement? Did the idea of tightening fiscal policy in order to ease monetary policy carry through into budget making? Certainly, there was no irresistible progress from one to the other. Perhaps there might have been if the outcome of the Autumn Statement had been triumphant, but it was far from that. One finds instead a variety of strong and weak connections.

Among the most straightforward and significant was that the measures passed muster in the markets. An MLR cut of some kind had already been discounted, the timing and the amount being the main issues. The associated fiscal measures did indeed provide cover, doctrine counting for little. Sterling had peaked against the dollar the month beforehand and continued to fall without trace of a rout.[46] Howe's fear that the two percentage point cut might prove too much of a stretch did not come to pass.[47]

Politically, however, the Autumn Statement proved costly – the government was badly battered in the Commons and the press – and it is more likely to have supplied lessons, or warnings, for the Budget. Howe experienced one of the worst periods of his Chancellorship, being sharply attacked by Conservatives as well as political opponents, who successfully maximised the damage by fastening on the failure of the Statement to spell out the fact that employers' National Insurance contributions were increasing.[48]

45 'It was noted that the authorities had not sought to determine interest rates by reference to movements in £M3, despite what had been seen as a commitment to do this': A. J. Wiggins, 'Note of a meeting held in the Chancellor of the Exchequer's room, HM Treasury on Friday, 6 February, 1981 at 2.45 pm', 10 February 1981, TNA, T386/550, MTFW 114048.

46 J. G. Hill, 'Foreign exchange and gold markets: Monday, 24 November 1980', BOE, C8/52, MTFW 128446; J. G. Hill, 'Foreign exchange and gold markets: Tuesday, 25 November 1980', BOE, C8/52, MTFW 128446.

47 On the gilt side, perhaps more attention was paid to the MTFS: '[T]he discount market welcomed the drop and for the moment is optimistic about the course of events.' The cut had bred an expectation that the November £M3 figures 'must be very good indeed'. They were not, and the caveat grew stronger until, six weeks before the Budget, it was recalled that the reduction 'was not well received by the gilts market': M. T. R. Smith, 'Money markets during the week ended 26 November', 27 November 1980, BOE, C39/2, MTFW 128448; N. J. Monck, 'MLR reduction', 30 January 1981, TNA, T386/549, MTFW 114067.

48 Notable among the critics was the *Daily Mail*, which published a front-page editorial on 26 November 1980 demanding 'Maggie must do a U-turn' and take charge of the economy herself for six months. Howe was among the 'carriers of self-deception' who should be sacked. In addition, the *Evening Standard* wrote: 'Many MPs think that the next full budget in the spring will be introduced by someone else.' 'Question mark over Howe's future', *Evening Standard*, 26 November 1980. Whether Thatcher retained confidence in her Chancellor was openly questioned: H. J. S Young, 'Chancellor Howe's fatal flaw', *Sunday Times*, 30 November 1980, MTFW 128453.

As the architect of the MTFS and chief apologist for sterling's stratospheric rate, Lawson was scarcely less vulnerable. Under such pressure public divisions emerged within the government, even between ministers counted as Thatcherite. The Chief Secretary to the Treasury, John Biffen, publicly expressed sympathy for the critics' point on NICs, as well as sharply distancing himself from the MTFS in a chat with Conservative backbenchers, while Howe was left for the best part of a week without public support from Thatcher, noticeably and ominously so.[49] Support, when it came, was of a lukewarm variety: a No. 10 briefing to the Sunday lobby stating that a reshuffle was planned shortly and that Howe would not be moved.[50] When Sir Keith Joseph spoke publicly at this time of the government having had a 'lost year', Mrs Thatcher's Press Secretary, Bernard Ingham, told Joseph's anxious press officer that Thatcher was 'quite relaxed about it': 'I believe she agrees with Sir Keith but for the sake of the Government and confidence in it does not say so.'[51]

The political climate for the Treasury remained acutely uncomfortable throughout the run-up to the Budget, and improved only as the first signs of recovery appeared – a fact not reflected as much as one might expect in accounts of the Budget.[52] One consequence was that Howe, who was always inclined to discuss and consult, at length, and – in Thatcher's

