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12A110/3

A MEETING OF DIRECTORS AT THE BANK

THURSDAY 3 JUNE 1993

Present

Brian Quinn, Esq
Andrew Duncan Crockett, Esq

Ian Plenderleith, Esq

In the absence of the Governor and the Deputy Governor, Mr Quinn was appointed Chairman pursuant to the provisions of Clause 6(2) of the Charter of 1 March 1946.

The number of Directors assembled being insufficient to form a quorum, those present proceeded to the business, subject to ratification by the next Court.

The Minutes of the last Court, having been circulated, were approved.

There being no comments on the weekly figures, Mr Plenderleith spoke about the foreign exchanges, including the Official Reserves figures for May, and the state of the domestic markets.

G. A. Croughton. Secretary.

E. A. J. George
10th June 1993

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A COURT OF DIRECTORS AT THE BANK

THURSDAY 10 JUNE 1993

Present

The Rt Hon Robert Leigh-Pemberton, Governor
Edward Alan John George, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Anthony Laurie Coleby, Esq
Sir Colin Ross Corness
Andrew Duncan Crockett, Esq
Sir Christopher Anthony Hogg
Sir Martin Wakefield Jacomb
Sir John Chippendale Lindley Keswick
Mervyn Allister King, Esq
Gavin Harry Laird, Esq, CBE
Sir David Bryan Lees
Brian Quinn, Esq
Professor Sir Roland Smith
Sir Colin Grieve Southgate

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq

The Minutes of the Court of 27 May were confirmed and those of the Meeting of 3 June, having been circulated, were approved.

Details of the weekly figures and graphs relating to the state of the foreign exchanges and the domestic markets were laid before Court.

Under the weekly executive report and with reference to the Minutes of 19 March and 26 November 1992 Mr Quinn reminded Court that following the earlier discussion about the supervisory issues in Gibraltar arising from the implementation of the Second Banking Co-ordination Directive, Court had

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advised the Bank to avoid being placed in a position of responsibility without having the necessary powers. HM Government subsequently had agreed to adopt the "colonial option" whereby supervision in Gibraltar would be conducted in accordance with UK standards; the Bank would advise on the appointment of the Financial Services Commissioner; and provide technical assistance and expertise to carry out periodic audits. There would be a moratorium on the issue of licences until the implementation of a structure based on UK practice and evidence of adequate resources to carry out the supervision.

Discussions with the Government of Gibraltar had since been difficult on constitutional grounds. They had insisted that the Financial Services Commissioner be appointed by the Governor of Gibraltar; they could not agree to the moratorium on new licences nor to the standards of supervision being set without the prior agreement of the Governor of Gibraltar. A minute from the Foreign Secretary proposed to concede these requirements. The Bank was preparing to respond to the FCO reiterating the conditions for the Bank's involvement and making it clear that we would not be able to provide the technical assistance and support which we had originally offered if the proposals contained in the Foreign Secretary's minute were to go ahead as at present.

The Governor said that one of the main difficulties was that under EC legislation any new bank established in Gibraltar would automatically have access to Europe.

Court supported the Bank's proposed response.

At the Governor's invitation, Mr Harris introduced a paper setting out the Bank's proposed response to the pay claims submitted by the Bank of England Section of BIFU, to be effective from 1 July 1993. He explained that staff had been made aware earlier that year that the Bank would be bound by the public sector pay policy and the claims from the Union were

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consistent with that policy. However, there were other elements in the claims relating to accumulation of leave, buying out of coffee breaks and the extension of health checks, which the Executive were not intending to meet.

In response to Sir Colin Southgate's enquiry about the recruitment of graduates, Mr Harris said that there was strong competition to recruit good graduates and the proposed increase in recruitment salaries would enable the Bank to maintain its current position vis-a-vis analogues in the financial services sector. Sir Colin and Sir David Lees both agreed however that it was important for the Bank to recruit staff of the right calibre and that the salaries at recruitment level should be increased as necessary in order to achieve this. In response to a question about the recruitment of economists, Mr King said that the greater difficulty was in retaining them. The pressure point came later in their careers when they looked for greater responsibility and promotion prospects, an argument endorsed by Mr Crockett. The Deputy Governor said that this should be dealt with through flexible use of the pay scheme. Court agreed that Mr Harris should enter into negotiations with the Union on the basis he had outlined.

The Governor introduced two matters arising from the impending appointment of Mr George to the position of Governor and Mr Pennant-Rea to the position of Deputy Governor of the Bank:-

1. It was RESOLVED that in pursuance of Clause 3 of the Trust Deed of the Houblon-Norman Fund, Mr R L Pennant-Rea, in his capacity as Deputy Governor, be appointed to succeed Mr E A J George as a Trustee of the Fund with effect from 1 July 1993.

2. With effect from 1 July 1993, and pursuant to Section 375 of the Companies Act 1985, as amended and extended by the Companies Act 1989, and until otherwise resolved by the Court of Directors it was agreed that:-

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(i) MR R L PENNANT-REA shall become Chairman of Bank of England Nominees Ltd in place of MR E A J GEORGE. The Board will then consist of Mr Pennant-Rea (Chairman) and Mr Coleby.

MR R L PENNANT-REA, or failing him MR A L COLEBY, be authorised to act as representative of the Governor and Company of the Bank of England at any meeting of Bank of England Nominees Ltd.

(ii) MR R L PENNANT-REA shall become Chairman of BE Property Holdings Ltd in place of MR E A J GEORGE. The Board will then consist of Mr Pennant-Rea (Chairman), Mr Harris and Mr Rumins.

MR R L PENNANT-REA, or failing him, MR H C E HARRIS, or failing him, MR J S RUMINS be authorised to act as representative of the Governor and Company of the Bank of England at any meeting of BE Property Holdings Ltd.

Court also noted that consequent upon the retirement of Mr J P Charkham, Mr H C E Harris, who was already a Director of BE Museum Ltd, would take over as Chairman of the Board of that Company with effect from 1 July 1993.

At the Governor's invitation, and with the agreement of Members of Court, Mr Clark, the Head of the European Division, Mr Taylor, Chief Adviser in the European Division, and Mr Latter, Head of the Developing World Division, attended Court for the following discussion.

In introducing the paper 'Prospects for the ERM' Mr Crockett attributed the recent problems in the ERM to excessive hardening. This was bound to produce problems in circumstances where convergence had not been established. He pointed to UK re-entry as the key issue for discussion,

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mentioning the acquisition of external discipline, membership of EMU, and exchange rate stability, as the principal benefits; and a loss of monetary independence as the principal disadvantage from re-entry. The Governor remarked that the future of the ERM had been very much on participants' minds at the International Monetary Conference he had been attending in Stockholm in the past few days. A critical question would be what one should expect from the EMI in this regard.

Sir Christopher Hogg felt that the focus of the paper was unduly narrow, lacking as it did a positive statement of what the Bank actually intended to do - would the Bank prefer to rejoin sooner or later? He was particularly concerned that the problem of the lack of EC competitiveness against the rest of the world was not being faced up to. The proliferation of social legislation in the Community was hindering progress. There was a tremendous gap in perception between industrialists and politicians in this sphere. He agreed that it was helpful to have a monetary discipline, but among the faults in the system was perhaps its failure to deal with currency speculators with huge open positions. The dangers of competitive devaluation nevertheless meant that one had to have a stable exchange rate system of some kind. Mr Crockett suggested that a code of conduct on exchange rate behaviour might be helpful. The Deputy Governor wondered how competitive exchange rate behaviour should be assessed and questioned whether the exchange rate itself was an adequate criterion. It was hard to argue competitive devaluation if there was <u>domestic</u> stability.

Sir Martin Jacomb emphasised that the devaluation of sterling had not been a competitive devaluation; UK monetary policy had not been too lax. He thought that any measure to tax speculators' deposits was likely to be ineffective; the result would be to simply drive the deposits off-shore.

Sir Adrian Cadbury believed that asymmetry had been part of the problem and was not an essential feature of the System. He saw a need for better co-ordination of information sharing and

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action on realignment. The key requirement was that countries should be encouraged to adopt appropriate monetary policies, which would lead to convergence eventually, and would produce exchange rate stability along the way. The Deputy Governor agreed. Had it not been for the inheritance from Bretton Woods, co-operative international arrangements might well have been built around domestic price stability rather than exchange rate stability. It was not clear then why one should add an exchange rate adjustment.

Sir David Lees recalled that leaving the ERM had been a tremendous shock and had done considerable damage to confidence in industry. These problems would not be overcome quickly. The ERM had manifestly been a failure in encouraging convergence, from which we were still miles away. He doubted the ability of the mechanism to deliver convergence. Instead we should really be considering how the ECB would eventually achieve this. Looking ahead to Stage 2 and beyond, the Governor observed that it would be essential for Finance Ministers to back up the Governors in the EMI solidly eg by pursuing persistent policies. Without that, independent central banks would be in difficulty.

Mr King agreed that a strong ministerial commitment to independent central banks would be the key thing. Hardening had indeed undermined the System in recent years, but it was by no means clear what would follow. It was difficult to see what the ERM would look like in the future. Different countries had very different objectives and this implied tension within the System. For example it was unclear whether it would continue to offer a fixed peg as an alternative to domestic focus for monetary policy. It was accordingly very important for us to make our domestic policy framework operate well. The best form of discipline was self-discipline. The volatility of exchange rates seen in the recent past was in fact a result of the fixed rate system coming unstuck.

