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PRIVY COUNCIL - PERSONAL AND CONFIDENTIAL.

Dear Prime Minister,

50 of our money -
"Rebollar"

That you should have been reported publicly as saying that you personally thought that the £ in terms of US \$ had fallen too far will do more good than anything else could to restore confidence in the £ after this sad saga in which I have to say I think you have been poorly served. I hope that this troublesome affair will not influence you to deviate an iota from your declared economic policies which I am sure will achieve the sound prosperity which is our aim. To trim the ship by occasional resort to increases temporarily of money rates is only sensible and no indication of U-turns or other nonsense. But if such recourse has to be made it should be sufficient to mean business; there is still much to be said of the old adage - 2% up and down by $\frac{1}{2}$ % steps as soon as possible. I see no reason why this should not work now as it did in my day.

The fall in the rate of the £ starting about the second week in November last when sterling was already as low as \$1.27 (surely low enough for export competitive advantage) seems to have coincided with and perhaps was triggered off by the seeming quasi-official public Whitehall castigation of the Bank of England over the Johnson Matthey affair. I know nothing about this business and it may well be that the Bank deserved censure but not public official censure. It is always harmful to confidence when the media are able to contrive alleged conflict between the Treasury and the Bank. In the ensuing weeks fuel was added to the decline by some singularly inept and/or hackneyed comments on the exchange markets from Whitehall coupled, it would seem, with a remarkable degree of invisibility of the Governor and apparent absence from the market by the Bank of England who would have been expected to be burning the fingers of the speculators in traditional fashion; the whole culminating in encouraging the speculators to go further. This may well be a travesty of the reality but it was the scene as it appeared to markets and which speculators happily exploited. A further fall-out of this media mischief was the media association with surmise regarding the re-appointment of the Deputy-Governor of the Bank, and this again fed suspicions that the Treasury was attempting to interfere unduly in the professional day-to-day activities of the Bank. Such allegations do crop up from time to time, more often than not without cause, but they do need to be quashed as they tend to reflect in markets on the professional integrity of the Bank. Civil Servant and market operator (both of which I have been privileged to be) work on entirely different mental wavelengths and hence the essential role of the Central Bank to interpret in both directions and most particularly to achieve in the market environment the policy of the Government. I think that the recent intrusion by other Whitehall Departments apart from the Treasury into traditional City affairs may well be the cause of present misgivings. I am sure that your Government has no intention of accomplishing what Dr Dalton failed to achieve in 1947, namely to render the Bank of England the East End Branch of the Treasury.

I hope that you will accept, Prime Minister, that an 'elder statesman' (I have no choice but to claim the former, albeit not arrogant enough to claim the latter) may have the audacity to propose what might be impertinent from one with fewer years and less experience.



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This unhappy spasm in the exchange markets has left its bruises. I would suggest, with all respect, that the authority and responsibility of the Governor and the Bank, in their proper field, which of course includes, inter alia, day-to-day management of the Reserves, be, in some manner made manifest subject of course to reporting on their stewardship as frequently as may be appropriate through the Treasury and Chancellor to the Prime Minister. The Governor and the Bank can only serve the Government best when the Government displays publicly confidence in the Bank and does not confuse the Public within the proper domain of the Bank. I think that for a variety of reasons over the years respect for the Bank has been eroded. The aura of the Governor needs careful husbanding; he can be of great support to the Government of the day, which as a Crown Appointment, regardless of party politics, he is committed to serve.

I could not have without this aura, for example, on more than one occasion summoned immediately to London presidents of leading American Banks and other financial institutions and successfully persuade them to put to rights affairs injurious to our interests although perfectly legal in American terms. With the invasion of the City by American interests I can well envisage the need to do this may well be more frequent in the future than it has been in the past. A summons across the Atlantic by the Governor of the Bank of England was far more effective and speedily attended to than any threats of legal action which would in all probability have merely unleashed a covey of American lawyers. In many other ways this aura made possible what was to the Public Good which would have been impossible in its absence.

The re-appointment of McMahon as Deputy-Governor can only be of the greatest value to the Bank particularly in the international monetary circles where he is widely known and respected as the professional economist that he is; but he is neither a market man nor an administrator which the Governor has to be and which I am sure the present incumbent has the capacity to become given the necessary support and recognition. To command the aura of which I speak and to be worthy of it demands full-time devotion by the Governor to his Bank responsibilities. By the same token, if the Bank is to establish and maintain confidence in financial markets at home and internationally, such degree of autonomy as Government delegates to the Bank must be, and be seen to be, unreluctant and unrestricted by Officials as much as by Ministers.

It is in the nature of things that sooner or later the tidal wave in favour of the US \$ will wane and even reverse. The question is whether the adjustment to this will be tidy or untidy. Experience of markets would point to adjustment being untidy and probably exaggerated. Against the likelihood of this supposition I think that we would be well advised to join the EMS at the earliest convenient opportunity. Now that sterling no longer enjoys special consideration as automatically the alternative reserve and trading currency to the US \$ I have little doubt that, come



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the next international payments crisis heavy resort will be made to seek solutions through wider use of the Ecu. I believe that we would be well advised to be involved without further delay in the evolution of the EMS. If we had not walked out at Salerno, think of the countless days, nights, weeks and months that would have been saved subsequently had the Treaty of Rome been forged to a pattern acceptable to us from the start rather than calling for subsequent painful, and at times necessarily brutal, modification. The EMS is still, I believe, in sufficiently embryonic condition to permit embodiment of contributions by us in its evolution, but this state of affairs will not continue indefinitely. We may easily at some time in the future need the support of an EMS constructed as we would wish it to be.

Of no less importance is the degree and manner in which the discipline of exchange rates has been jettisoned has eliminated many restraints on possible destructive policies of some possible socialist government, unrestrained by our membership of the EMS. This is surely a jeopardy which this Government would not wish to bequeath to some future socialist successor.

Lastly may I take this opportunity to congratulate you most warmly on your invitation to address both Houses of Congress in Washington next month. This is a much greater honour, as I know from my Washington days, than is generally recognised in this country and, if I may say so, most richly deserved.

Recognising as I do the immensity of the burdens which you are carrying with such gallantry and success, I hesitate to add to them but I do not think you would wish me to let these matters go by default. This has been a crisis which should not have occurred, particularly irritating at this time as a small solace to Mr Scargill's supporters notwithstanding its irrelevancy. It goes without saying that I remain always at your disposal should you wish me to wait upon you although I am off this coming week to visit a cousin in Kenya for some four weeks.

Yours sincerely,
Robert Carr

The Rt. Hon. Margaret Thatcher, M.P.,
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