[49] Ian Gow warned Thatcher that 'Geoffrey and others are concerned about John Biffen's reply to Waldegrave', saying: 'I have never found the MTFS an easy concept to market. I understand people who nail their flag to the MTFS, but it is all a foreign tongue to me. It is liable to excite enthusiasm, too, and that is a very unConservative emotion. For the time being M3 [sic] has lost its credibility.' P. J. Cropper, 'Conservative Finance Committee – 9 December 1980', 10 December 1980, Churchill, THCR 2/6/2/15, part 2, MTFW 112647, and cover note by Ian Gow. Biffen's diary of 16 December 1980 records: 'I was given an oblique dressing down by MT for my Finance Committee speech. "Do we have any more Biffenism to come?".' See W. J. Biffen, *Semi-detached* (London, 2013), 321. In the January reshuffle Biffen was replaced as Chief Secretary by Leon Brittan, an old friend of the Howes. The appointment deeply frustrated Lawson; he tactfully attributes it more to the influence of Willie Whitelaw, the Deputy Prime Minister, than to Howe: Lawson, *The view from No. 11*, 73.

[50] See Adam Raphael, 'Maggie goes to Howe's aid', *Observer*, 7 December 1980. The information proved accurate as to outcome. Hacche and Taylor, *Inside the Bank of England*, 172: 'Maggie left him a week without coming to his aid.' Privately, Thatcher discussed removing Howe, but without seeing her way. Almost her first remarks to Walters when he became her economic adviser in January 1981 were along the lines of: 'What should she do about Geoffrey? Who could she promote? No one.' A. A. Walters, 'Diary entry', 6 January 1981, Churchill, WTRS 3/1/1, MTFW 114203.

[51] 'B. Ingham to J. Woodrow', 1 December 1980, Churchill, THCR 5/2/42, MTFW 113207.

[52] On 15 April 1981 John Hoskyns registered a turning point: 'Before going out to lunch GH asked me to see him at No 11 (Ian [Gow] was there). He discerns signs of upturn and looked more relaxed than I've seen him in weeks, affable and jokey. He said it was also easing relations with the colleagues too.' 'Hoskyns diary', 15 April 1981, Hoskyns MSS (privately held), MTFW 113018; Hoskyns, *Just in time*, 294.

view – to a fault, took particular pains to keep important colleagues in touch with his thinking.[53] He had one notable success. The Environment Secretary, Michael Heseltine, was won around in advance of the Budget to the view that cutting PSBR was essential to the reduction of MLR, which he favoured over particular reliefs as the measure best designed to aid industry. He even urged the freezing of personal allowances to help achieve it.[54] As Secretary of State for Industry, Joseph was involved in these discussions, taking a line that gave some comfort to the wets, perhaps by design.[55] It is revealing that Howe successfully deployed the trade-off argument in this context, and perhaps not altogether surprising that an idea that had commended itself to Wass and Ryrie made appeal to some of his Cabinet critics – as long as they felt constrained to live within the MTFS (which, as events established, finally they did).

Where did the Autumn Statement leave the MTFS? Certainly, the MLR cut on 24 November 1980 decisively established within the government that short-term interest rates were not being set solely, or even primarily, with reference to £M3. The archives are unambiguous on this point. At the very least, then, the November measures opened up the possibility of a further MLR cut at the time of the Budget, regardless of the monetary aggregates. This was a point grasped and reinforced by the markets, forging a relatively strong connection between the two events. But it would be a mistake to suppose that the MTFS was hollowed out by the Autumn Statement and that a reign of 'pragmatism' had begun, as some critics suggested.[56] If anything, the Statement made it more pressing to reassert commitment to the MTFS, so that when Treasury ministers drew up their 'sighting shots' for the Budget two weeks before Christmas a general impulse to tighten fiscal policy was evident, well before any decisions were taken about further MLR cuts or the monetary stance in general. This carried solidly through into the phase of budget making proper. Ministers met to consider their stance on 16 January and

[53] The Treasury also seems to have had its doubts on this point. Howe asked Sir Kenneth Couzens whether he should circulate a paper explaining sterling policy to his E Committee colleagues. Couzens pointedly replied that 'you would wish to avoid putting policy on the exchange rate into commission': K. E. Couzens, 'The exchange rate: ministerial briefing', 13 February 1981, TNA, T386/551, MTFW 114073.