Mr Coleby pointed to an important "Catch 22" under a more flexibly managed system: discipline would only be there if

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exchange rate adjustment was some way "down the line". The Basle-Nyborg Agreement had endorsed this. Looking back, a contributory factor to the problems in the system had been failure to see the shock of German re-unification as a legitimate ground for re-alignment. He was nevertheless concerned about seeking to introduce greater flexibility, which cut across the earlier objective of importing an external monetary discipline. Experience taught that the ERM was hard to live with unless you don't need it.

Mr Crockett observed that common pursuit of price stability was not a sufficient condition for exchange rate stability. Even given convergence, it was still possible to find large fluctuations of real exchange rates; witness the experience of the large dollar fluctuations in the early 1980s. Exchange rates do not necessarily adjust smoothly of their own accord. A degree of international co-ordination is needed to reduce exchange rate fluctuations and for that reason a Europe-wide framework that delivered a useful degree of exchange stabilisation would be valuable for promoting trade and investment in the integrated European market. He saw UK re-entry and the re-establishment of exchange rate predictability as desirable in the long run. Mr Kent agreed. There was a danger that liberalisation of current and capital account transactions in the past decades would lead in due course to a resurgence of trade protection which would be highly damaging. The volume of currency assets washing around the globe was very large; accordingly stability of fundamentals does not guarantee stability of exchange rates themselves. As a noted home for multi-national enterprise, the UK would find it useful to have some predictability of exchange rates to set alongside the development of the single European market. The Deputy Governor pointed out that the question was not whether exchange rate stability was desirable; it was how far and by what means it was achievable. You could not achieve it simply by decree.

Sir Christopher Hogg said that he remained confused about what the Executive of the Bank thought it should be doing in this context. The Deputy Governor assured him that there was no

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doubt about this. In the foreseeable future, the likely divergencies between the major European economies were simply too great to permit thinking of UK entry until they came substantially down. In the meantime, we were intent on pursuing the convergence criteria in the Maastricht Treaty. There was no disagreement within the Bank on this. Asked by Sir Christopher Hogg whether this meant that the Bank was totally against rejoining an exchange rate regime, the Deputy Governor said that it depended whether one was talking of five months or five years ahead.

In introducing the paper "The Role of ECGD", Mr Crockett said that there were two views on this subject. On the one hand there was the view that long term export cover should be provided to support UK industry even if it was at a cost to the exchequer, while the contrary view was that there was nothing particular about this category of trade and that market forces should prevail. The Bank view probably tended towards the latter in being quite hard-headed while at the same time acknowledging that political pressures often dictated a contrary outturn.

Sir Martin Jacomb said that export support was critically important to the UK as our balance of trade was so bad. In focusing on the paper, Sir Martin challenged the statement suggesting that support for long term exports might drive up the exchange rate. He suggested that the two possible arguments against export support were that too much credit was inflationary and there was always the possibility of default. However, in his view the critical question was whether or not there should be any subsidy. Other countries provided such support for capital goods exports and the UK should do likewise to be competitive.

Sir Christopher Hogg said that the entire structure of such subsidies was deplorable and questioned whether it would be possible to reach an international agreement to wind them all down. Sir Roland Smith said that long term cover was simply

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not available through the insurance market and so it was necessary to go along with practice in other countries. He suggested that if support was not given by way of subsidy, Government would be paying out nevertheless by way of unemployment benefit etc. He queried the wisdom of having sold off ECGD's short term business to the Dutch company which he said was playing into the hands of our competitors.

Sir David Lees said he very much supported the views expressed by Sir Martin and Sir Roland. The ideal arrangement would be for a multilateral "disarmament" of subsidies but that was wholly unrealistic in practice. In his view we should provide support at least to the extent that other countries did. Sir David said that earlier that day he had been talking to the Director General of the CBI about the issues raised in this paper. The Director General had offered to provide a paper addressing these questions, an offer which the Governor said Court would welcome.

Sir Colin Southgate said that he had attended a conference the previous year which had focused on the question of export subsidy. From his memory a number of comparisons with Germany were worthy of repetition. The German capital goods industry had thrived and the government seemed to provide support for more exports than did the UK government and with a lower default rate. He suggested that it might be worth investigating how they managed this. He also recalled that the Germans seemed to be much better organised in tendering for major overseas projects, ensuring that there was only one eventual bidder who had the necessary export credit support already arranged. By contrast British consortia often appeared to be competing against themselves and were unsure of whether or not they would be able to secure export credit support. He too agreed that there was no likelihood of persuading other countries to withdraw export subsidies and so the UK should do likewise to be competitive.

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In accordance with Section 10 of the Charter, the Governor, the Deputy Governor and Messrs Quinn, Crockett, Coleby and King withdrew, together with Messrs Harris and Kent.

Sir Adrian Cadbury, in his capacity as Chairman of the Remuneration Committee, introduced a Recommendation of that Committee concerning the Governor's pension. After some discussion the Recommendation was approved.

G. A. Croughton.
Secretary.

E. A. J. George
24th June 1993

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A MEETING OF DIRECTORS AT THE BANK

THURSDAY 17 JUNE 1993

Present

The Rt Hon Robert Leigh-Pemberton, Governor
Anthony Laurie Coleby, Esq
Mervyn Allister King, Esq

Hugh Christopher Emlyn Harris, Esq

The number of Directors assembled being insufficient to form a quorum, those present proceeded to the business, subject to ratification by the next Court.

The Minutes of the last Court, having been circulated, were approved.

There being no comments on the weekly figures, Mr Coleby spoke about the foreign exchanges and the state of the domestic markets.

E.A.J. George
24th June 1993

G. A. Croughton
Secretary

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A COURT OF DIRECTORS AT THE BANK

THURSDAY 24 JUNE 1993

Present

The Rt Hon Robert Leigh-Pemberton, Governor
Edward Alan John George, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Anthony Laurie Coleby, Esq
Andrew Duncan Crockett, Esq
Sir John Chippendale Lindley Keswick
Mervyn Allister King, Esq
Sir David Bryan Lees
Sir Christopher Jeremy Morse, KCMG
Brian Quinn, Esq
Sir Colin Grieve Southgate

Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The Minutes of the Court of 10 June were confirmed and those of the previous week's Meeting, having been circulated, were approved.

Mr Quinn commented on the weekly figures and Mr Plenderleith spoke about the foreign exchanges and the state of the domestic markets.

Under the weekly executive report:-

1 Mr Kent said that the report of the Task Force would be published shortly. It would contain a number of recommendations the first of which was that by mid 1994 there should be rolling settlement based on trading day plus 10 days, and by early 1995 this should be reduced to trading day plus 5 days. However, this practice

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would not be mandatory particularly for the smaller investor. The introduction of the rolling settlement would be managed by the Stock Exchange, and would be conditional on solving some practical difficulties.

Looking further ahead it was proposed that the facility of "name on the register" would remain as at present but for members of the new settlement system transactions would be paperless, based on a book entry transfer system. This would mean inevitably that a quicker response would be required from registrars, which they had said they could deliver.

Small investors would be able to continue to keep share certificates and companies, ie the issuers of shares, would not need to take any action. The ability of companies to identify the ownership of their shares would be no worse than at present although it had been hoped that improvements could have been made in this area. This had not been possible so far but one possibility would be to reduce the level of compulsory disclosure from 3% to 2% or less. However this could lead to a constant reporting process. Referring to the payment arrangements for the settlement system, Mr Kent said that it would be based on the existing system for wholesale transactions in the London market with settlement through CHAPS banks.

Mr Kent said that the proposals for a new equity system would require secondary legislation under the Companies Act 1989. It was the intention that the Bank would take the lead in carrying the whole process forward to the next stage in establishing the requirements for the new system.
He had also consulted the CBI about the proposals of his Task Force and they were content. The Report of the Task Force would be published on 1 July and copies would be made available to Members on that day.

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In response to Sir Colin Southgate's concern about the reliability of registrars, Mr Kent said that they knew what was expected of them and had committed themselves in writing. Nevertheless he anticipated that it would be necessary to provide continuous encouragement to them to deliver. Sir Jeremy Morse enquired how the discussions and negotiations had gone. Mr Kent said they had not been easy as there were conflicting hopes and expectations from such a wide representation. Some of the small client brokers had looked for no change in the present practice while others in the securities industry, market making firms in particular, were keen that the rolling settlement should be brought in, and quickly.

Finally, the Governor extended his congratulations to Mr Kent and the members of his Task Force on their very commendable efforts in producing the Report on schedule.

2 The Deputy Governor drew attention to a letter from the Lord Mayor of London and the proposal that the City Corporation should establish a fund of £1 million specifically for information leading to arrests in connection with the Bishopsgate bombing. The Bank had reservations about the original proposals on a number of counts: the basic principle of paying informants, about the structure covering past and future incidents, and finally the focus being on the City rather than country wide. Subsequently, the City Corporation had discussed the issue with representatives of Government and the Police who had said that they would welcome such a fund.

Although some members of the Bank's Executive still had misgivings it was difficult to second guess the security experts. The proposals had since been modified to some extent and it was the intention that the scheme should be announced by New Scotland Yard with all subscriptions to the fund remaining anonymous.

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On balance the Executive's view was that they were less uncomfortable about giving, rather than not giving because the fund represented the Corporation's response to the security problems, and because of recent much closer relations between the Bank and the City Corporation on a number of issues.

