This began as a chapter in *Prawn Cocktail Party*. (On which sorry tale see 'View from the Bridge' in this issue.) When I used some of that for the *Well, how did we get here?* essay, I reread this section for the first time in years and it struck me as rather interesting that the last prime minister who had tried to challenge the City was Thatcher, and she lost.

Thatcher versus the City of London

Robin Ramsay

The older I get the more I am struck by the economic illiteracy of our politicians. I don't mean their grasp of economic theory, most of which is bollocks or irrelevant; I mean their grasp of our economic history and the structural conflict between domestic and overseas economies. The last prime minister to understand this was Harold Wilson. Edward Heath did economics as part of his undergraduate degree but was conned by the City and the Bank of England into passing the Competition and Credit Control Act, which allowed the British banks to massively expand their lending, caused the secondary banking crisis of 1973/4 and was one of the causes of the inflation of the 1970s (which reached 25% in 1975). That inflation became a stick with which the Tories beat Labour and unions in the 1974-79 period and beyond, and a section of the Tory right beat the Heathites.

Mrs Thatcher and her faction promised to defeat inflation by 'controlling the money supply'. Mrs Thatcher seems to have assumed that 'controlling the money supply' could be done relatively easily and quickly, and didn't grasp that the City's real agenda – i.e. more 'freedom' to lend money and more 'freedom' to move money abroad – which was being articulated notably by the chief secretary to the Treasury, Nigel Lawson, would make impossible measuring, let alone 'controlling' the money supply. When Thatcher saw what the consequences were for the domestic economy of the regime of high interest rates, introduced to 'control the money supply', she began looking for an alternative.

Nigel Lawson sneers in his memoirs:

> '....there was no more assiduous seeker for *gimmicks* which would supposedly give us tight money without high interest rates than Margaret Thatcher.' (Emphasis added.)[1]

Lawson only mentions one such 'gimmick', monetary base control, which, instead of trying to influence the *demand* for money by raising interest rates, tries to control the *supply* of money by regulating the amount the banks could lend.[2]

Regulating the amount the banks could lend? This the City was not going to wear.

Thatcher versus the Treasury ministers

1 Nigel Lawson, *The View from No. 10* (London: Corgi, 1992) p. 77.

2 On MBC see the discussion in David Llewelyn (ed), *The Framework of UK Monetary Policy* (London: Heinemann, 1982) pp. 56-60 and Lawson (see note 1) pp. 80 and 81 for his reasons for rejecting it. Milton Friedman, the guru of monetarism: '*Direct control* of the monetary base is an alternative to fiscal policy [i.e. taxes] and interest rates as a means of controlling monetary growth.' (Emphasis added.) Cited in David Smith, *The Rise and Fall of Monetarism* (Harmondsworth: Penguin, 1987) p. 95. Direct control was precisely what the City did not want

In October 1979 Chancellor Geoffrey Howe announced the end of the remaining exchange controls (some had been scrapped in June). The following month the Thatcher Government raised interest rates to a minimum 17% – nearer 30% for many individual customers – where they stayed for eight months. The pound soared in value as 'hot money' poured into London attracted by real interest rates of over 5%.[3] British exporters and manufacturers began to collapse but the champagne flowed in the boardrooms of the banks. No exchange controls, no limits on lending, and record interest rates – this was everything the City had been seeking since the end of World War 2 and more.

Against the alliance of City interests led by Nigel Lawson and the chancellor, Geoffrey Howe, and, lined up Mrs Thatcher and a group of advisors – economists such as Brian Griffiths, Gordon Pepper and Alan Walters – who urged the adoption of control of the monetary base (MBC) as the better method of 'controlling the money supply'.[4] Pepper, one of the first within the City to express concern at the growth of the money supply in the 1970s, was the editor of monetary bulletins published by the stockbrokers, Greenwells.[5]

> '[Pepper] had established a private line to Margaret Thatcher when she was Leader of the Opposition.... [and] persuaded her that a given degree of monetary tightness could, through MBC (monetary base control), be secured at an appreciably lower level of interest rates than the UK was experiencing. Given her – by no means unique – detestation of high interest rates, a promise of sufficient monetary tightness to bring down inflation at

3 The 'real' interest rate is the stated interest rate minus inflation. 17% interest rate with 12% inflation is a real interest rate of 5%. In the 1930s real interest rates were 3% or less.

4 Margaret Thatcher, *Path to Power* (London: HarperCollins, 1993) pp. 133 and 4

5 William Keegan, *Mrs Thatcher's Economic Experiment* (Harmondsworth: Penguin, 1985) p. 41

> lower interest rates had an irresistible appeal.' [6]

But the financial system would not have it.

Nigel Lawson tells us that the Bank of England 'deeply disliked the whole idea of MBC,' and he 'was convinced that such an experiment had a chance of success only if those responsible for its implementation wished to make it a success. Given the Bank's profound antipathy, it would all too likely have proved the disaster they predicted.' [7]

Mrs Thatcher tells us that, 'the Treasury *were not prepared* to move to the system of monetary base control which Alan [Walters] favoured and to which I was attracted by his clear and persuasive analysis.' [8] (Emphasis added.)

Philip Stephens tells us that the Treasury was hostile to MBC because its officials regarded controlling public spending as more important than controlling the money supply and public spending was a key element of their adopted money supply indicator, sterling M3; they could use M3 to reduce public spending.[9]

Thatcher got the consolation prize.