[54] 'M. R. D. Heseltine to R. E. G. Howe', 16 February 1981, TNA, PREM 19/438, MTFW 114004.

[55] On measures to help industry, the Employment Secretary, Jim Prior, also noted: 'I am glad to add my voice to Keith's.' 'J. M. L. Prior to R. E. G. Howe', 9 February 1981, TNA, PREM 19/438, MTFW 113995.

[56] Former Cabinet minister Geoffrey Rippon ironically praised the November Statement as a move from 'dogma to something near pragmatism': M. Hatfield, 'I am hemmed in by our election promises, Sir Geoffrey Howe tells Conservative backbenchers', *The Times*, 26 November 1980.

registered 'the need for fiscal tightening in the Budget to demonstrate that the PSBR would be reduced and to help re-establish the credibility of the medium-term financial strategy'.[57]

By this time ministerial hints of one kind or another had reinforced expectations that a further downward move in MLR was coming – expectations that were helping the Bank to sell gilts and that, unsurprisingly, it sought to reinforce ('opportunism', commented the Treasury Deputy Secretary, Peter Middleton).[58] The files suggest that the only debates about MLR within the Treasury and the Bank in January and February 1981 were between cutting before the Budget or at the despatch box, and 1 versus 2 per cent. There was more than market sentiment involved: it was common ground in these internal debates that monetary conditions were tight, whatever £M3 was saying – indeed, that it had perverse characteristics as an indicator.[59]

In the light of these discussions it is hard to share the commonly held view that the 'Niehans report' of January 1981 played an important part in shifting policy by alerting ministers and officials to the tightness of monetary policy and the waywardness of £M3, the Budget adjusting course accordingly. At most, Niehans provided helpful theoretical underpinning for the Treasury and the Bank's existing judgement of market conditions from a source monetarists could not ignore – a kind of imprimatur. The report's influence at No. 10 is also overstated. Walters needed no teaching, while Thatcher herself remained unwilling to relinquish £M3 (of which more below). She also disliked the very idea of such a report – ultimately, a private initiative of Alfred Sherman (one of Thatcher's advisers), Brunner and Walters recommending Niehans – fearing it would leak and undermine credibility. And Niehans' advocacy of intervention to bring sterling down found no takers, the most recent battle on that topic having been fought in the autumn. Ultimately, his report made little or no impact on the Budget, the course for which had already been set.[60]

57 F. A. Cockfield, '1981 Budget', 16 December 1980, private office files of Geoffrey Howe, MTFW 127438. See also A. J. Wiggins, 'Chancellor – 1981 Budget', 18 December 1980, Chancellor's private office files, MTFW 127445 (also 127436–127447); N. J. Monck, 'Meeting with the Governor on Thursday 22 January', 21 January 1981, TNA, T386/549, MTFW 114058.

58 P. E. Middleton, 'Minimum lending rate', 2 February 1981, TNA, T386/549, MTFW 114066.

59 P. E. Middleton, 'Minimum lending rate', 10 February 1981, TNA, T386/550, MTFW 114052.

60 Walters wrote in his diary, 'Told MT about JN's seminar and his findings. MT very defensive: NO ONE must know about it – especially Bank of England. Why? Frightened of calls for relaxation or sops to the wets. Am rapidly learning the political game – never admit to an error.' A. A. Walters, 'Diary entry', 8 January 1981, Churchill, WTRS 3/1/1,

A fortiori, the November measures could not have mattered if the key decisions in the Budget were taken in the last weeks of February 1981. But we have already noted that the eleventh-hour stress in the ministerial memoirs bears the influence of later quarrels, and the detailed account by John Hoskyns in his memoir *Just in time*, which, like them, focuses on the final PSBR decisions, also looks suspect, for all its fascination and richness. Based closely on his diary, Hoskyns frames the Budget as a make-or-break crisis requiring a 'Hayekian' response; Charles Moore's biography of Thatcher was evidently influenced by it.[61] The picture is of No. 10 advisers manoeuvring the Prime Minister into bullying the Treasury to draw up a tough budget. There is something inherently improbable about this version of events, both as to character and the realities of life in Whitehall, and Sir Tim Lankester's chapter in this volume convincingly shows that the process of budget making in January and February 1981 does not bear out the Hoskyns interpretation. Examination of where the Treasury actually stood in the last part of 1980 reinforces this impression. In truth, Hoskyns was a figure on the margin of macroeconomic policy making, despite his location at the centre of power.