The Deputy Governor proposed therefore, and it was agreed, that the Bank should underwrite the fund for the sum of £10,000 and that the Bank's continuing reservations should be made known to the City Corporation although our response would not be conditional on any change in that respect.

At the Governor's invitation and with the consent of Members of Court, Mr Charkham, an Adviser to the Governors, attended Court to present a paper entitled 'The Bank and Corporate Governance - past, present and future'. The paper had been prepared by Mr Charkham, with the assistance of his colleagues in Industrial Finance Division, and it set out a brief history of the Bank's involvement in corporate governance, the present position, and outlined some future issues.

In introducing his paper, Mr Charkham said that in his view the production of the Cadbury Report brought to an end a phase in the evolution of corporate governance in the UK. As it coincided with his departure from the Bank he thought it useful to take stock of the Bank's contribution in this direction. What role the Bank chose to play in future remained to be seen. There were some signs that the authorities with whom responsibility firmly lay, particularly the Department of Trade and Industry, may now be marginally more active. There was much left to do and the paper signposted some of the main issues. However what one did not want was a system so overloaded by procedures that management could not drive business forward and that if this were the outcome of shareholders' activism it would be unwelcome. At the same time however he suggested that the UK's diminishing industrial base could not stand much more of the ineffectiveness of

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accountability that had aided its decline. Striking the right balance would be a critical issue for the 1990s, if the UK was to stand up to ever fiercer competition.

Sir David Lees said that the Cadbury Committee had aired the subject fully and very well; it was now time to take a rest from corporate governance and wait and see how the proposals were taken forward by shareholders. It was a pity that the Institutional Shareholders Committee was not more powerful and that it was not particularly helpful. It was important therefore to see how the recommendations of the Cadbury Report would work and how they would be received particularly by institutional shareholders. Sir Colin Southgate endorsed this view saying that regulation was becoming too much of a burden and he suggested that stockholders generally could do more to reconsider their positions.

Sir Jeremy Morse said that it was unlikely that any other central bank had such expertise as the Bank of England in these fields. He said that the Bank should carry on doing this work, particularly while it was in a position to do so. Referring to the paper, Sir Jeremy said that although PRONED was an excellent organisation his experience in referring people to PRONED for jobs had not been particularly successful. On the subject of institutional shareholders, Sir Jeremy said that the Bank had always been pressing institutions to be more responsible shareholders. Whether they were or not, they were certainly a much bigger force in the market now and so he was concerned about the close link between companies and their institutional shareholders and the gap that was being created between them and private shareholders. It was difficult therefore to make them more effective without widening the gap with the private shareholders. In focusing on the roles of Chairman and Chief Executive, Sir Jeremy said that he thought it was very important in cases such as banks that were in the risk taking business that there should be "two hands on the tiller".

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Sir Adrian Cadbury supported Mr Charkham's paper which he found helpful and interesting to read. The Bank's influence in this area had been particularly important over the years. Referring to the issues raised in the paper, Sir Adrian said that he agreed with the comments about the widening gap between private and institutional shareholders but one of the difficulties was that institutional shareholders had quick and ready access to a great deal of information that, realistically, could not be available to private shareholders. He felt that shareholders' committees could not be representative of all shareholders and if that was the case he questioned their purpose. Reverting to his work on corporate governance, Sir Adrian said there was a framework in place and he agreed that it was now up to shareholders and boards to take it forward. Finally he mentioned that a major review of PRONED was in hand.

Mr Kent challenged the comments about there being too much change and it becoming a burden: the number of collapses recently had created legitimate public interest and had raised questions about accounting standards. It was important, therefore, that questions were being asked and that progress was being made in these areas.

Finally, the Governor thanked Mr Charkham for all he had done for the Bank, for Court and for the achievements in corporate governance both in the UK and internationally. He had enhanced the reputation and position of the Bank in this field. Sir Adrian Cadbury endorsed fully the Governor's remarks.

In presenting the Economic and Financial Report for June, Mr King said that the Governor would recall that at his first Court as Governor, the discussion had a familiar ring. The Minutes recorded that there was a discussion about the relationship between the yields of conventional and index-linked gilt-edged stock - this was something on which we now commented at length in the Inflation Report. Sir David - then Mr - Scholey had spoken about his recent visit to Germany, with a fading of the initial euphoria of the new administration,

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anxiety over unemployment, and the absence of export-led growth, made more acute by the difficult situation in France, and the present Deputy Governor - then an Executive Director - had commented that it was dispiriting that narrow money was growing above the top of its target range. The parallels between then and now went wider, as the Governor had made clear in the Mansion House speech, but this helped to put in perspective the puzzling - indeed frustrating - claims that inflation is "dead".

The uneven nature of the recovery was illustrated by the contrasting statistics produced over the last week or so. Manufacturing output rose by 0.7% in April, and was now around 2 1/2% higher than a year ago. Total non-oil output rose, also by 0.7%, in the first quarter and was 1% above its level a year ago. Unemployment fell by 26,000 in May, the fourth consecutive monthly fall, and this latest fall seemed to confirm that there had been a change in the relationship between output and unemployment. Employment in the economy as a whole fell in the first quarter of this year by less than in earlier quarters, although it did fall.
In contrast, retail sales fell again in May, and have been broadly flat since January, and house prices - as measured by the Halifax Index - fell in May following increases in both March and April. Such month to month variations in the picture of recovery painted by various statistics are likely to continue, but compared with a year ago, manufacturing output, investment, consumers' expenditure and exports were all significantly up.

On the inflation front, the latest figure for the underlying rate of inflation was 2.8%. This was lower than expected, but would almost certainly rise over the next four months. The replacement of the Community Charge by the Council Tax meant that the published rate of underlying inflation underestimated the increase in the price of goods and services - an effect which will disappear next Spring - and the "true" measure was almost certainly in the 3-4% range. The figure for headline inflation - of only 1.3% in May - had led some commentators to

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claim that "inflation is dead". This was an unfortunate choice of metaphor. Our view was that the underlying rate of inflation was in the 3-4% range. There was, therefore, still work to be done to get inflation down into the bottom half of the target range, by the end of this Parliament. That would depend on future monetary policy, and not on the lagged effect of present monetary policy.

One reason behind the figure of 3-4% was the response of the prices of imported goods to the depreciation of sterling that had occurred since last September. This was largely a one-off effect. Inflation generated domestically was perhaps better measured by the GDP deflator, a monthly estimate of which was presented in Chart 1 of the monthly report. This measure of inflation had fallen continually since the beginning of last year and was running at just over 2%. This was the encouraging news on inflation. The output gap was still positive - and the commentary referred to estimates of the order of about 4%. Even with an increase in output over the next year of around 3%, there would be no significant closing of the output gap. In turn, this would mean no upward pressure on the rate of domestically generated inflation. The immediate threat to the inflation target derived largely from the impact of higher indirect taxes, the impact of changes in local authority taxes, and the adjustment of domestic prices to a lower exchange rate. If all went well, these effects might lead to a peak in recorded inflation in the first half of next year. Our task was to ensure that the rate of domestically generated inflation continued at a very low level.

It was clear that output will have to grow by 3% or so a year over the next few years in order for the output gap to close and for unemployment to fall. It was very likely that this would occur without any further easing of policy. And, as the recovery proceeds, the emphasis would switch more to the timing of a tightening in policy. Given the substantial fiscal deficit, it would be right to focus on fiscal tightening rather than monetary tightening in the first instance. At this stage there was no obvious case for a change in interest rates.

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Mr Coleby said that in looking at the monetary data narrow money was better discussed in terms of the currency circulation rather than M0, which contained some very erratic elements. The currency circulation had been volatile, up by nearly 10% in the first quarter, down in both April and May, but now growing again in June, so that over the second quarter as a whole it was likely to be flat. The year-on-year growth had peaked in March at just over 5%, fallen to 4% at end May and would be around 4 1/2% at end June, above the top end of the monitoring range for M0 of 0 - 4%.

This pattern followed that for retail sales: the pace of advance in the earlier months of the year would have become worrying had it continued for very long, but which seemed now to have consolidated at a satisfactory level.

There was still a contrast between M4 and M4 lending. M4 had grown for the fourth consecutive month at around 1/2% with the year-on-year figure gently rising to 3.8% in May, its highest level since last November though still quite low within the monitoring range of 3 - 9%. M4 lending was positive again in May with a rise of 0.3%, but the growth was not strong enough to arrest the progressive decline in the year-on-year figure to 3.4%. Lending had been heavily dependent on personal borrowing, almost wholly on mortgages, while demand from the corporate sector had been very flat. This reflected the comfortable financial position of corporates: industrial and commercial companies' income and expenditure were back in balance in the first quarter after some five years in deficit. At the same time however there had been a strong take up from the capital markets. Recovery in stocks and work in progress was the likeliest source of revival in loan demand, but this was not yet visible. Until it was, the durability of the recovery must be regarded as uncertain.

The exchange rate remained basically steady but it was perhaps disappointing that it was not stronger given the problems in Germany and elsewhere and the interest rate reductions in many European countries.

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So far as policy was concerned, the concern of two months ago that recovery might be running too strongly and require early restraint, had now gone away. But recovery still seemed to have sufficient substance for further easing of policy to be unnecessary. The picture could change if the exchange rate began to climb strongly on account of interest rate cuts elsewhere and if the domestic economy appeared to falter. However, that seemed still some way off and, on balance, unlikely.

