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5/1/58

Financial Secretary
copy attached for:
Chancellor
Chief Secretary
Minister of State (L)
Minister of State (C)

cc Sir Douglas Wass
Mr Rylie
Mr Burns
Sir Kenneth Couzens
Mr Berratt
Mr Bridgeman
Mr Britton
Mrs Gilmore Mrs Lomax
Mr Riley
Mr Grice
Mr Williams
Mr Ridley
Mr Cardona
Mr Fforde }
Mr George } B/Eng
Mr Goodhart }

MONETARY CONTROL

1. I attach a revised draft of the first part of the paper on Monetary Control. This is in the form of a Green Paper. The second part, which we will let you have early next week, consists of a detailed exposition of monetary base, reserve asset ratios and related issues.
2. The draft follows the structure which we agreed at your meeting. It also takes account of a further discussion which Mr Bridgeman had with the Bank. In its opening sections it is consistent with the presentation of the medium term financial plan as set out in Mr Cassell's minute of 13 February. The objective has been to put monetary base schemes of the sort described by Brian Griffiths and Gordon Pepper into the general framework of monetary control. The paper concludes by setting out the questions for consultation.
3. The techniques on which the paper invites discussion are those concerned with the generation of short term interest rates. Inevitably therefore the paper is not about the biggest issues in monetary policy; we simply assert that the Government intends to achieve its medium term aims by the appropriate use of fiscal policy and interest rates - on the assumption that the exchange rate is determined by market forces. So it will disappoint some. But though the issues it considers are not the biggest, they are certainly important.
4. The key question on which Ministers will have to make up their mind is whether they are willing to assign to the market a greater

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role in the determination of short rates. The Government is of course always part of the market, whatever the technique used. Under a MBC regime the authorities would still be left to decide when and how the base should be changed if money supply deviated from the target. But there would be no point in going through all the upset which would be involved if the authorities continued to exercise the same degree of discretion as they do at present. In circumstances such as those of the past few weeks, a MBC regime under which the Government worked to set rules, would have caused the market to carry interest rates up; that would have been the justification for the scheme in the eyes of its proponents.

5. I hasten to say that this is not a reason for delaying the issue of a discussion document. Rather it is a good reason for getting it out as a lightning conductor. Whether or not the Government wants to move in this direction, there is a great deal to be said for allowing all those with strong ideas, those who would be affected, and those who are simply generally apprehensive about what sort of rabbit might be coming out of the hat, to have their say.

6. The document is not very encouraging about the merits of a move. But I think the mood is right for the sort of sober assessment which it contains. Provided we conduct the discussions in an open handed way, I think it should be well, if quietly, received.

7. I should say that in one respect the draft does not follow the suggestions made at your meeting. It has proved very difficult to expand the opening paragraphs on the transmission mechanism in a simple and convincing way. We either have to put a lot more material - of a kind which would be hotly disputed in some quarters - or rely on simple assertion as we do now. The latter seems to me to be a much more effective means of presentation given that the paper is leading up to a discussion of MBC and related issues. But we can have another try if you wish.

E. K. Clark

PP

P E MIDDLETON
15 February 1980

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