The sad history of the Exchange Rate Mechanism

In interviews about Nigel Lawson I have discovered a lot of journalist uncertainties about shadowing the DM and seeking to join the Exchange Rate Mechanism. Let me tell you more of what I know, based on the advice I gave Margaret as her Economic Adviser /Head of Policy Unit in the middle period, and as an informal adviser in the later years.

I argued that ERM membership would be destabilising. When the pound was rising money would be created to sell pounds, swelling sterling money and credit. This would prove inflationary. When the pound wanted to go down the Bank would buy up pounds. This would be contractionary. I wanted the government to stick with the Medium Term Financial strategy Nigel Lawson had helped to create. Margaret agreed and thought her new Chancellor accepted the position.She made her view clear.

It later became apparent to me that despite the MTFS in place, despite the PM's wishes, and despite the absence of any formal statement to Parliament of a change of economic policy control the Treasury and Bank were shadowing the DM. Interest rate moves seemed to be related to maintaining the exchange rate. I appreciated this was an inconvenient view for the PM but she came to believe it. One day when I was with her in the study she turned on the news only to hear the BBC claim a policy shift based on DM fluctuations. In later years Treasury pressure to join the ERM worsened the relationship with Number 10 more.

It was a sadness that a good reforming Chancellor who worked well with a reforming PM and her advisers on tax cuts and privatisation got into a fight over using the DM exchange rate as the economic control. In the later Thatcher years following the DM led to excessive money and credit creation and to inflation. The Treasury who never much liked tax cuts tried to blame them for the inflation. In the 1980 s the Treasury and Bank worked closely together and Ministers were involved in interest rate and money policy.

The ERM led to the economic problems of the early 1990s, undermined the Conservative reputation for economic competence and was the reason for the defeat in 1997. The irony was this bad economic policy was supported by the other main parties, the CBI and TUC.

Dear Colleague on Water

Please find below the Dear Colleague letter that I have received from the Government

Dear Colleagues,

Our Integrated Plan for Delivering Clean and Plentiful Water

I’m pleased to announce that the government has today published a Plan for Water.

Link can be found here – https://www.gov.uk/government/publications/plan-for-water-ourintegrated-plan-for-delivering-clean-and-plentiful-water/plan-for-water-our-integrated-plan[1]for-delivering-clean-and-plentiful-water.

I completely understand the concerns that you and your constituents have about the health and resilience of our rivers, lakes and seas, and the pressures they face, which is why I am setting out this plan for a truly national effort to protect and improve them. Here in the UK, we look after globally significant wetlands, 85% of the world’s rare chalk streams, and world-famous coastlines, lakes, and rivers. These waters are a focal point of local communities and an important part of our national heritage. More than ever, people expect access to clean and plentiful water. Yet our complex, interconnected water system is under greater pressure than ever before from population growth to climate change. Through investment and regulation, we have seen improvements in recent years.

We have cleaner bathing waters – 93% are ‘good’ or ‘excellent’, up from 76% in 2010. Since privatisation, leakage has reduced by a third and we are five times less likely to suffer supply interruptions. We were the first government to start comprehensively monitoring storm overflows – from 10% in 2015 to 100% by the end of this year, and to introduce new targets on water companies to increase investment and tighten legal permits on storm overflows. In January 2023 we set out our goals and targets with the Environmental Improvement Plan. We are now delivering an Integrated Plan for Water which brings together the significant action already taken, along with more investment, stronger regulation and tougher enforcement on those who pollute.

The Plan covers both the water environment – how clean it is – and water resources – how much of it we have. We need to look at both things together. It addresses every source of pollution, including from storm overflows, agriculture, plastics, road run-off, chemicals and pesticides – as well as the pressures on our water resources as a result of hotter, drier summers and population growth. The Plan outlines our actions across three areas. Firstly, we will transform management of the whole water system in a joined-up way.

We will deliver new long-term catchment action plans, backed up by new funding, to improve all water bodies in England. Water companies will speed up their infrastructure upgrades – bringing forward around £1.6 billion for work to start between now and 2025 to reduce sewage discharges, nutrient pollution and increase water resilience. This includes creating a new Water Restoration Fund, using money from water company fines and penalties to support local groups and projects like re-meandering rivers and restoring habitats, as well as increasing the scope and maximum penalty amount that the

Environment Agency can issue against water companies for damaging the environment.

Our actions will secondly deliver a clean water environment for nature and people, by addressing each of the multiple pressures and sources of pollution on our water bodies. This includes a ban, subject to consultation, on the sale of wet wipes containing plastic, developing new proposals to restrict the use of ‘forever’ chemicals (PFAS), and more than doubling the money for slurry grant infrastructure for farmers to £34 million.

Finally, the plan sets out actions to secure a plentiful supply of water, in order to meet our long-term water needs for people, businesses, and the environment and close the 4 billion litres of water a day supply-demand gap we will experience by 2050 otherwise. This includes streamlining the planning process so that key water supply infrastructure – such as reservoirs and water transfer schemes – can be built more quickly, and securing new investment by water companies to spend on new water infrastructure in the next two years, including to increase our water resilience. The attached Annex includes further details on our new policies. If you would like to discuss, please do not hesitate to contact me.