On the occasion of the Governor's last attendance at Court, the Deputy Governor said that on behalf of Members of Court and his Executive colleagues in particular he wished to thank the Governor for all he had done for the Bank and particularly for his leadership of the Court. The role of Court had changed substantially and had been greatly enhanced during the Governor's period in office. Speaking on behalf of the Non-Executive Directors, Sir Adrian Cadbury said that he wished to endorse everything that the Deputy Governor had said. The Governor had led the Bank through an unprecedented period of turmoil. So far as Court was concerned he had encouraged Members to become involved in the Bank's affairs which they had greatly appreciated.

In response the Governor said that presiding over Court was one of the best parts of the Governor's life. Referring back to the earlier discussion the Governor said that the Court of the Bank was an exemplary illustration of corporate governance. Members of Court had always been courteous, supportive, expert and perceptive and had shown great understanding and penetration in their questions and contributions.

Rupert Pennant-Rea

G. A. Craghts.
Secretary 1 July 1993.

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COURT OF DIRECTORS

During year ended 28 February 1994

Declaration Made before	Date	
		The Rt Hon Robert Leigh-Pemberton, Governor
The Governor	29. 6.93	*Edward Alan John George, Esq, Deputy Governor
		Sir George Adrian Hayhurst Cadbury
		Sir David Gerald Scholey, CBE
		Gavin Harry Laird Esq, CBE
		Sir Martin Wakefield Jacomb
		Sir Colin Ross Corness
		Brian Quinn, Esq
		Andrew Duncan Crockett, Esq
		Anthony Laurie Coleby, Esq
		Mervyn Allister King, Esq
		Sir David Bryan Lees
		Professor Sir Roland Smith
		Sir Colin Grieve Southgate
		Sir Christopher Anthony Hogg
		Mrs Frances Anne Heaton
		Sir John Chippendale Lindley Keswick
		Sir Christopher Jeremy Morse, KCMG
The Governor	29. 6.93	#Rupert Lascelles Pennant-Rea, Esq

* Appointed 1 July 1993 as Governor

\# Appointed 1 July 1993 as Deputy Governor

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A COURT OF DIRECTORS AT THE BANK

THURSDAY 1 JULY 1993

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Anthony Laurie Coleby, Esq
Sir Colin Ross Corness
Andrew Duncan Crockett, Esq
Sir Christopher Anthony Hogg
Sir John Chippendale Lindley Keswick
Mervyn Allister King, Esq
Gavin Harry Laird, Esq, CBE
Sir David Bryan Lees
Sir Christopher Jeremy Morse, KCMG
Brian Quinn, Esq
Sir David Gerald Scholey, CBE
Professor Sir Roland Smith
Sir Colin Grieve Southgate

Hugh Christopher Emlyn Harris, Esq
Ian Plenderleith, Esq

The Minutes of the last Court, having been circulated, were approved.

At the Governor's invitation, Mr Bull, the Head of Financial Statistics Division spoke to Court about the work of the Division. He said that their main functions were to collect, process and present a mass of statistical information collected from banks and certain other financial institutions and to present the results to those responsible for financial policy, and to provide Banking Supervision with statistical material to

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aid their work. The functions of FSD therefore fell very much within the scope of the Bank's first and second core purposes. On a rough calculation 75% of the costs of the Division were attributable to core purpose 1 and 22% to core purpose 2.

Apart from processing, the development of statistics was an important aspect of the Division's work, particularly in keeping up to date with the requirements of users; statistics on derivatives and interest rates were of current interest.

It was necessary to pay close attention to the costs of all the Division's operations (including the costs borne by suppliers of the statistics).

It was worth recording a number of achievements during the past year which would be of interest to Court. The Division had shed a considerable amount of work which was now being done by the Central Statistical Office. This covered areas that did not clearly relate to the core purposes of the Bank. The main criteria for retaining work must be that it related to the business of institutions that were of interest to the Bank, that were active in the markets and in other areas that had a close link with the Bank, for example off-shore banks, and mortgage finance vehicles, and security dealers. This principle coincided with the recommendations of the Pickford Report that had suggested that work relating to the national accounts should be done by the Central Statistical Office. The Bank is not responsible for the balance of payments, flow of funds accounts, and many non-bank financial statistics.

As a result of these changes the Bank's statistical functions were now narrower than those of most other European central banks. Mr Bull said that this had created some awkwardness at meetings and had led him to take a different line from some of his European colleagues particularly in the area of statistics for which the European Monetary Institute and European Central Bank would be responsible. These European central banks tended to expect the central European institutions to cover statistically all that they did on a national basis. In his

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view it was important to prevent duplication of effort at an EC level with the work of the European Statistics Office.

Focusing on the related question of what statistics would be needed for policy purposes in Europe in future stages of monetary union, Mr Bull said that it was important to seek the views of representative users and to compile an inventory of available statistics. From this it would be possible to identify the gaps that needed to be filled which the EMI could then take forward. This work was proceeding. The difficulty was that, in his view, the requirements which users had identified were not sufficiently focused on policy needs in the new environment of monetary union. A report should be ready for the EC Governors' meeting in September.

Mr Laird recalled that at earlier discussions at Court reservations had been expressed about the quality of the work emanating from the Central Statistical Office and enquired whether the Bank accepted their work or attempted to validate it. In response Mr Bull said that there had been a major improvement in the quality of their work and he was much more comfortable with the present position. His Division confined their checking to statistical series put out by the CSO to which the Bank had made an input. Sir Chips Keswick said that in his view London as a financial centre was falling behind in the netting off processes for derivatives particularly from the legal and statistical points of view.

Sir Jeremy Morse enquired whether the Bank's statistics gave us a particular advantage over Government departments when it came to considering financial policy. Mr Bull said that this was certainly so in connection with banking and monetary statistics. He thought the point was not so strong in the case of balance of payments statistics and the financial accounts, where the Bank's contribution was largely a spin-off from the banking statistics; here other parts of the Bank used the complete data compiled by the CSO much as the Treasury would do.

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Mr King said that the main objective of the split of responsibilities with the Central Statistical Office had been to enable the Bank to concentrate on money and banking statistics leaving the national accounts statistics to the CSO. The Governor commented that the same formula was appropriate for Europe with a European Statistical Office concentrating on non-banking and non-monetary statistics leaving the European central banks to concentrate on the financial statistics.

Sir Colin Southgate said that from his point of view accuracy was always the problem with statistics and that a number of decisions were obviously made based upon poor data. In response Mr Bull said that so far as the monetary statistics were concerned that was not a problem. Our record in this respect was good. The record of the Central Statistics Office in dealing with general economic statistics had been less good and that was one of the reasons that had led to the recent changes. They had put a huge effort into improving economic statistics in the last 3-4 years. But by their very nature economic statistics could never be totally accurate: the aim must be to avoid misleading users in any important way. Sir Colin Southgate suggested that data were not always collected in a sensible way and this was a contributory factor to the inaccuracies; he instanced some service transactions in the invisibles account.

Sir David Scholey asked whether the Bank charged external customers? Mr Bull said that in some cases, where FSD had incurred processing or other costs to meet a request, they would charge but they did not impose charges on institutions such as the BIS and the IMF. Referring to Sir David's second question about the staff's perceptions of the Financial Statistics Division as a useful stepping stone along their career path, Mr Bull said that for Officials, who were a Bank-wide resource, it was valuable to have spent some time in FSD and for them to take their knowledge out into other Divisions. Until quite recently there had been a fairly major turnover of staff but this had slowed down in the past year. He was particularly keen to have people back after they had gained

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experience in other areas of the Bank. In his view it was bad for statisticians to cut themselves off from the rest of the Bank. However he had experienced difficulty in attracting staff back to the Division unless there was promotion in sight - FSD was perhaps not one of the most glamorous parts of the Bank, more of an acquired taste!

Mr Plenderleith said that the staff of the Financial Statistics Division were very much part of the monetary policy team. His staff worked closely with the analysts who made a very important contribution to monetary analysis.

In reverting to the question of the accuracy of statistics, Mr King said that the abolition of Exchange Control had reduced quite considerably the accuracy of statistics in the balance of payments area. Secondly, it was important not to judge statistics simply on the basis of revisions. Improvements to the statistics often led to revisions; statisticians should not be discouraged from making them.

Sir Jeremy Morse enquired whether the Bundesbank was guilty of statistical overlap with the German Government and whether there was a sense in which they felt they had greater control if they had a wider statistical base. In response Mr Bull said that to the extent that the Bundesbank also concentrated on non-financial statistics there was inevitably some overlap with government. Mr Crockett said that most central banks collected balance of payments statistics which had been built up from Exchange Control procedures and they had maintained large Departments to carry out this operation.

This, he believed, influenced their view of statistical activities at the European level in the later stages of monetary union. It was clear to him that balance of payments statistics would be much less important to a monetary union than they were now to its prospective members; indeed, there could be no policy need for balance of payments statistics within the monetary union. The Governor commented that we should continue to press for what we thought was right for the

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new circumstances. He was not, however, wholly against duplication with the work of the European Statistics Office to the extent that it gave the EMI/ECB a better grip of matters concerning them.

There being no comments on the weekly figures, Mr Coleby spoke about the foreign exchanges and the state of the domestic markets.