Potentially, Walters was in a stronger position to influence the Budget, but at the very beginning of his tenure (he arrived at No. 10 on 6 January 1981) he was not the figure he later became. The Treasury was constrained to be more open with him than Hoskyns, but candour certainly had its limits. And, initially, trust was lacking between Walters and Thatcher herself. She excluded him from some crucial final meetings in the budget-making process; and, at the time, he chose to distance himself from the result, writing to Wass the day after the Budget deadline closed to record his view that not enough had been done to justify a cut in MLR, but that, if one had to happen, in view of strong market expectations, one percentage point was the maximum. He anticipated 'crisis measures after a few months'.[62]

MTFW 114203 [emphasis in original]. Niehans' report was published later in the year 'as originally submitted', but in the United States and with a low profile, as Niehans, *The appreciation of sterling: causes, effects, policies*, and it is available at Churchill, WTRS 1/4, MTFW 128452. On Sherman's role in conjuring up Niehans, see 'A. Sherman to R. G. Puttick (chairman, Taylor Woodrow)', 14 November 1980, Churchill, THCR 2/11/3/1, part 1, MTFW 121407. Sherman also played a crucial role in the appointment of Walters.

61 Moore, *Margaret Thatcher*, 623 onwards.

62 Thatcher certainly never forgot the funding crisis of November 1979, which forced a three percentage point increase in MLR, but it is hard to agree with Moore's suggestion that the 'threat of a crisis in the gilt markets dominated everything' in the making of the Budget. If nothing else her determination to see a significant cut in MLR makes little sense in those terms. Clearly she also had in mind ending the recession and rendering the Budget

One is brought then, finally, to the monetary side of the Budget. The November 1980 measures were powerfully influenced by a desire to reduce the value of sterling. How far did this motivation still operate by the time of the Budget? The currency had weakened significantly and steadily against the dollar after its late October peak, falling to $2.2150 on Budget day, only a cent and a half about the level Thatcher had wished for at her meeting of 18 September 1980. On 17 February 1981, when it stood at $2.2635, Howe and Richardson had discussed the rate and felt that 'substantial depreciation would have serious adverse implications for inflation'.[63] The underlying condition was a strengthening dollar, as the tightening introduced by the Federal Reserve Chairman, Paul Volcker, took hold, while the pound was rising markedly against European currencies, so that sterling might now have been constraining a cut in MLR as well as motivating one. And in fact there is no sign that a desire to influence sterling played any part in Treasury thinking on interest rates at the time of the Budget.[64] The case for a reduction in MLR was made in relation to its impact on the finances of the company sector, action on the National Insurance surcharge having been ruled out.

It has been argued that the Treasury did not seek an MLR cut at all. Lawson's memoirs handle this question bluntly, drawing a sharp distinction in the paternity tradition. For the Treasury, he asserts that '[t]he 1981 Budget was essentially a response to the fiscal difficulties which had emerged in the financial year 1980–81', a salutary demonstration of resolve, whereas, for Thatcher and 'in particular Walters', the cutting of MLR was 'its *raison d'être*'.[65] The MLR cut on Budget day he presents as a misguided and ultimately unsuccessful initiative from No. 10, needing to be reversed in the autumn in two successive two percentage point increases.[66]

In fact, the records do not support as sharp a line on the narrow question of MLR. Walters did not consistently press for a cut; as already noted, by the end of the budget-making process his position was quite the reverse. The Treasury and the Bank did, on the other hand, despite their concerns for sterling. The *size* of the cut, and to a lesser degree its timing,

politically saleable, reasoning evident in her (and Lawson's) subsequent defence of the Budget. Moore, *Margaret Thatcher*, 627; 'A. A. Walters to D. W. G. Wass', 26 February 1981, MTFW 114026.