Your sincerely

[We mourn the loss of a great man, Nigel Lawson]

I mourn the passing of Nigel Lawson. He gave great service and lifted the UK economy after the bruising experiences of the 1970 s. He showed that lower tax rates, more competition and nationalised industry reform boosts living standards and opportunities for the many.

In 1983 I was appointed Head of Margaret Thatcher’s Policy Unit. I pressed successfully to merge the Economic Adviser to the PM job in with being Head of the Policy Unit. Alan Walters had departed leaving a vacancy for Economic Adviser. As I advised that the main policy task was making sweeping changes to the UK’s wider economic policy and performance it would be good to unite these roles. It was also necessary in my view to change the way the Economic Adviser role was performed. Alan had allowed or encouraged himself to be part of the public story. He got himself involved in the crucial relationship of PM to Chancellor in a way which made it difficult for the Chancellor. Stories of public splits were not helpful to either principal.

I was positive about Nigel’s appointment as Chancellor. I liked the work he had done as Financial Secretary to the Treasury to establish a new economic policy framework. Control of state borrowing allied to money and credit restraint would provide the best backdrop for low inflation and growth. I thought he would be a tax cutter, as big reductions in personal and business income taxes were essential to end Labour's brain drain sucking talent and investment out of the country. Privatisation and wider ownership were critical to economic progress. Nigel as Energy Secretary seemed sympathetic to such moves, which would help pay for the programme whilst curbing the deficit.

I explained to a nervous Treasury I would give my views only to the PM. In order to be involved in budget planning I agreed to all those papers being excluded from general Policy Unit consideration. Budget secrecy was taken very seriously then. I was delighted with the big reductions in tax rates, which as I hoped brought in more revenue not less. Margaret and Nigel liked the proposals on privatisation, where I recommended John Moore as a Treasury Minister to drive a government wide programme of reforms, sales and wider ownership. Inflation came down and growth improved.

It then became apparent to me that the Chancellor had changed his mind about his Medium Term Financial strategy and had moved to a personal belief that the UK should join the European Exchange Rate Mechanism instead. I warned the PM in private why this would be a harmful and destabilising course. She did not want to believe Nigel would do that, but eventually accepted the evidence. It was such a pity, as their joint enthusiasm for lower taxes, more growth and wider ownership was so successful. The move away from a UK domestic financial discipline to trying to harness to German discipline by proxy spoilt their later partnership in office. Ultimately through John Major's insistence on joining it led to another boom bust and the large Conservative defeat of 1997. The period of shadowing the DM as the main policy guide had itself given the UK an inflationary boom, as it led directly to creating more money to try to keep the exchange rate down. Meanwhile the German cornerstone of the ERM was based on a low inflationary Germany using domestic money targets to keep their own prices down.

Nigel Lawson went on to make a further important contribution to modern politics through the Global Warming Foundation. He sought to spell out the economic realities and challenges on the road to net zero to remind us that the policy comes with a price tag that needs to be affordable and fitted into a cogent economic policy framework.

Today's Treasury could learn a lot from Nigel's success with big tax rate reductions, incentives for more self employment and small business and transformational policies to major industries. He will be long remembered for his big contribution to UK economic and industrial policy.

Removing blockages to growth

The government says it wants to promote growth. Growth is one of the Prime Minister's five aims. The latest budget confirming high tax rises on business will not help pursue this aim. I will write a series of pieces over the weeks ahead containing proposals for regulatory and tax change that could assist growth.

The car industry is under pressure from the wish of the government to ban the sales of new diesel and petrol cars from 2030. This is a bad idea which will mean premature closure of petrol and diesel car and van making facilities here, with more car companies taking their investment into diesel, petrol and hybrid elsewhere where there is no such time limit on the sales of the products. This ban should be lifted.

The government thinks an early ban will deliver more investment in all electric vehicles. This is proving difficult to land, with the car industry wanting to see established battery making lines here first whilst those considering battery investment want orders from car companies to make their big investment worthwhile.

They all need more evidence of the wish of many consumers to trade in old diesels and petrol vehicles for all battery models. I continue to meet many people who think the current electric cars have too short a range, are difficult to recharge and too expensive. Our generating and grid capacity is not up to most of us switching to electric vehicles.

The government needs to work with the industry to see what improvements can be made in the electric offerings to make them more attractive to more people. They need a more realistic timetable for expanding the grid and reliable power generation to service more electric cars. A 2030 ban is a very bad idea.

My supplementary question on the Powering Up Britain debate

John Redwood (Wokingham) (Con)
Who will pay for CCS as it does not generate any direct revenue from retail customers?

Graham Stuart (Minister of State for Energy Security and Net Zero)
To decarbonise industry, we will need CCS and hydrogen. We are socialising the funding requirements across the piece to ensure that we deliver what is necessary to meet our carbon targets, at the lowest possible cost to consumers. This year we are also consulting on measures to prevent carbon leakage, ensure that we do not drive UK industry abroad, which I know my right hon. Friend is concerned about, and instead maintain our competitiveness as we move towards net zero.