Under the weekly executive report:-

1 Mr Harris reported that the salary negotiations with BIFU in respect of the two bargaining units, for Officers and Officials, had been settled. An increase of 1.5% across-the-board would be effective from 1 July 1993. The Governors had subsequently agreed that the salaries for Senior Officials should be increased by the same percentage.

2 Mr Harris went on to respond to a question raised previously by Sir Colin Southgate about the need for two separate pension funds to cover Directors and Staff. Mr Harris explained that the main differences between the two funds were that the Staff Fund enjoyed a favourable definition of final remuneration which might have to be changed if the Bank applied to the Pension Schemes Office to merge the Staff and Court arrangements. Secondly, the Court Scheme accrued at 1/30th of final remuneration as opposed to 1/60th for the Staff Fund. In view of these differences the preference was to maintain two separate funds. However, it was the intention to consider pooling the investments of the two funds and this would be considered in the light of the Goode Committee Report which was due later in the year.

3 Mr Plenderleith reminded Members that in October 1992 the Bank had taken steps to establish the Financial Law Panel following the recommendations of the Legal Risk Review Committee. The Panel, chaired by Lord Donaldson, had

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been established to consider legal uncertainties in financial markets. It was hoped to appoint a Chief Executive shortly.

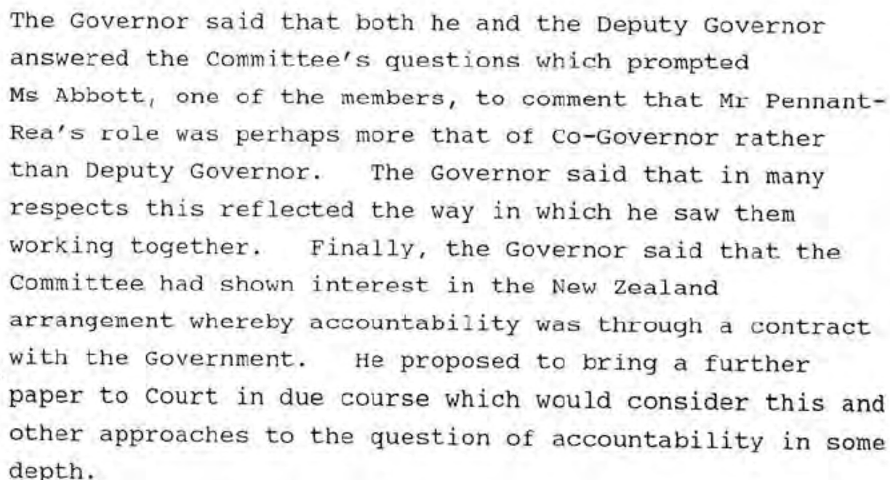
Having considered the legal status of the Panel, it was now proposed to incorporate it as a private company limited by guarantee of £1. However, it would need an owner and as the Bank had set it up and the Governor of the Bank appointed its members, it seemed appropriate for the Bank to take on the role of ownership.

Members of Court were content with this proposal.

4 The Governor drew Members' attention to the paper 'Trends in Current Expenditure' copies of which had been circulated earlier that week.

5 The Governor also spoke about his appearance with the Deputy Governor before the TCSC the previous day. The questioning had not been hostile and he had been particularly encouraged that Members of that Committee appeared to accept that independence for the Bank was a good thing but that accountability was the inhibiting issue. In this respect a number of members of the TCSC saw a significant role for that Committee.

The Governor said that both he and the Deputy Governor answered the Committee's questions which prompted Ms Abbott, one of the members, to comment that Mr Pennant-Rea's role was perhaps more that of Co-Governor rather than Deputy Governor. The Governor said that in many respects this reflected the way in which he saw them working together. Finally, the Governor said that the Committee had shown interest in the New Zealand arrangement whereby accountability was through a contract with the Government. He proposed to bring a further paper to Court in due course which would consider this and other approaches to the question of accountability in some depth.



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Court gave their approval to Sir Chips Keswick joining the Board of De Beers as a non-executive Director.

Sir David Scholey, as Chairman of the Audit Committee, introduced a Report of that Committee which was laid before Court. He said that for the future the Committee would be considering the format for the Bank's accounts in the light of the EC Bank Accounts Directive and this would be brought to Court in due course.

The Governor thanked Sir David and his colleagues who served on the Audit Committee for their contribution particularly over the past two years which had seen a marked increase in the role and work of that Committee.

Rupert Pennant-Rea

G. A. Croughton.
Secretary 8 July 1993.

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A COURT OF DIRECTORS AT THE BANK

THURSDAY 8 JULY 1993

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Anthony Laurie Coleby, Esq
Sir Colin Ross Corness
Andrew Duncan Crockett, Esq
Mrs Frances Anne Heaton
Sir Christopher Anthony Hogg
Sir Martin Wakefield Jacomb
Sir John Chippendale Lindley Keswick
Gavin Harry Laird, Esq, CBE
Sir David Bryan Lees
Sir David Gerald Scholey, CBE
Professor Sir Roland Smith
Sir Colin Grieve Southgate

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The Minutes of the last Court, having been circulated, were approved.

Details of the weekly figures and graphs relating to the state of the foreign exchanges, including the Official Reserves figures for June, and the domestic markets were laid before Court. Mr Coleby commented briefly on the weekly figures.

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Under the weekly executive report the Governor said that a Member of Court had raised with him recently the suggestion that Non-Executive Directors might welcome having the opportunity once during each term of office to use the Bank's facilities for a private function. For example, this might be a reception for a charity with which the Member of Court was associated or even a private or corporate event. Having discussed this with the Executive of the Bank, the Governor said that he would be happy to implement this. It would give the Bank an opportunity to express in a tangible way, its appreciation for all that the Non-Executive Directors did for the Bank.
He proposed that if a Non-Executive Director wished to hold a reception for a charitable event in either the Museum or the Court Room, the Bank would pay. If, however, Directors chose to have a personal or corporate event or if they chose to have a dinner, then the proposition was that they should pay. The Governor suggested that those who wished to take advantage of this offer might, in the first instance, speak to the Secretary to ensure that their plans were not likely to cause any embarrassment to the Bank.

The Non-Executive Directors welcomed this proposal.

At the Governor's invitation, and with the agreement of Members of Court, [redacted] a Senior Manager in the Financial Markets and Institutions Division, and the author of the paper 'The Current State of the UK Equity Markets' and Mr Beverly, the Head of FMID, attended Court for the ensuing discussion.

In introducing the paper, Mr Kent said that the particular questions posed related to the role of the Stock Exchange in raising capital for British industry and whether it was effectively serving the wider community.

In the view of Sir Chips Keswick, the paper was - appropriately - not in any way dirigiste. The fact that it came to no firm conclusions was correct. Sir Chips's view was that on balance

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the system was functioning well and it was therefore appropriate to leave it alone. He saw the City as a whole as providing capital; the Stock Exchange was not the key component since other markets provided capital in greater measure.

Sir Martin Jacomb characterised the Stock Exchange as a channel between savers and borrowers. He agreed that, broadly speaking, it had done its job well, at least for large companies. His question was whether it had done it as cheaply as it might. Transaction costs could perhaps be reduced and the rules on rights issues could be improved. The most important current function of the Exchange was to provide the international capital market for equities. The earlier failure to capture eurobond business had been recovered by the development of SEAQI. This had proved a great success and it was very important that we all continued to support it.

The Governor then asked the users of capital around the table for their views.

Sir David Lees said that he had no problem as far as his own firm was concerned about the way the Exchange provided capital. In addition, he had no strong feelings on costs. Sir Colin Southgate also supported the effectiveness of the Exchange as a provider of capital. In his experience, the goods had always been delivered. Sir Roland Smith contrasted the effectiveness in the provision of capital with the process of that provision. The latter, he claimed, was becoming increasingly expensive, especially for smaller companies. Regulation was imposing increasing and costly burdens.

The Governor then asked whether things were getting worse rather than better.

Mr Kent highlighted two different external pressures. On the one hand we had come through a fairly severe recession. On the other, the power of institutions was growing. The fact that we had seen fewer flotations in the last few years, especially among small companies, was a natural function of recession.

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The Stock Exchange review of what should happen after the USM disappears is obviously important. There must be a way for smaller companies to graduate to the main market. As far as costs were concerned, the issue was complicated. A large initial outlay might well, after the event, be seen to have been worth spending if an extra amount had been squeezed out of investors in the offer price.

Sir Christopher Hogg, having declared his interest as Chairman of Reuters, which was in practice and in theory a direct competitor of the Exchange in some of its activities, said that he felt the paper was somewhat frustrating insofar as it raised the whole question of what the Bank meant by its third core purpose. In his eyes the paper was too accepting of the status quo; our third core purpose would be better fulfilled if we asked whether the Stock Exchange could perform even more effectively. An important discipline here would be benchmarks. We should look at the competition and try to assess the challenges over the next five to ten years and then reach some conclusions on ways in which the Exchange might do better. In other words we should start from the ultimate objective and move on from there. His own feeling was that the Stock Exchange was rooted in the past. It had had to change painfully but there was still some way to go. It could be helped by a dispassionate intellectual critic, a role which the Bank of England could well perform. He felt that the Exchange's ultimate role was still confused between its public and its private functions and he felt that the Bank could provide it with some guidance on the balance to be struck between these two.

