

The operation of monetary policy since the Radcliffe Report

A paper prepared in the Bank of England in consultation with H.M. Treasury, as one of a number of papers presented at a conference held at Hove in October on the subject "Radcliffe – ten years after". The paper will be re-printed in a book entitled Money in Britain 1959/69, to be published by the Clarendon Press in March 1970.

If the fundamental nature of the economic difficulties confronting the United Kingdom has perhaps not altered over the past decade, the difficulties have certainly become much more severe. There have at the same time been dramatic developments in financial institutions and markets, both domestically and internationally. In these circumstances, and especially as some of the limitations of demand management through fiscal policy have been revealed, there has been considerable evolution in the methods and tactics of monetary policy. Broadly, however, the approach to policy has been similar to that of the Radcliffe Committee in that the authorities have consistently believed that it was right to pay attention to and try to understand the general financial position of all sectors of the economy and insufficient to concentrate exclusively on a single variable such as the quantity of money, however that may be defined.

This paper begins with a brief survey of some of the developments in the general economic context within which monetary policy has had to work. This is followed by a discussion of the actual operation of policy over the period – the broad approach followed, the problems and complications which have been encountered and the responses which have been made in methods and tactics. Finally, there is an attempt to assess the effects of monetary policy, both in itself and in relation to fiscal policy.

I The context of monetary policy

a The economic problems and objectives

During the ten years since 1959 official policy has been particularly concerned to achieve two major economic objectives – the acceleration of the sustainable rate of growth of the economy and the rectification of the balance of payments – without sacrificing the goal of a high level of employment to which all post-war British governments have been committed. Though the Radcliffe Committee discussed both these objectives, they were, perhaps, not as acutely aware as we are today of the difficulty of pursuing both of them at the same time. Nor was the problem of the balance of payments as serious then as it became later. Indeed, the Committee looked back (paragraph 633) to "a substantial surplus on current account over the past ten years" suggesting "no fundamental lack of balance in the United Kingdom's trading position". The repeated exchange crises had, in the Committee's view, been due not "to any failure on the part of the United Kingdom to pay her way but to the volatility of various elements in the balance of payments and to the lack of reserves adequate to withstand the resulting pressure on them".

In the attempts made by successive administrations since 1959 to foster an acceleration of the United Kingdom's growth rate by official policies, monetary policy was seen as having primarily a permissive rôle. In the earlier part of the period, when it was hoped it would be possible to provide a long-term solution to the balance of payments problem

through an acceleration of the increase in national productivity, monetary policy therefore occupied a somewhat subsidiary rôle. Monetary measures were largely taken, as had been common in the earlier period, as supporting elements in general 'packages' of measures. Later, as a short-term conflict between the balance of payments and domestic expansion – especially expansion not centred on productive capital expenditures – became increasingly strong, economic policy had increasingly to be directed to the short-term balance of payments problem. The earlier conception of prolonged periods of relatively permissive monetary policy punctuated only occasionally by bouts of short-lived severe measures gave way to the prolonged use of stringent measures of all kinds. Moreover, as the limits of effectiveness of fiscal policies, incomes policies and exchange controls appeared to be more nearly reached, the relative emphasis placed on monetary policy increased.

b International developments

Externally, the Radcliffe Committee looked back on the years of the dollar shortage, inconvertible European currencies and relatively low levels for interest rates throughout the world. Although the United States had by 1959 already moved into the position of substantial external deficit which has been maintained ever since, this major change was not yet widely recognised. The Committee suggest (paragraph 684) that the problem of dollar shortage might be ". . . more intermittent and less intractable than is sometimes supposed, and that it has already changed in character and is likely to continue to do so"; but they did not believe ". . . that the rest of the world, including the United Kingdom, can safely dismiss from its calculations any future difficulty in effecting settlements with the United States." Certainly they did not foresee the problem of dollar surplus.

The major European currencies only became fully convertible in 1958 and there were a number of liberalising moves in the next few years. As a result the sixties have seen an international mobility of short-term capital on a scale unprecedented since pre-war days.