> 'Bank of England and Treasury officials were instructed to put together *proposals* for changing the methods of monetary control, with a view to *moving away from* excessive reliance on high interest rates.' [10] (Emphases added.)

'Action this day' it was not.

The Bank of England and Treasury proposals on monetary control were published in March 1980 as a 'green paper' – a discussion document – which 'stopped well short of

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6 Lawson (see note 1) pp. 79 and 80

7 *Ibid.* pp. 80 and 81.

8 Margaret Thatcher, *Downing Street Years* (London: HarperCollins, 1995) pp. 133 and 4.

9 Philip Stephens, *Politics and the pound* (London: Macmillan, 1996) p. 20

10 *Ibid*.

a move towards a monetary base system'. [11] While sterling M3 was to remain the guiding light of policy, changes in methods 'consistent with the *eventual* adoption of a monetary base system' were also introduced.[12] (Emphasis added.) 'Consistent with' and 'eventual' – this was looking down a long, foggy road. Mrs Thatcher and the MBC lobby had been repulsed. High interest rates would remain the policy. Recession and unemployment would reduce inflation: no pain, no gain.

But Thatcher had another try.

> 'Holidaying in Switzerland.... Mrs Thatcher met Fritz Leutweilerm, head of the Swiss Central Bank, and the economist Professor Karl Brunner of Rochester University in the US.....[who] both blamed the Bank of England, saying its method of controlling the money supply was all wrong. The answer to controlling inflation was to control the monetary base.' [13]

Thus fortified, Mrs Thatcher called a meeting in September 1980 to discuss MBC again. According to one of its participants, Christopher Johnson, at that meeting:

> 'After a memorable debate with academics and City economists on 29 September 1980..... the Bank and Treasury officials joined in rejecting the plan [MBC] as impracticable, to Mrs Thatcher's disappointment.' [14]

On 16 November 1980 the Bank of England finally reduced the Minimum Lending Rate to 14%. This, argues David Smith, was

11 *Ibid.* p. 95

12 *Ibid.*

13 William Keegan (see note 5), p. 153. I doubt this 'holidaying' story. Mrs Thatcher hated holidays. Perhaps she was at the annual gathering of the Mount Pelerin Society, worshipping at the shrine of Hayek. On Pelerin see Richard Cockett, *Thinking the Unthinkable* (London: HarperCollins, 1985)

14 Christopher Johnson, *The Economy Under Mrs Thatcher* (Harmondsworth: Penguin, 1991) p. 34.

a direct consequence of the notorious speech (which cost him his job) by the Director General of the CBI calling for a 'bare knuckle fight' with the government over economic policy, and the Chair of ICI warning Mrs Thatcher that the recession was so serious ICI was going to announce a third quarter loss. [15] She had already admitted to leaders of the CBI that she was concerned about interest rates and the exchange rate.[16] This interest rate reduction is now seen as the end of the 'monetarist' experiment, for the monetary figures did not justify the cut.

Eight days later Chancellor Howe announced a number of minor economic changes, framed by the explanation that:

> 'These steps would be *consistent* with the *gradual* evolution towards a monetary base system and will help to judge how far such a system will contribute towards our medium-term monetary objectives.' [17] (Emphases added.)

This may have sounded like progress to Mrs Thatcher – at last her Chancellor was actually talking about moving towards a monetary base system – but in his memoir Nigel Lawson commented: 'An experienced Whitehall watcher would have seen that this was in fact the thumbs down for MBC.'[18]

The Prime Minister and her allies tried again to get MBC taken seriously by Whitehall. They commissioned Professor Jurg Niehans, a Swiss monetarist economist, recommended by Walters, John Hoskyns and Alfred Sherman of the Centre for Policy Studies, to study the British monetary system and its experience since the Tories took office. In Mrs Thatcher's account of it, Niehans report had 'a clear message':

> '....we should use the *monetary base* rather than sterling

15 Smith (see note 9) p. 98
16 Donald Macdougal, *Don and Mandarin* (London: John Murray, 1987) p. 248
17 Lawson (see note 1) p. 85
18 *Ibid*.

> M3 as the main monetary measure and [he] suggested that we should allow it to rise in the first half of 1981. In short, Professor Niehans thought monetary policy was too tight and should quickly be loosened. Alan [Walters] emphatically agreed with him.'[19] (Emphasis added.)

But Niehans' report changed nothing.[20] Lawson omits the Niehans visit from his memoir.

In late 1981 there were rumours – presumably from the Thatcher camp – that Thatcher ally and monetary base control advocate, Gordon Pepper, would be the next Governor of the Bank of England. But Mrs Thatcher failed to get her way on that one, too.

In 1985 Mrs Thatcher and Walters tried once again, to get MBC off the ground, but, says Lawson: 'The issue was satisfactorily put to bed with the promise of "further studies" of the US and German systems.'[21]

The first big interest group Mrs Thatcher took on was the City-Treasury-Bank of England nexus – and she was defeated.

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19 Thatcher (see note 8) pp. 133 and 4. In June that year Niehans repeated at the LSE the seminar he had given in private in February. See the *Guardian*, 27 June 1981. On the Niehans report see also Keegan 1985 (see note 5), p. 160.
20 The Economics Editor of the *Sunday Times* commented on 14 June 1981: 'There will be no further step towards monetary base control...'
21 Lawson (see note 1) p. 480.