The Governor felt that a lot of what Sir Christopher had said was in fact implicit in the paper before Court. His impression was that the Exchange had made a lot of progress.
Sir Christopher did not dissent from this but reiterated that he would have appreciated a stronger Bank view. He was aware that the paper may well have been written deliberately to avoid giving views but he hoped that, at some stage, our real view would become clear.

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Mr Kent said that, personally, he had a clear view but that what he was unclear about was how we would go about imposing this view. The most important question, in his eyes, was how the City found the right structure for conducting its business. If the Bank was dirigiste, things would be easy because we would just tell the City what to do. In the past, while not telling, there have been occasions (Big Bang etc) where we have pushed and cajoled. But once various changes are made, it seems only sensible that we leave time for new arrangements to bed down. So far as the Exchange was concerned, for example, it was felt important that the new Board be given time to work out its own destiny. One of his own firm beliefs was in the virtues of a unified market. He accepted that some of his colleagues in the Bank - the economists perhaps - may have other views on the benefits of competing markets and raised the question as to whether the Bank should be expected to have a monolithic view.

The Governor agreed that in the mid 1980s we had been very clear on certain things - removing barriers to what the market wanted to do, for example. This had traditionally been the Bank's approach. It is alien to our approach to inhibit things happening. We are permissive rather than directive.

Sir Christopher Hogg admitted to some sympathy with this. On the other hand, however, it was important to consider the competition and he remained very uneasy that the Exchange was not moving fast enough to counter this.

Sir Martin Jacomb intervened to say that in his view the central market was essential. Indeed, our whole effort should be directed toward London becoming the central market in equity trading for the European time zone. He accepted that Big Bang had been badly managed by the Exchange - in his view the needs of market makers had been ignored, for example. There had in addition been conflicts between the treatment of large and small brokers. The Exchange, above all, needed to face issues with greater clarity. In spite of all its defects, however, he

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continued to support the Exchange in what it was trying to do because of the importance of centrality.

Sir David Scholey agreed that the Exchange had had to make some painful adjustments. He felt, however, that it may now be coming in sight of the true role that it should play. London was a significant node in the global equity markets and it should be this function on which the Bank - and the City in general - should really concentrate, rather than simply the single element of the Exchange within the wider picture. He hoped that this paper would be a starting point for a continuing discussion.

Sir David then raised a number of questions. As far as the central market was concerned, he agreed entirely with Sir Martin Jacomb. It was essential to London's continuing success. It was very important that the benefits of the central market were understood and the Bank was well-positioned to give its supportive views on this. Things could, however, work even better. The question of pre-emption rights, for example, which could prevent companies raising capital in the most efficient way. These were a result of an institutional cartel. The question was hardly ever raised - let alone addressed - because there were too many vested interests involved.

Variable voting rights were another question. He mentioned the question of Reuters's two tier share structure when it was floated. Doctrinaire traditions continued to be a weakness in the City.

On the question of transparency he felt that the community as a whole still did not appreciate the question. For the most part, continental markets had nowhere near the same liquidity as London and were therefore not as successful. Nevertheless, many companies did not mind that for much of the time, because they were quite happy to see less trading in their shares rather than more. On costs, he took the point but, as far as benchmarking was concerned, it was important to realise that

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there had been times of great strain in the past and profits had slumped as a result.

Referring to Big Bang, Sir David said that this had been an example of a search for perfection. TAURUS had been another. What tended to be left out of account was the importance of profits as the driving force. It was important that the Bank should ensure that questions such as these were aired in a dispassionate way and carefully analysed so that the outside world fully understood the issues.

The Governor summed up the discussion to this stage by asking whether it was felt that the Stock Exchange's outlook was too narrow - should it look more widely? And should the Bank be leading it in any way?

Sir Christopher Hogg made it clear that he had no problem with the Bank supporting the Exchange and saying that practitioners should continue to work through it. His concern, however, was that it and we should be more forward looking.

The Governor accepted this and went on to ask what were the issues. Did everyone agree that a central market was vital? Sir Christopher Hogg felt that a distinction should be made between the Exchange on the one hand and markets as a whole on the other. The former was a sub-set of the latter and technology was moving on the whole time. Sir David Scholey agreed that it was important that the Exchange was able to adapt. If it did not do that, and competing systems grew up, chaos could ensue.

Mr Kent distinguished between the primary and the secondary markets. The former had many different ways of raising capital and could, in that sense, be described as fragmented. The secondary markets, on the other hand, were the means by which all these originally primary products came together under one roof. It was important that this remained unified.

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Sir Martin Jacomb noted the obvious symbiosis between primary and secondary markets. He felt, however, that it was not essential that each part of the process took place under a Stock Exchange umbrella. For example, one of London's major advantages was in being the most important multi-currency centre. That meant that the necessary foreign exchange deals in connection with securities issues could be done in one place. On the other hand, he pointed to what he termed a major inhibition in settlement. This was that settlement in SEAQI still had to be in the domestic markets. Things would be far more efficient if a trade in London in French equities could also be settled in London rather than in Paris.

The Governor asked whether it was commonly accepted that the Bank should not try to suppress natural developments in the market. There was no disagreement with this proposition.

Sir Chips Keswick felt that Mr Kent's distinction between primary and secondary markets was important. In his view, London had hijacked Europe's savings in the primary market. The secondary market, on the other hand, might be fragmented but it still existed in London. How the trading was done was secondary, provided that it was here. As an aside, he felt that suggestions that we should have a central debt registry would have a deleterious effect on London insofar as it would increase the regulatory burden.

The Governor felt that the substance of what had just been said was that London must have an adequate infrastructure to allow the market to deal in whichever way it wanted. Sir David Scholey felt that that implied that London's systems should be compatible and also, importantly, in London's interest. Given that, he thought that there did need to be some support and encouragement from the centre to ensure that London was put first. Foreign operators in London did not necessarily have this as their prime objective.

At this stage, the Governor confessed that he was a bit confused. In his eyes, centrality did not mean suppressing

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other natural developments. Mr Kent, on the other hand, thought that there might at times be things which we would want to suppress. What for example, if the market makers said that they were interested in making markets only in FTSE 100 stocks? What effect would that have on those foreign institutions thinking of coming to London if they had to choose between several different systems? It was quite possible that fragmentation could happen without us noticing it if we lacked a prior view on the sort of things which should be kept central.

The Governor then moved the discussion on to the question of market structure. He noted that we were the odd man out in Europe by having a quote driven system. Did the Court have views on this?

Sir Martin Jacomb felt very strongly that the success of SEAQI was based on the fact that, when you dealt, you got commitment there and then. He felt that market making should certainly continue for all securities where there was a significantly large market.

Sir Christopher Hogg said that he was still trying to understand the different concepts. Was it the view of Court that, for example, the foreign exchange market was quote or order driven? The conclusion, supported by the Governor, Sir Martin Jacomb and Sir David Scholey, was that it was clearly quote driven given that dealers stood ready at all times to make firm two-way prices. Sir Christopher noted that, on the other hand, there was no transparency on the size of trades. It was generally accepted that there were very good reasons why that should not be the case. The Governor said that transparency clearly was intimately connected with the nature of the market making structure.

In Sir Christopher's view, if the market in a security was large and liquid enough the question of transparency disappeared. Sir David Scholey agreed that this was correct 95% of the time. But where significant players came in - the

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Government or George Soros for example - transparency (lack of) was important. In this context, Sir Martin Jacomb noted that customers wanted immediacy. They were not concerned about transparency at the time of dealing, though of course they did need an audit trail for retrospective checking. Sir Chips Keswick said that total transparency would clearly be the death of any market. The Governor agreed that this would certainly be the case in this particular type of quote driven market.

Mr Kent noted that the UK had fought hard to preserve the viability of market making under the Investment Services Directive. He raised, however, the separate question of derivatives. Did lack of transparency for large deals in the cash market inhibit a flourishing equity options market? He noted this was a live issue and the question was bound to get more complicated. For the longer term, we should ask ourselves whether inhibiting derivatives in favour of cash might actually do long term damage to London.

The Governor said that this was a new thought to him. Was it because of the difficulty involved in pricing the derivative? Mr Kent agreed that this was the case. Mr Plenderleith intervened to say that he agreed entirely with Sir Martin Jacomb. It seemed to him that price formation in London was extremely good; we could therefore afford to be more relaxed on the question of transparency. He found it hard to understand the argument about derivatives. There were many other markets where cash prices were even less transparent but derivatives were thriving. He suspected that the problem stemmed from the position of sole traders in the derivatives markets who did not have the knowledge of cash transactions which integrated houses had.

The Governor then moved to the question of profitability. If market making was not viable should we in the Bank take any action? In his view, the answer in this case would be no.

Sir David Lees wondered why profits were so low. Was it simply a question of excess capacity? If so, why didn't the normal

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rules of the market apply and market makers go out of business? Sir David Scholey accepted that this was a good question. The return on capital in market making since Big Bang was certainly unacceptably low. On the other hand, it had been extremely volatile and depended on turnover. He accepted that there was over capacity and, at the time of Big Bang, a lemming principle had operated.

In the Governor's eyes, the market making industry was very much like any normal industry. Firms had indeed gone out of business. Sir David Scholey noted that the death knell had tolled over the US specialist system many years ago but it was still there.