The prolonged U.S. deficit and the convertibility of major currencies have had several important consequences for the operation of U.K. monetary policy. One was the enormous growth of the euro-dollar market, which barely existed in 1959 and now amounts to some \$40 billion. London is, of course, the major centre for euro-dollar transactions, and the effects of this development on the structure of both financial institutions and financial markets in the United Kingdom are discussed briefly below. A further effect has been that both in 1966–67 and 1968–69 a restrictive U.S. monetary policy has had a substantial influence on short-term flows and on international interest rate levels. Although 'covered margins' have ceased to have the significance they previously had, they obviously remain important.

c The central government borrowing requirement

The period has been marked by a rapid growth in the borrowing requirement of the central government – from a position of approximate balance in 1958/59 to £1,335 million

in 1967/68 – and by a similar increase in the borrowing requirement of the public sector as a whole. Implicit in this trend is the problem of ensuring that public expenditure does not pre-empt an excessive share of the growth of real resources. But there are monetary problems, too, in financing a deficit for the public sector; and as the deficit grew, the means of financing it had increasingly severe implications for finance in the private sector. The Radcliffe Committee reported (in paragraph 528) that they could “. . . find no automatic rule for restricting a Government that is determined to spend.” Ten years later we are still without an automatic rule. But much effort has been, and is being, devoted to improving the statistics and the administrative techniques for keeping public spending and borrowing on course. The results are already apparent in a striking reversal since 1967/68: the central government has moved from a deficit of £1,335 million in 1967/68 to a surplus of £273 million in 1968/69. And in 1969/70 not only the central government but the whole public sector should be in a position to make a net repayment of debt. This in turn will have unfamiliar consequences for finance in the rest of the economy.

d Institutional financial developments

In 1959 the deposit banks (the London clearing banks, together with the Scottish and Northern Ireland banks) accounted for 85% of the total sterling deposits of the U.K. banking sector. By 1968 they had increased their deposits by about two thirds; but their share of total sterling deposits had fallen to 75%, as the sterling deposits of the accepting houses, overseas banks and other banks trebled, from about £1,000 million to £3,000 million. Meanwhile the rapid growth of the euro-dollar market has resulted in an increase in foreign currency deposits from a few hundred million in 1959 to about £16,000 million now. Not only has the business of existing banks in London increased, but also many overseas banks have been encouraged by the development of the euro-dollar market to set up new offices or branches in London. The total number of banks in London has risen by more than 50% since 1959. The deposit banks have, however, been inhibited from directly taking in any significant amount of foreign currency deposits by their cash and liquidity ratios which make it difficult for these banks to employ such deposits profitably – though many of them have been able to participate in the business through their subsidiaries. Their share of the U.K. banking sector's total sterling and foreign currency deposits has thus fallen to 50%.

The overall growth of the accepting houses, overseas banks and other U.K. banks has had a number of important consequences for policy. Restriction of the lending of the deposit banks alone would have been increasingly inequitable and ineffective in restricting total bank credit; on the other hand, the structures of the balance sheets of the other banks differ so greatly from those of the deposit banks and from one another, that control over their lending by means of balance sheet ratios poses difficult problems, and the possibility of switching in and out of foreign currency has had implications for the balance of payments, interest rate policy and exchange control.

e Developments of financial markets

As striking as the growth of the accepting houses and overseas banks, and very closely linked with it, has been the growth of new short-term financial markets unknown, or relatively unimportant, when the Radcliffe Report was written. The euro-dollar market has already been mentioned. Domestically the parallel money markets – the market in sterling inter-bank funds and the market for local authority deposits (each attracting about 8% of the assets of the accepting houses, overseas and other banks) – have grown up alongside the Treasury bill market; interest rates in these markets are not in any fixed or conventional relation to Treasury bill rates. More recently, important markets first in dollar, then in sterling certificates of deposit have grown up. There has also been a strong revival of the use of commercial bills over the ten-year period.

f Developments in information

Finally, a very important change has occurred in the information available to the policy-makers. As the magnitude of this change and the extremely short period for which usable statistics have been available are often underrated, it may be worth saying a little about it.

The approach of the Radcliffe Committee to monetary policy, with which, as has already been indicated, the authorities have been broadly in sympathy, could not be realised without a major development in statistical information on the financial positions of all the main sectors of the economy and the flows of funds between them. The Radcliffe Committee remarked that appropriate financial statistics should “. . . be capable of being fitted together so as to show the total movement of funds, not merely the flow through individual financial institutions” (paragraph 865) and this is the aim which has been kept in mind in developing the flow of funds or sector financing accounts.