63 A. J. Wiggins, 'Monetary affairs', 17 February 1981, TNA, T386/551.

64 Advising Howe on 5 March, Couzens thought a two percentage point cut had been discounted by the markets, so that it would not weaken sterling, 'and might cause some rise', there having been expectations earlier of a three percentage point cut: K. E. Couzens, 'MLR in the Budget: the exchange rate', 5 March 1981, TNA, T386/552, MTFW 133731.

65 Lawson, *The view from No. 11*, 88, 98. 66 Ibid., 98.

were at issue for them, but not its *desirability*. By this stage monetary conditions were seen as too tight, although there was no agreement as to how to present this insight.

Even as to the size of the MLR cut there was only limited debate within the Treasury. Middleton took the lead in urging two percentage points rather than one, arguing that such a cut would be seen as consistent with the Budget's target for £M3, so that 'the deciding factor might be the general reaction to the Budget and particularly the reaction of industry', for which a one percentage point cut 'just does not seem enough'. (The Budget announced a new target of 6 to 10 per cent annual growth in £M3 over the period from February 1981 to April 1982, helpfully removing the post-'corset' bulge from the figures, the manoeuvre being dubbed a 'roll-forward' or 'rollover' of the previous target in preference to blunter descriptions.)[67] Wass told Howe that he would have plumped for a one percentage point cut '[i]f the Budget were not as tough as it now is and if we were doing a little more for industry', describing the case for a two percentage point cut now as 'in my view largely political'. For good measure, he even circulated Walters' letter warning against a larger cut – a little provocatively, perhaps. Finally, though, Wass concluded: 'On balance, despite the lack of convincing intellectual reasoning, I am inclined to be on the side of those who want a 2 per cent [sic] reduction.'[68] Ryrie trod a similar path. Among ministers, Biffen was adamant on two percentage points, with Lawson also in fact supportive, briefly minuting his agreement with Middleton.

[67] The sensitive decision to delay the 'roll-forward' till the Budget was taken prior to the Autumn Statement: A. J. Wiggins, 'Note of a meeting held in the Chancellor of the Exchequer's room, HM Treasury on Thursday, 6 November, 1980 at 4.30 pm', BOE, 7A 133/2, MTFW 113151; R. E. G. Howe, 'Rolling over the monetary target', TNA, PREM 19/180, MTFW 113302.

[68] P. E. Middleton, 'MLR in the Budget', 27 February 1981, TNA, T386/552, MTFW 133722. N. Lawson, 'MLR in the Budget', 2 March 1981, TNA, T386/552, MTFW 133725 (saying a two percentage point cut was needed 'to give a proper balance to the budget'); D. W. G. Wass, 'MLR in the Budget', 2 March 1981, TNA, T386/552, MTFW 133727. Biffen reacted angrily to sight of the Walters letter: J. W. Biffen, 'MLR in the Budget', 3 March 1981, TNA, T386/552, MTFW 133728. See also A. J. Wiggins, 'Note of a meeting held in the Chancellor of the Exchequer's room, House of Commons, at 4.45 pm on Thursday, 19 February 1981', TNA, T386/551, MTFW 114079, in which Ryrie made the case for a two percentage point cut. The most persistent argument for a one percentage point cut was made from a technical point of view: C. J. Riley, 'MLR cuts in the budget', 27 February 1981, TNA, T386/552, MTFW 133723, suggesting a one percentage point cut in the Budget and another later, to achieve 'smoother monetary growth through the year'. See also C. J. Riley, 'MLR in the Budget', 3 March 1981, TNA, T386/552, MTFW 133729; and P. E. Middleton, 'MLR in the Budget', TNA, T386/552, MTFW 133729.