In response to the Governor raising the question of it being London's importance, rather than the importance of British houses above foreign houses, which really mattered, there was general agreement that this was indeed the case. One caveat was, however, entered by Sir Martin Jacomb who put in a plea for UK houses being given some preference in HMG primary issues. Sir David Scholey felt that the particular world view of US firms needed to be watched. They, above all nations, had the concept of dominating the world securities industry. Their natural inclination was to try to change domestic habits to fit the US paradigm. Underwriting was an example. This did not fit with certain SEC rules and, in Sir David's view, the UK should be very careful before accommodating itself to them. There were dangers of shooting ourselves in the foot.

The Governor asked whether Sir David was saying that all equity raised in London should be underwritten. Sir David said that that was not his meaning, but rather that we must watch for pressures which might risk undermining underwriting - which was a fundamentally healthy system. Mr Plenderleith noted that he had met the same phenomenon in other markets - bonds and money, for example. There was a common assumption that the US model was the only one. On the other hand, in his experience, once the position had been explained to them, US firms came to

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understand that there may be good reasons for alternative systems.

Sir Colin Southgate asked whether underwriting new issues was more expensive than other methods. Sir Martin Jacomb said firmly that the reverse was in fact the case and Mr Plenderleith confirmed that all the studies he had seen suggested that the UK system was cheaper to the issuer than the American. Sir David Scholey noted the large selling commissions in the US. Sir Colin Southgate and Professor Sir Roland Smith, while accepting that US commissions were higher, nevertheless confessed to irritation with the fact that UK underwriting commissions were fixed and non-negotiable. They were not concerned about the discount involved in a rights issue, because the proceeds ultimately reverted to the shareholders anyway; but they were concerned about the lack of competition. Sir Chips Keswick, on the other hand, felt that the UK system allowed the saver to have the benefit of whatever discount was available rather than the investment banker.

There were two final points on this item. First, the Governor noted that sometimes - as in BP and the 1987 crash - underwriting commissions were well earned. And Mr Kent noted that fixed commissions were much simpler and saved time. To allow time for negotiation of commissions would undoubtedly introduce more risk and therefore higher prices. He nevertheless drew to Court's attention the fact that the Inland Revenue were worrying about whether commissions were or were not trading income; and the OFT remained concerned about their seemingly anti-competitive nature.

Sir Adrian Cadbury said that he tended to be sceptical of privilege. There always appeared to be good reasons for it but it always tended to re-inforce the status quo. In securities markets technology was, and would increasingly become, very important. He was therefore personally in favour of allowing one thousand flowers to bloom - if we didn't, others would. He was concerned about London's slowness in adapting to technological change. If this in fact was in danger of

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creating problems, a different approach might well be required from the Bank.

Sir Roland Smith then raised a different issue; he asked whether, with the tremendous demands on UK savings, companies were going to find themselves squeezed out. Would they have to use overseas finance? In five years time, would industry still be as satisfied with the Exchange's performance in supplying capital as it was now?

In Mr Kent's view, savings were like water: they found their own level - and, of course, they were now global. He felt that capital would still be available for viable projects but maybe at a slightly higher price. He was in practice not concerned about the supply. His concern rather was where borrowers would go to tap that supply - London or elsewhere. He agreed that the position of small companies may be somewhat different since they, by their nature, could not expect to go to the international markets in the same way as their larger brethren.

The discussion then moved finally on to the role which the Bank should play in these issues. Sir David Lees said that he was worried about the Bank's active involvement in the replacement for TAURUS. He saw the Bank's role as one of "illuminating" the issues. Active involvement might not square with this role as illuminator; he had some anxieties on the Bank becoming too sucked in.

The Governor noted that the Bank had more than one interest in the question of settlement. There were potential systemic concerns, even in equity markets, though he accepted that this question was much more clear cut in gilts or money. The failure of TAURUS was the third example of competing interests in the settlements area making common cause impossible. There may perhaps be a question of whether the Bank should have anticipated the failure of TAURUS earlier - but, even if we had, we should probably not then have found the support for us doing something about it. He reiterated that the Bank does have a specific interest in settlement, though there may be

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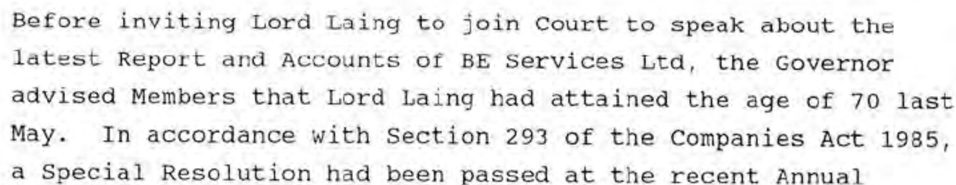
legitimate questions about whether we were stretching ourselves too far in going into the equity area.

The Governor then raised again the question of what the Bank should be doing. Perhaps Sir Adrian Cadbury's point about technological change was the most important? He sensed that, on the structural questions raised by the paper, there was broad agreement around the table about what the Bank had done and should be doing.

Sir Christopher Hogg noted the Stock Exchange's vested interests in all these questions. He felt that it was important that the Bank did not trumpet its third core purpose if it was at the same time going to be too laissez faire. Mr Plenderleith accepted this point but also pointed to the need to avoid over-engineering. Markets needed to be given scope to breathe and evolve, and the best outcome was unlikely if we were too dogmatic.

The Governor concluded the discussion by suggesting that a brief paper should be prepared setting out the positive things that we would want to see happen. In other words, we should define the areas of laissez faire and dirigisme. In the latter field these would be partly procedural - things we might want to urge the Stock Exchange to consider, for example - and partly things which we actively wanted to promote - for example the virtues of market making. It was left that Mr Kent and his team would attempt to draw up such a list.

Sir Martin Jacomb introduced a Report of the Committee to consider the Securities of Certain Funds covering the period 1 October 1992 to 31 March 1993, which was laid before Court.



Before inviting Lord Laing to join Court to speak about the latest Report and Accounts of BE Services Ltd, the Governor advised Members that Lord Laing had attained the age of 70 last May. In accordance with Section 293 of the Companies Act 1985, a Special Resolution had been passed at the recent Annual

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General Meeting of BE Services Ltd, reappointing Lord Laing as a Director of the company.

In his capacity as Chairman of BE Services Ltd, Lord Laing attended Court and introduced the Company's Report and Accounts for the year ended 28 February 1993 which were laid on the table.

Rupert Pennant-Rea

G. A. Croughton.
Secretary.
22nd July 1993.

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A MEETING OF DIRECTORS AT THE BANK

THURSDAY 15 JULY 1993

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Anthony Laurie Coleby, Esq
Andrew Duncan Crockett, Esq
Brian Quinn, Esq

Hugh Christopher Emlyn Harris, Esq

The number of Directors assembled being insufficient to form a quorum, those present proceeded to the business, subject to ratification by the next Court.

The Minutes of the last Court, having been circulated, were approved.

There being no comments on the weekly figures, Mr Coleby spoke about the foreign exchanges and the state of the domestic markets.

There were no items for discussion under the weekly executive report.

Rupert Pennant-Rea

G. A. Croughton
Secretary. 22 July 1993

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A COURT OF DIRECTORS AT THE BANK

THURSDAY 22 JULY 1993

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Anthony Laurie Coleby, Esq
Andrew Duncan Crockett, Esq
Sir Christopher Anthony Hogg
Sir John Chippendale Lindley Keswick
Mervyn Allister King, Esq
Gavin Harry Laird, Esq, CBE
Sir David Bryan Lees
Sir Christopher Jeremy Morse, KCMG
Brian Quinn, Esq
Sir David Gerald Scholey, CBE
Professor Sir Roland Smith

Pendarell Hugh Kent, Esq

The Minutes of the Court of 8 July were confirmed and those of the Meeting of 15 July, having been circulated, were approved.

Mr Quinn commented on the weekly figures and Mr Coleby spoke about the foreign exchanges and the state of the domestic markets.

The Governor said that he had been considering how best to keep Court fully abreast of current issues and proposed that greater emphasis might be placed on brief oral reports under the weekly executive report. To avoid crowding out the main topics on the agenda he also suggested that the executive report should in future feature after the main discussions. Court agreed.

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At the Governor's invitation and with the agreement of Members of Court, [redacted] Mr King's Personal Assistant, attended for the discussion of the draft Inflation Report, which would appear in the next edition of the Quarterly Bulletin, to be published on 10 August.

In introducing the draft Inflation Report, Mr King said that the draft circulated to Members of Court was the third draft. We were now into the fifth draft, and both the details and the projection of inflation had been revised since the previous week. This was inevitable given the statistics which appear in the run-up to the production of the final draft.

As before, the structure of the Report was in three main parts. First a review of recent developments in inflation. Second, an analysis of both the monetary and the short-term real factors which influenced the course of inflation, and third, our overall judgment about the prospects for inflation over the next two years. There was one innovation in this Report - a separate section on the labour market which should reassure people that we still covered nearly all the issues which used to be discussed in the commentary section of the Quarterly Bulletin.

Mr King suggested that it would be most helpful if Members of Court could provide input on two major questions. First, what were the prospects for the growth of earnings over the next year or so. And, second, what were the pressures on profit margins and on the corporate sector to raise prices as the recovery develops?

The most significant "news" since the May Inflation Report had been the continuing fall in inflation itself. With the headline rate at only 1.2%, and the RPI, excluding mortgage interest payments, having risen by only 2.8% over the past year, inflation was now at its lowest level for a generation. However it was not quite that simple. Even the measure of underlying inflation used to define the official inflation target was now a distorted measure of "true" underlying inflation. This was because of changes in both indirect

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taxes - which will come into play next year when VAT is extended to cover domestic fuel and power - and the switch to the Council Tax which has led to a distortion in the current figures for inflation. Making adjustments for these, it would appear that the best estimate of current underlying inflation was just over 3%.