Six sectors are now distinguished – personal, public, banking, other financial institutions, industrial and commercial companies, and overseas. These accounts have been linked to the capital accounts of the corresponding sectors derived from the national income statistics, with the aim of explaining the financial surplus or deficit of each sector – *i.e.* the residual after setting the sector's capital expenditure against its savings – which is what it is presumed to have lent to, or borrowed from, other sectors. Ideally, within such a framework it should be possible to decide on appropriate measures to influence the flows of funds between sectors and their effects on real expenditures. Considerable progress has in fact been made towards using the statistics, in a rough and ready way, for these purposes. The estimates of the financial surpluses and deficits themselves cannot provide any independent check on the national income estimates and forecasts, since they are derived from them; but the process of completing the sector financing tables can often provide 'plausibility checks' by bringing to light relationships between financial and real magnitudes which are implied in the national income forecasts but look unlikely in relation to past experience (*e.g.* between company profits and fixed investment). More directly related to the conduct

of monetary policy is the assessment of the outlook for the flows of funds between sectors. Attempts are made to forecast these flows in the light of past experience, and in particular to assess the sources from which the public sector will derive whatever it will need to borrow – or to which it may be able to repay debt.

In this field, however, although we have come a long way since 1959, it is perhaps more striking how far we have still to go. The figures go back only a very small distance: annual data (with a high degree of estimation) to 1952, quarterly data only to 1963. There are many difficulties in deriving sector figures accurately from the available statistics. There are serious conceptual problems in seasonally adjusting these financial figures, so that it is only within the last year or two that it has been possible to make a sensible attempt to do so: and we are still far from satisfied with the results. Moreover, many of the relationships are likely to vary cyclically, so that in effect four or five years' figures may provide only one set of parameters.

There is considerable delay in collecting the figures: it takes at present up to four months after the end of a quarter to assemble a set of financing accounts for that quarter. But perhaps the most important barrier to intelligent use of the financial statistics lies in the large residual errors. One of the main advantages of the technique is supposed to be that it goes beyond the statistics of financial institutions as such and displays what is happening in the company and personal sectors. Yet it is just in these two sectors that the largest residual discrepancies appear. Thus on average over the four years to 1968 over £500 million a year of net lending or spending by companies remains unexplained and over £600 million a year of net borrowing or receipts by persons is similarly unaccounted for. Discrepancies of this order naturally weaken confidence in the estimates as a whole.

Of course, the errors indicated by these discrepancies may derive at least partly from the national income and expenditure accounts. But there are certain known gaps in the sector financing accounts, outstanding among which are the lack of any adequate figures of trade credit and the lack of any regular reports by companies of their transactions in financial assets/liabilities. Attempts are being made to close these gaps, which are no doubt responsible for swelling the residual discrepancies. Meanwhile, it is useful to have constantly in view a measure of the mismatch of the two sets of data.

Whatever the shortcomings of the data, however, a position has certainly been reached where much useful analysis can be undertaken with a view to determining some of the important relationships – both between financial and real variables and within the financial framework itself. We are stepping up very sharply work of this kind in the Bank and the Treasury; and we hope to learn from work done outside – for example, from the studies on the company sector at present being done at Stirling University. Indeed, we have deliberately extended this section of this paper in the hope of stimulating interest in the academic world in work in conjunction with the authorities on areas important for policy-making.

Even if it could be compiled with reliable estimates in

there are 1/6

every box, however, the complete flow-of-funds matrix is not a handy means of communicating running comment on the latest developments, nor therefore a convenient aid to short-term policy reviews. There is a parallel need for prompt and frequent indicators as to how the underlying position is developing. Interest rates and such magnitudes as the government deficit, the level of bank advances, the sale of gilts – and of course the transactions of the Exchange Equalisation Account – have long been watched. More recently, however, an aggregate comprising broadly the growth of the domestic money supply plus or minus any external deficit or surplus and styled "domestic credit expansion" (D.C.E.) which is available relatively quickly has come into use as a helpful additional indicator.¹

Much work remains to be done on the nature of any causal inter-relationships between D.C.E. and the important real magnitudes; but there is some indication from work already carried out of some statistically significant associations, and charts comparing the movements of D.C.E. and some expenditure series have been published in the Bank's *Quarterly Bulletin*. The stress at present laid on D.C.E. is as a prompt, shorthand supplement to, rather than a replacement of, the regular 'real' and financial forecasts for the economy. Moreover, fully to interpret and draw policy significance from movements in D.C.E. it is necessary to disaggregate it and analyse developments in its constituent parts. For this, of course, the sector financing accounts are useful.

