Baker MP

27th December 1979

In case you have not seen it, I am enclosing a copy of a speech which Kenneth Baker made to the Conservative City Forum on 14th December.

Are you able, please, to identify the quote from you in the second paragraph (which I have underlined)?

If the quotation is from a speech of yours, may I please have a copy?

I hope that by the time you receive this, you and Sarah will have had a super holiday in Kenya.

Kenneth Baker's speech is a thoughtful one, about which I would like to have a word with you.

Ian Gow MP
Parliamentary Private Secretary

The Rt Hon John Biffen MP

BAKER MP

27th December 1979

I think that Kenneth Baker sent to you direct a copy of his thoughtful speech to the Conservative City Forum on 14th December.

However, in case he did not, I am enclosing a copy now.

Kenneth Baker came to see the Prime Minister earlier this month, together with the officers of our Industrial Committee, of which he is Chairman. Kenneth was eloquent and pursuasive, and his remarks to the Prime Minister on that occasion were wholly consistent with the enclosed speech. Keith was present at that meeting.

I have had a brief word with Kenneth Baker, and hope to lunch or dine with him before the House re-assembles.

I have a high regard for Kenneth Baker's ability and am very anxious that he should be kept on side.

Ian Gow MP
Parliamentary Private Secretary

The Rt Hon Sir Geoffrey Howe QC MP

RELEASE TIME 1300hrs.
Friday, December 14, 1979

Mr. Kenneth Baker, Conservative M.P. for St. Marylebone and Chairman of the Conservative M.P.s Industry Committee, speaking to the Conservative City Forum, said:

Towards lower interest rates - and quickly please

High interest rates are damaging for a number of reasons. First, by adding to industrial costs they make goods and services more expensive and they can push the over-borrowed company into bankruptcy. Secondly, they crush the enterprising spirit. If you can get 20% plus simply by lending your money, why bother to go to the trouble of expanding your small business? Thirdly, they suck into Britain large sums from the international money markets - this is already happening - and this over-reinforces support for the £ which many industrialists think is over-valued. Fourthly, they push up the cost of mortgages and it is this that works through more quickly than anything else in demands for higher wages. Brave is the politician who would try to explain to a young couple that their contribution to national recovery is to pay a higher mortgage. Moreover it will slow down, if not stop, the sale of council houses which is one of the government's main social objectives. Fifthly, high interest rates actually increase government expenditure through the extra cost of debt servicing.

Interest rates, therefore, are inflationary and counter-productive in that they undermine other economic objectives of the government. Clearly ministers are also uneasy. John Biffen, the Chief Secretary to the Treasury, recently said that 'high interest rates are a parody of monetarism'. Yes, indeed, but at the moment they appear to be its inevitable consequence. Some fresh thinking is needed, so let's begin by clearing away some of the illusions that surround interest rates.

Some argue that governments can't really control money rates and that we are in the grip of forces the irresistible power of which we must recognise. The logical conclusion of that dangerous nonsense is that

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governments can relax and reduce their activities just by protecting the lives of their citizens. We should certainly resist that thinking, which is often dressed up in simplistic arguments about water not running uphill. Archimedes invented a screw which made water do just that, to the great benefit of the people at the top of the hill.

Others argue that as interest rates rise around the world, so must ours. This is a crazy form of international competition, where sometimes we've led and at others followed. In the past we've had to do it to support the £, but our petro-currency is so resilient that it is now higher than before the abolition of exchange control. How much would it fall if Mimimum Lending Rate was 14% instead of 17%? Probably very little, but a reduction in the value of sterling would be welcomed by exporters and the higher cost of imports would work through slowly and probably be less than the inflationary effect of high interest rates.

Another school of argument asserts that high interest rates are necessary to control the money supply. This is simply not true, as the latest bank lending figures show. The money supply can and should be controlled by other means and other policies, and we all hope that the government's Green Paper is going to indicate this. To depend upon interest rates as the crucial method of control would mean that M.L.R. should go to 25%. Should we not all recognise that the price of money has a marginal effect upon the supply of money, much in the same way that the price of petrol at the pump will do little to check the consumption of petrol? The need for money and petrol is far too strong to respond so elegantly and precisely to the price mechanism. Indeed high interest rates can increase the money supply since borrowers will tend to borrow more to cover their higher loan charges. In this way a régime of high interest rates will, in the short term, actually increase the money supply.

It is also deceptive to believe that high interest rates are the penalty we pay for high government expenditure. The Public Sector Borrowing Requirement is now 4.25% of the Gross National Product, which is roughly the level it was in the early 1970s, but the level of interest rates then was much lower. The government is right to contain public expenditure, but it can't depend upon its success in doing this to bring down interest rates since the time scale would be too long. Interest rates must certainly come down before the P.S.B.R. as a percentage of the G.N.P. comes down.

One is driven to only one reason for high interest rates, and that is the need of the Government to finance its P.S.B.R. by selling gilt edged stock. Presumably the advice was that stock could not be sold at 14%. I think the answer to that is maybe we should try. For example, the government could control or influence the short term interest rate by lowering M.L.R. and at the same time introducing controls on credit creation. Long term interest rates would continue to be determined at a higher level by the market, where the government could fund its deficit.

The need for some more effective control of credit creation is not a matter of economic principle, it is a question of judgement and management. The government and the banks do need some more effective levers, whether in the form of a monetary base control, or a tightening of the corset which the Chancellor is going to extend for a further six months, or some more immediate control on personal borrowing. Such measures by their very nature need not be permanent and could be eased when there are signs of a continuous slowing down in the money supply.

There will be many who would say that this won't work, and my reply to that is that the present system isn't working at all well. The existing high level of interest rates is putting into jeopardy the economic, social and political objectives of the government. I am concerned that we should reach those objectives, and to get back onto course the government must find a way that will lead in the early months of 1980 to a steady and continuing reduction in the level of interest rates.

Baker MP

CHANCELLOR OF THE EXCHEQUER

Treasury Chambers, Parliament Street, SW1P 3AG
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January, 1980

Dear Mr Gow,

KENNETH BAKER, M.P.

I am writing just to let you know, following your letter of 27th December to the Chancellor, that we shall be letting you have very soon a short analysis of Mr. Baker's speech, by way of background briefing.

Yours ever,

Martin Hall

M. A. HALL
Private Secretary

Ian Gow, M.P.