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Competition and Credit Control, 1971–73

We little knew that Ted Heath would lose his head and bolt for wildly exorbitant expansion just after C and CC started.

‘A former top Bank of England man’.¹

Introduction

After four months of consultation within Whitehall and the City, Competition and Credit Control (CCC) became fully operational in September 1971.² Credit rationing by cost replaced rationing by control. Quantitative ceilings were removed after several years of often-painful operation, special deposits were repaid, and the decades-old banking cartels were dissolved.³ What followed was one of the most intense periods of monetary chaos in recent British history. By the time the policy was de facto abandoned in December 1973, the broad money supply had grown by 72 per cent. Britain’s highest-ever inflation, and the worst banking crisis since the nineteenth century, followed hard on the heels of CCC, and despite its adroit handling of the ‘Lifeboat’ operation to rescue the stricken secondary banks, the Bank’s reputation suffered a serious blow.⁴ Failure to control the money supply under CCC would shape the Bank’s attitude to monetary policy for years to come.

CCC was predicated upon the Bank’s belief that it could forecast M₃ growth using its demand for money equations, and control it with more frequent use of the interest rate weapon and special deposits. Given the embarrassment of missing bank lending ceilings, and the political and technical difficulties associated with published Domestic Credit Expansion (DCE) limits, the authorities did not announce their M₃ objectives. This has led a number of commentators to presume that unpublished targets did not arrive until 1973 with the limits on deposit
liabilities (the ‘corset’) that heralded the end of CCC. Capie goes further, writing that ‘a story has developed that there were unpublished monetary targets in use as early as 1973. This is not something that is in evidence in the documents’. Yet, as John Fforde admitted in March 1973, M3 had long since been the ‘one new simple aim’ of monetary policy.

Capie also suggests that Bank officials were unfamiliar with Thomas Saving’s 1967 lexicon of monetary instruments, indicators, and targets. Certainly, officials referred to M3 as a target, an indicator and an objective at different times between 1971 and 1973. But, as Benjamin Friedman shows, central bankers everywhere were still feeling their way with the new terminology in the early 1970s. This lack of precision was unsurprising, given that the academic high priests of monetarism could themselves rarely agree on clear-cut definitions. The critical question is not whether M3 conformed to one particular monetarist’s definition of a target. What matters is how committed the authorities were to achieving the M3 numbers produced by the Bank’s demand for money equations. Specifically, what were the normative connotations for the three main monetary policy instruments: Bank Rate, bank reserves, and gilt sales to the non-bank private-sector.

This chapter shows the Bank and Treasury framing monetary policy advice to ministers in terms of unpublished M3 targets between 1971 and 1973. Their advice was rarely acted upon because Conservative ministers had not undergone the same intellectual journey as their officials in the period after devaluation. Moreover, because Fforde had sold the new approach to the Conservatives on its supposed competitive merits, it is likely that Ted Heath never fully understood that CCC was primarily about controlling the money supply by varying interest rates. The result was a money supply explosion.

The forecasts

After launching CCC in September 1971, the next practical consideration was the construction of the autumn financial forecasts. Previously, the Bank had framed a set of interest rate assumptions which were incorporated into both the financial forecasts and the thrice-yearly National Income Forecasts. In January 1972, Treasury economist Frank Cassell explained the implications of the increased emphasis on the money supply to the Chancellor:

The financial forecasts were constructed so as to explore the implications of following a particular growth target for money supply; and it