II Policy developments over the last ten years

As has already been emphasised, the official approach to policy has over the whole period laid stress on influencing the cost or availability of credit flows to the various sectors of the economy.

Developments over the last ten years in the means of giving effect to credit policy were a continuation of a process already under way before the Radcliffe Enquiry. Credit controls have gradually become more specific and direct, in that the forms of credit to which restrictions are applied, the priorities to be observed and the exemptions to be allowed have been defined in more detail (though the authorities continue to have a strong aversion to making the banks' individual decisions for them). Moreover, various forms of control have been applied to a widening range of banks and other financial institutions have been covered.

Certain areas have been subject to quite specific control by the authorities. Thus credit extended through finance houses for the purchase of cars or consumer durables has been affected by variations in the regulations concerning down-payments and the terms of repayment. Hire purchase controls were used quite actively in the 1950s and despite the Radcliffe Report's verdict that they were suitable for use only for short periods at times of emergency, they have been employed for quite long periods and the terms have been changed thirteen times since 1959. Controls were reimposed in April 1960, and were tightened progressively in June 1965, February 1966 and July 1966. Following relaxations in 1967, the controls were tightened at the time of devaluation and again in November 1968, when they reached the same level

¹ For the detailed composition of D.C.E. see articles in *Economic Trends*, May 1969 and *Bank of England Quarterly Bulletin*, September 1969.

as at July 1966. There has, however, been persistent criticism of this particular weapon both because of its high specificity of effect – though this can also be seen as one of its principal advantages – and also because of a steady increase in avoidance. Official recognition of the problems of controls in this area was underlined by the appointment of the Crowther Committee (see page 527, 458).

Private housebuilding is another sector which has been subject to quite specific effects from monetary policy, not because of any direct official controls over the flow of credit through the financial intermediaries concerned, but as a result of changes in the general level of interest rates brought about by the authorities. The institutional fact that building society rates are sticky and respond to movements in general rates only partially and with a lag means that raising the general level of interest rates usually produces a marked reduction in the supply of funds available for house purchase, which in turn influences the rate of housebuilding.

Apart from these two specific areas, the authorities have concentrated their efforts in monetary policy largely on influencing lending by the banking system; but they have not attempted to achieve this by acting to reduce the cash base of the system. The authorities are always prepared to deal in Treasury bills and gilt-edged stocks at a price, because they attach importance to the maintenance of an effective market in these instruments. So any holder of such government debt – and indeed of other types of government debt such as national savings – can always switch into or out of cash at will; should the debt instrument be near to maturity, at little cost. To achieve influence over the banks' lending by means of pressure on their cash must involve conscious manipulation of interest rates primarily to that end. But in the short run at least, the market's reaction to interest changes can be perverse in the sense that the public will sell as rates rise – expecting worse to come – and is generally unpredictable. The authorities' stance has generally been to decide on an interest rate policy broadly appropriate to the general aims of economic policy at the time rather than using it to enforce a particular level of cash reserves irrespective of the wider effects of such a policy.

Broadly similar considerations govern action on the liquidity ratios of the clearing banks and Scottish banks, but it has nevertheless been possible to exert some leverage by this means. This pressure has been, on occasions, reinforced by the use of the Special Deposits scheme. Although the first impact of a call for Special Deposits is on the banks' cash position, their normal and expected reaction is to encash enough of their liquid assets to make the payment, so that the impact is immediately transmitted to their liquidity position. Use of the Special Deposits scheme can also cause interest rate variations – if, for example, the banks are induced to sell gilts – which are not entirely to the liking of the authorities, but at least such a response is more calculable and subject to the influence of the authorities. The scheme, which at the time of the Radcliffe Report had been worked out but not used, was first employed in April 1960. Except for a period of about two and a half years between 1962 and 1965, some calls on the clearing banks

and Scottish banks have been outstanding even since.