As to the timing, the Bank urged a one percentage point cut before Budget day, and tried to nudge Thatcher and Howe towards openly acknowledging that it was taking place outside the framework of the MTFS, to reflect the behaviour of monetary aggregates other than £M3 and 'to reduce the upward pressure on the exchange rate'.[69] But the Bank was asking for too much, too soon, contributing to the decision to announce the MLR cut from the despatch box in the Budget itself; this was a further politicising of interest rates, disliked by Howe and many other Conservatives, but one that would permit an extensive restatement of the framework, if desired – and give longer to think about it. In the run-up to the Budget Howe was deeply uncertain where monetary policy should go. He wanted the exchange rate to be taken into account, although he rejected an explicit target (and, for the moment, the European Monetary System); he was attracted to monetary base control and saw a valuable role for monetary targets, but 'thought £M3 would have to remain a central feature'.[70]

Lawson's position, as ever, was more crisp. In the last weeks of budget making he twice gave Howe his thinking on this topic, the first via his Private Secretary on 2 February 1981:

> [W]e should perhaps learn to have increased respect for our forefathers, who plumped for separate and simultaneous monetary targets (the note issue, the then equivalent of the monetary base M0) and fiscal targets (the balanced budget). He [Lawson] does not think the attempt to conflate these two into a single hybrid target, £M3, has proved an unqualified improvement.[71]

[69] Peter Middleton agreed that a cut in these circumstances would be a struggle to present as anything but a departure from the policy framework. He made an ad hoc case for relaxing outside the framework in an unimpressed analysis of the Niehans report: 'If it is accepted – which it usually is – that there is no very clear explanation for the exchange rate in terms of conventional indicators, but that the high exchange rate does exert a strong downward influence in inflation, then so long as the exchange rate remains high there is a case for relaxing domestic monetary policy – something has done the job for you and you do not need to do it twice.' Lawson also noted 'serious shortcomings' in Niehans, thought Middleton's minute 'wholly valid' and later made a similar argument in his memoirs. N. Lawson, 'Niehans', 17 February 1981, MTFW 128602; P. E. Middleton, 'Niehans', 16 February 1981, private office files of Geoffrey Howe, MTFW 128601; 'T. P. Lankester to A. J. Wiggins', 29 January 1981, BOE, 7A133/5, MTFW 127453.

[70] Wiggins, 'Note of a meeting held. . .6 February, 1981, at 2.45 pm', MTFW 114048.

[71] S. A. J. Locke, 'The money supply target', 2 February 1981, TNA, T386/549, MTFW 114065. Lawson's own turn towards the EMS came in the summer of 1981, towards the end of his time in Howe's Treasury: N. Lawson, 'EMS', 15 June 1981, Oxford, Christ Church College (hereafter 'Christ Church'), Lawson MSS 1/2, MTFW 128449; N. Lawson, 'EMS', 14 September 1981, Christ Church, Lawson MSS, MTFW 128450. During his tenure as Chancellor Howe chose not to press the EMS as an issue, while remaining fundamentally positive towards it: 'HMT wants to push EMS well into the future. FCO does not', 'J. S. Fforde to the Governor', 16 January 1980, BOE, 7A133/2, MTFW 113114.

Then, on 13 February, came a firm prescription:

> [N]ominal short-term interest rates should be basically determined by the growth of M0, with some regard however to the other aggregates (*including* £M3) and the level of real interest rates. There should be *no* explicit link with the exchange rate, although inasmuch as exchange rate rises reduce inflation and thus increase the real interest rate, there will be an implicit link.[72]

But one person remained who was far from ready to relinquish £M3. Although Thatcher was attracted to MBC and was more than willing to achieve greater discretion by paying attention to other variables, she saw a high political cost in changing the target, so many painful things having been done in its name. She had a strong suspicion that £M3 meant *something*; after all, hadn't Walters predicted where the 'Barber boom' would end by reference to the broad money supply? And she had no desire either, then or later, to abandon the idea of trading off tighter fiscal policy for looser monetary policy, particularly if tightening could be achieved by public expenditure control rather than tax increases. As Chancellor, Lawson later had many fights with the Prime Minister to refute the notion that she had hit upon a timeless formula to this effect. Unsurprisingly, then, the Budget did not offer a full-scale reformulation of monetary policy; as in November 1980, it was politically impossible to construct a wholly adequate doctrinal basis for the MLR cut.

[72] N. Lawson, 'Changes in the banks' money market operations and policy for short-term interest rates', 13 February 1981, TNA, T386/551, MTFW 114074 [emphasis in original].