

PRIME MINISTER

## AN INDEPENDENT CENTRAL BANK

The Chancellor of the Exchequer's minute below puts forward the most radical proposal to come from the Treasury during your time in Government. It is:

to give statutory independence to the Bank of England, charging with it the statutory duty to preserve the value of the currency.

He wants to announce this proposal in a White Paper at Budget time with legislation next Session.

My first reaction and Paul's is that the Chancellor's objective - to entrench a non-inflationary psychology ~~stance~~ - is obviously right. We believe too that technically the proposed scheme is feasible in the sense that it would permit the implementation of Government's economic policy, though there are some formidable technical issues which would need to be solved. But the real issues are not technical economic ones. They are:

- (i) Political —
- (ii) Constitutional —
- (iii) Presentational —

And I doubt whether we have got sufficient of the right people at present

(i) Political

This Government has made control of inflation the cornerstone of its economic policy. You have consistently argued that inflation is a monetary phenomenon and it is the Government's responsibility to control inflation. There is surely some inconsistency in a decision whereby Ministers surrender responsibility for this cornerstone of economic policy. Why,



it will be asked, if you attach so much importance to the control of inflation, do not Ministers themselves continue to take responsibility for controlling it? The obvious implication behind the Chancellor's proposals is either that a Conservative Government cannot be trusted to keep inflation down or that the Government needs to plan for circumstances in which it could lose an election. Neither are comfortable propositions.

There must be some doubt too about one of the assumptions underlying the Chancellor's view of the effectiveness of the scheme - ie a future Government would be inhibited from repealing legislation because the mere announcement of any such attention would damage market confidence. Maybe. But Mr. Kinnock might on the announcement of legislation give a commitment to repeal it and use any chaos caused at the time of the repeal to introduce even more draconian controls.

(ii) Constitutional

It would be unprecedented under our (non-Federal) Constitution for responsibility for such a fundamental Governmental objective, the control of inflation, and for the exercise of such an important function, interest rate policy, to be moved outside Ministerial control. Certainly our Constitutional structure might be adapted to accommodate such a scheme. But such adaptation would require

- making the Bank accountable to the Courts through a judicial review procedure

or

- making the Bank accountable to some body other than Ministers - which can only be Parliament.

The first route - accountable to the Courts through judicial review - seems inconceivable. Courts would be asked effectively to arbitrate on economic policy. That is not what



the Courts are for. The second route - accountability to Parliament - seems, according to points v and vi of the note attached to the Chancellor's minute, to be the route chosen by the Chancellor; in point v there is a reference to the Bank being "answerable to Parliament"; and in point vi to the possibility of the appointment of the Directors to the Bank being "subject to the approval of the Select Committee".

Such an arrangement amounts to a form of oversight by Parliament and would be the first time, I think, that Parliament had been given direct (without Ministerial intermediation) powers over such an important function. You will want to consider the consequences of such a Constitutional step and whether there would be pressures for it to be extended.

(iii) Presentational

The Chancellor wishes to announce the proposal at Budget time. Then inflation could be over 7 per cent, perhaps a little more, if today's base rate puts up the mortgage rate. This is hardly a good backdrop for the scheme's presentation.

The political, constitutional and presentational issues are formidable. But I do not think they are necessarily insuperable. The crucial judgment, and it has to be a political one, is whether the prospect of the benefits of an independent Central Bank - entrenching the fight against inflation - are worth the costs outlined above.

You need to decide whether:

- (a) the scheme is so fundamentally unattractive that you would not wish it to be discussed with the Bank as the Chancellor wants

or

- (b) you do not necessarily rule out the scheme and, while reserving judgment on its principles, are willing for it to be considered with the Bank.

Paul and I would welcome a word. When we have your reaction, we can prepare a more detailed brief for your talk with the Chancellor.

N.L.W.

N. L. WICKS

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