One of the authorities' problems has been that monetary restraint has frequently seemed necessary at times when it would have been difficult to sell large quantities of government debt to the public at any reasonable price. So at such times the banks often obtained additional liquid assets. Moreover in the earlier years of this decade, largely as a consequence of war-time finance, they were still holding very large quantities of liquid assets and short-dated gilts.

One solution to problems of this kind might have been to require the banks to keep their total lending to the private sector within a specified ratio to their deposits (as proposed in paragraph 527 of the Radcliffe Report). A 'private sector lending ratio' may indeed appear to have substantial advantages over a liquidity ratio, because it would be simpler in appearance and because it might be thought to be more certain in its effect. There are several reasons why the device has not been adopted. First, there are, of course, seasonal variations in lending to the private sector, so that the prescribed ratio would either have to look forward to the next seasonal peak – and so look too relaxed for the intervening months – or be varied frequently in an attempt to follow the seasonal pattern. In either case it would be difficult to give the changes any clear and decisive impact. And there would be no safety-valve (such as is provided with a liquidity ratio by sales of gilt-edged). This looks at first sight like an advantage; but the practical result would probably be that the banks would fail to maintain the prescribed lending ratio, because they do not have 'instant' control over their advances and deposits. There are obvious embarrassments in prescribing a minimum ratio between quantities that are liable to large random fluctuations.

In recent years the situation has improved in one respect: the proportion of government debt in the banks' total assets has considerably declined during the past decade leaving the banks less scope for cushioning the impact of restraint by switching their lending from the public to the private sector. The problems of controlling both the credit base and monetary liquidity more generally, on the other hand, have not become significantly easier. The major difficulty is that circumstances which call for the dampening of economic activity tend to be unfavourable to government financing in non-liquid form particularly through sales of gilt-edged. Obviously the task may become more difficult at times when the central government needs to raise large amounts of new finance as it did, for example, during the bulge in public sector capital investment programmes in the middle 1960s. But even with the central government in overall surplus as at present, the position of the authorities remains vulnerable because of the constant need to refinance maturing debt.

With gilt-edged maturities currently at a rate of around £1,500 million a year, a primary official objective must continue to be that described in the Bank of England *Bulletin* in June 1966, that is to maintain market conditions that will maximise, both now and in the future, the desire of investors to hold British government debt. This long-term objective obviously affects the authorities' choice of tactics in a particular short-run situation. Because the market

response to a moderate price change for gilt-edged has been found to be unstable and often perverse in the short term, the movement of interest rates required to achieve adequate liquidity absorption through debt operations may be so large that a rapid or seemingly arbitrary adjustment could permanently damage the willingness of investors to hold gilt-edged, compounding the difficulties of monetary management in the future. What can be achieved at any given time is essentially a matter of judgment of the state of market expectations and of the effects upon them of alternative courses of action, both in the long and the short run, and both within and outside the gilt-edged field. This means that there can be no simple code of conduct for debt management but that each situation must be assessed in the light of the complex of circumstances then prevailing and the current aims of policy, including the need to preserve the attractiveness of the market in the longer term.

In some cases official judgment has favoured moderating considerably any movements of interest rates; in other situations, however, where the market was tending to move in a manner considered to be an appropriate adjustment to current conditions, official intervention has been on a very limited scale, allowing market forces to be much more fully reflected in prices. In the last years of the period, as greater weight has been placed on monetary policy, there has been a greater flexibility in policy on interest rates and a greater willingness to allow upward pressures on rates in the market to take effect; and this has given more scope for flexible tactics in debt management.

To allow the authorities to adapt their tactics to market conditions more readily, two changes of technique have recently been introduced in official dealings in the gilt-edged market. In July of this year it was made known that the authorities would no longer announce the price at which they were prepared to sell tap stocks, but would instead consider bids made by the market. Some two months earlier it was announced that the official buying price for stocks within three months of maturity would for the time being not be tied to the Treasury bill rate, but that the Government Broker remained ready to receive offers of such stock.

In practice during the past ten years the level of interest rates has fluctuated considerably, and there is little evidence that a more active approach would have been more effective. For example, even with yields at the historically high levels of the recent past, it was not at all clear that official sales of stock would have been increased in the short term by lowering prices still further, and the long-term effects of such tactics would certainly have been harmful. In short, official operations in gilt-edged continue to be constrained both by the underlying market situation and by long-term concern for the maintenance of a broad market.

For much of the ten-year period the circumstances required more severe restraint on credit than could be achieved by acting on liquidity and ratios. It was therefore necessary to have recourse to direct forms of control – the imposition of lending ceilings. Direct requests to the deposit banks to restrict the level of their advances had been made at times in the 1950s. A similar request was made in July 1961, in

association with a call for Special Deposits. However, it was no longer possible, on grounds of either equity or efficiency, to restrict ceilings to deposit banks alone, and on this occasion the request was addressed to all groups of banks and to a wide range of financial institutions. The terms of the request were fairly general (" . . . that the recent rate of increase in advances should be greatly reduced"). Lending ceilings were reimposed in 1965 when all banks and hire purchase finance houses were asked to restrict their lending to an annual rate of increase of 5% in the twelve months to March 1966. Specific ceilings of this general kind have been in force for most of the time since then. The quantitative ceilings have been accompanied by qualitative guidance – again, not a new development – on the direction of lending. This guidance has always accorded priority to export finance.

The increased importance of banks other than the deposit banks has made it appropriate to devise a form of control over their lending, analogous to Special Deposits, for use when moderate, rather than severe, restraint is necessary. Because of the wide diversity in the balance sheet structures of the accepting houses, overseas banks, etc. it would have been difficult to devise a mechanism which, like Special Deposits, worked simply by its effect on the banks' liquidity. The Cash Deposits scheme was therefore designed so that it could be made to impinge, if necessary, on the banks' earnings as well as on their liquidity. It provides for the banks to make cash deposits with the Bank of England calculated as a percentage of certain of their deposit liabilities in sterling (together with foreign currency deposits to the extent that they have been switched into sterling). The Bank would normally treat all participating banks alike and would pay a market rate of interest, linked to the Treasury bill rate, on all Cash Deposits. But they reserve a right in exceptional cases to treat banks individually; and also to pay a lower rate of interest than the Treasury bill rate. These penalty aspects of the scheme would not necessarily be invoked; their mere existence should help to reinforce any official guidance to the banks on their lending. However, this scheme has not yet been used because it has continued to be necessary to exercise tighter control through ceilings.

Problems have also arisen of influencing lending by other financial institutions, particularly finance houses. As has been pointed out above, hire purchase terms control, imposed by the Board of Trade, gives some measure of control over parts of the credit. But terms control applies to only certain goods and certain forms of lending and in any case has been subject to increasing avoidance. Direct requests by the Bank of England for the observance of ceilings over lending were therefore extended beyond the banking sector to include the members of the Finance Houses Association and larger non-members in 1965. At present they are being asked to bring their lending down to 98% of its level at end-October 1967. Within this ceiling, the finance houses have been asked not to grant personal loans for the purchase of goods subject to terms control on easier terms than would apply to a hire purchase agreement.

As with the banks, the Bank rely on the voluntary co-operation of the finance houses for the implementation of

ceiling control. Again as with the banks, there are obvious objections to ceiling control as a method of restricting credit – such as arbitrary choice of a base date, and curtailment of competition between controlled institutions. There is also the inescapable problem of the borderline (which has to be drawn somewhere) between institutions to which requests for credit restriction are directed and those to which they are not. But although check-traders, small finance houses and other institutions are not at present covered by ceiling controls, the Bank find that limiting their requests to members of the F.H.A. and to larger non-members covers the bulk of finance house lending, while avoiding the complexities that any significant extension of the present coverage would involve. It is also true that institutions not receiving the Bank's requests do not generally finance themselves to any significant extent by taking deposits or borrowing on the capital market, but have to rely on sources of finance already controlled. As noted above, the authorities are aware of the shortcomings of ceiling control for finance houses, and have been considering alternative methods of control for some time. The views of the Crowther Committee on Consumer Credit are expected to be received during 1970.

The Bank send copies of the notices or letters issued to the banks and finance houses on credit restraint to the British Insurance Association, the National Association of Pension Funds, the Building Societies Association, and to institutions such as Industrial and Commercial Finance Corporation and Finance Corporation for Industry. These institutions are asked to bear the Bank's objectives closely in mind, but are not asked to keep to ceilings on their lending.

III The effects of monetary policy

Preceding sections of this paper have attempted to describe briefly the changes in the context in which monetary policy has been operating over the past ten years and developments in the tactics and methods employed. It is reasonable to ask in conclusion what the result has been. What can monetary policy be said to have achieved? In fact, it is very difficult to answer such questions. Even the wider question of the effects of economic policy, comprising fiscal, monetary, incomes, industrial, regional and external policies, cannot be given a simple answer, for these, too, are inseparable from social and foreign policies. In one sense, economic policy may be said quite simply to have failed, in that none of the major economic problems facing the United Kingdom in 1959 can be said to have been solved and some of the most important of them have become more severe. But the explanation cannot be sought wholly in economic events and policies, still less in the narrower range of monetary policies. It would be necessary to analyse and relate the various objectives, not all of them economic and many of them conflicting, which the authorities were aiming to achieve at various times throughout the period. Such a discussion would lead far beyond the bounds of this paper.

When one attempts to measure and distinguish the effects of monetary and other policies the difficulties are even greater. Almost invariably moves in the monetary field have been taken in conjunction with fiscal measures (packages).

Moreover, the rôle of expectations is, in the authorities' view, much greater than is normally assumed in academic and journalistic comment. Changes in the climate of expectations – whether brought about by events outside the United Kingdom, by events within the country but outside the control of the policy-makers, or by the timing and manner of the announcement and implementation of policy measures – can often act either to negate or greatly to reinforce the tactics of the authorities. This is particularly important in relation to sales of government stock, but has much wider application. The winter of 1966/67 provides a striking example. All the indications were that there would be extreme financial stringency at this time when the first impact of selective employment tax (the once-for-all 'forced loan' to H.M. Government) on companies was being felt. In fact, as a result of the package of measures taken in July 1966, augmented by the radical change in expectations that this engendered, there was a marked weakening of demand and financial supply constraints were barely felt.

Certain effects of monetary policy can, however, be fairly clearly demonstrated. A substantial tightening or easing of terms control can be seen to be followed by marked changes in spending on the goods involved. Probably the most striking example of this occurred in 1966. Consumers' expenditure on durable goods fell from £492 million⁷ in the second quarter of 1966 to £429 million in the third quarter and £405 million in the fourth quarter. This change in terms was, however, part of the package of measures announced in July, which included higher purchase tax and an increase in Bank rate; the fall in spending cannot be attributed solely to a change in hire purchase terms. Similarly, private house-building has on occasions been severely affected by variations in the available flow of mortgage finance, as occurred, for example, during the mortgage 'famine' in 1965, when lending by the societies was sharply reduced, and the number of houses started for private owners fell from 64,000 in the last quarter of 1964 to 48,000 a year later. On business investment, despite the enormous amount of work that has been done, the evidence remains inconclusive as to the effects of either the cost or the availability of funds, though there is perhaps some support for the *a priori* expectation that investment would be affected. What does seem clear, however, is that the timing of any effect is very uncertain and that the lags as well as being variable tend to be rather long. On consumption, the evidence remains even more sketchy. However, there seem grounds for believing that really tight control of bank lending can, both directly and through its indirect effects on stock market values, exert some effect on consumers' expenditure.

Much will depend on the concurrent severity of fiscal and incomes policy. Following a fiscal year (1968/69) in which the central government was able to make net repayments of debt for the first time for a number of years, it is expected that in 1969/70 the central government surplus will more than offset the borrowing requirements of the local authorities and public corporations, enabling the public sector as a whole to repay debt for the first time certainly since the statistical series began in 1952 and almost certainly since

⁷ At 1963 prices, seasonally adjusted.

before the War. These surpluses and the current ceilings on credit together form much the most severe monetary restraint that has been imposed for a long time.

In general, it remains the authorities' belief that fiscal and monetary policy work – and must work – jointly. Without monetary restraint, fiscal restraint will either be largely ineffective or – if it is made effective in a conjunctural sense – is likely to have damaging longer-run effects on incentives or the provision of public services. Likewise with a large public sector deficit, monetary restraint to be effective at all will have to be so severe as to risk drastic and unpredictable consequences for the whole financial system. The lesson is perhaps not to expect too much of any one arm of economic policy, especially for 'fine tuning'. As we learn more we should be able to refine our techniques and predict better their effects; but, at least in the present state of our knowledge, it looks unlikely that we shall ever be able to rely primarily on monetary policy for short-term stabilisation of the economy and the balance of payments.