The next section of the Report took this as the starting point, and asked the question - given current monetary policy, and given the likely developments in the real economy over the next year or so, what was likely to happen to this underlying rate of inflation? Broadly speaking, our conclusion was that it should continue to fall for a while before turning up somewhat in late 1994 and 1995 in response to the recovery. There were, of course, many uncertainties connected with this projection which was made on the assumption of no change in interest rates. The central view was that inflation would remain within the target range throughout the horizon of the two years which were examined in the Report. But there were three important caveats to that conclusion. First, we were much more confident of this conclusion for the true underlying rate rather than the measure of inflation which merely excluded mortgage interest payments from the index. The impact of the extension of VAT both next year and in 1995, which has already been announced, and the potential double indexation of excise duties within one twelve-month period resulting from the change in the budget, and the changes to local authority taxes, meant that the published underlying rate may well rise close to 4% during the coming year. The second caveat was that even if one examined the true underlying rate - as one should for purposes of monetary policy - then we could not be confident at this stage that inflation would be in the lower half of the target range by the end of this Parliament as stated in the original commitment to the target.

Finally, there were a number of uncertainties about any such projection. Perhaps the most serious of these was the impact of declining growth in real wages on the pressure for wage settlements. After several years of rapid growth in real wages for those in employment, most scenarios for the next few years

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envisaged much lower growth rates of real wages. If expectations of inflation fell rapidly enough, then this reduction in the growth rate of real wages would result in low growth rates of wage settlements and earnings and low inflation. But if expectations of inflation do not fall rapidly enough, and if monetary policy accommodated higher wages then it was possible that wage pressures may result in higher growth rates of earnings and in turn somewhat higher inflation. Mr King said that he would be particularly interested to hear the views of Court on their perceptions about the development of earnings and inflation over the next two years.

Sir Jeremy Morse said that he understood that the Inflation Report was our main opportunity to give an independent statement on the course of policy until the Bank had won more autonomy. He found the Report well-written and impressive. However, its structure was not immediately persuasive. Three sections were devoted to the real economy, developments in which were asserted to have only a short-run impact on inflation. Yet he shared with Lord Lawson the view that the country's tendency to wage inflation was our Achilles' heel, and should not be dismissed as a short-term factor. Wages would tend to rise as pressures ease. We were half-way towards performance-related pay, which should help, but at an awkward stage where there was still an annual wage round and pay comparability was still an important influence on settlements. He wondered what tone would be adopted in the conclusion. Would the Report suggest things look frightfully good, but in fact are not? Or would it conclude prospects are good, but we must monitor inflation in the way middle-aged men have to 'watch their weight?' He asked whether the Bank had applied the analytical framework of the Report to 1987/88 - would our Inflation Report have helped us then? A glossary of definitions of inflation would be helpful. He also asked what the current mechanism is by which official rates affect the money markets?

In response Mr Coleby explained that there was no continuous Bank Rate or Minimum Lending Rate as there had been in the

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past, but the Bank still had the power of a simple announcement available to it which in substance was like setting MLR for just one day. Banks would immediately adjust their base rates and thereafter our money market operations would validate those new base rates.

Mr King argued that developments in the labour market would only affect inflation in the short-term unless they were validated by monetary policy. It was true that policymakers could be faced with a difficult choice between accommodating the inflationary pressure or allowing unemployment to increase. That was why an announced framework for policy was important, to convince people that inflationary pressures would not be validated. He said that there was a puzzle about the depreciation; the relationship between import prices and the RPI had changed. He believed that the Bank's warnings about developments in 1987/88, discernable in the Bulletins of the time, would have come over much more clearly in an Inflation Report, in which we were forced to be explicit.

Sir Jeremy Morse reiterated that one should not dismiss the importance of a phenomenon because it was only relevant in the short-term, and suggested we should make this clear in the Report with respect to labour market pressures.

Mr Laird made two points. First, he was surprised that manufactured output prices had risen by as much as 4%. Second, with respect to expectations, he said that he could not recall a time when his people had been less demanding. The Governor asked if he meant that wage pressures would not increase if confidence about the control of inflation could be maintained. In response Mr Laird said that in his view this was so but if doubts about inflation control rose, and nothing was done on unemployment, then "all bets were off".

Mr King noted that one problem in analysing wages was to establish to which price index they reacted. If it was the RPI, this was a little worrying, because it was bound to start rising faster. Mr Laird confirmed that headline RPI was still the focus of pay negotiations, but more attention was now paid

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to what affects the RPI. Similarly, trade unions now look at a whole range of issues, such as unit labour costs and competitiveness, which they used to dismiss as being someone else's concern. The Inflation Report helped to develop their understanding of the issues further.

Sir David Lees argued that the two topics mentioned by Mr King as areas of uncertainty - earnings and margins - were linked. On the basis of a forthcoming CBI survey, he was now less optimistic about the key indicators as he looked forward. He was influenced by the prospects in our export markets in particular. There would be continuing pressures on companies' margins and volumes, especially amongst exporters. Hence the danger of earnings accelerating was not very high. Unit labour costs would not turn upwards in a threatening manner. Survey indicators were less optimistic than they had been in the second quarter of this year.

Sir Chips Keswick felt we were in a lull. Predatory capitalist entrepreneurs like growth and do not mind whether it is real or nominal. But at the moment, they do not know where real growth prospects or inflationary pressures would arise. The lull would continue into the Autumn.

Sir David Scholey was particularly interested in the Report's section on wage settlements and earnings. He was also concerned about inflationary expectations. The Report as a whole led him to be more concerned about the prospects for inflation. It seemed that expectations of remaining between 1% and 4%, especially in the lower part of the range, were receding. Clearly, there was a tendency for people to concentrate on the headline RPI, so he had a 'medium range' anxiety about inflation. Did we need to change the current atmosphere?

Sir Roland Smith agreed with Sir David Lees about earnings. Perhaps we were too concerned about the link between wages and inflation because of our experience over the last three decades. Import prices may be more important now. He felt that the draft Report was more technical then the previous two.

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It gave the impression we were looking over our shoulders, not forward, at earnings. There was indeed pressure on margins; this affected manufacturers not just retailers. Activity might have increased, but activity was not necessarily aligned with profits.

Sir Christopher Hogg said that he was a permanent cynic about inflation but had to admit that, this time round, there was a discontinuity of some kind. We were in unknown territory. The outcome was uncertain and the Chancellor's Budget message in the Autumn would be critical in determining whether we had broken out of the cycle at last. The Governor noted that noises were not discouraging on this front.

Mr King commended Sir Jeremy's analogy of weight-watching for the monitoring of inflation. Crash diets and bingeing were not sustainable; we needed to change our 'lifestyle' to adopt a diet - policy - that would keep weight down - inflation under control. Sir Jeremy noted that the analogy was Sir Kit McMahon's, not his own.

In summing up, the Governor noted that Members of Court on the financial side seemed to be more worried that history would repeat itself. This implied that, while we were 'nervously extrapolating' a central forecast of underlying inflation that was roughly constant, the risks lay on the upside rather than the downside. Those from the industrial sector were rather more sanguine.

Sir Jeremy Morse also noted the contrast between the views of finance and industry, but pointed out that each side was addressing somewhat different issues. There was not a clear-cut disagreement between the two. The analysis of the Inflation Report could address the issues raised.

The Governor said that with reduced membership of the Debden Committee it had often been difficult recently to find a quorum. Accordingly, and with the agreement of Mr Laird, the Chairman of the Committee, he proposed that Sir Roland Smith

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should join the Committee where his industrial experience would be particularly valuable. Court agreed thereto.

Under the weekly executive report:-

1 With reference to a Minute of 24 June, the Governor referred to the "ring of steel" which the City Corporation had introduced to counter the threat of bombs being planted within the City. Its introduction had been successful and had caused the minimum of disruption. This move was experimental and if it were to become permanent the Corporation would need the support of Government. Reaction at Westminster, however, had been somewhat hostile but the Bank had been supportive of the City Corporation: it was inconceivable that they could have not responded to the second bomb.

Nevertheless, he suggested that the City Corporation could still do considerably more to improve security in the City, in particular by improving communications, co-ordinating the use of security cameras and security forces, and perhaps in pedestrianising certain areas of the City. He said that the Bank would continue to support the City in these efforts and in particular would encourage them to communicate with the surrounding Boroughs.

Sir David Scholey said that he would very much welcome the proposed wider dialogue. His offices and those of Broadgate were located in the Borough of Hackney and were outside the "ring". A number of people were of the view that the "ring of steel" had been introduced without sufficient consultation. Mr Laird said that the impact of security cameras had proved very effective in a number of instances and he encouraged the Corporation to explore their wider use.

The Governor said that there was to be an early meeting of the City Steering Group to review the programme of work

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and he would revert to Court on this subject in due course.

2 The Governor said that it was becoming clear that there was no prospect of the EMI being located in London but there remained some hope that the location might be Bonn rather than Frankfurt. It was important that our reaction to this should not be one of disaster for the City, more that it was disappointing for the EMI. Our view had always been that London was good for the EMI, not the reverse.

Sir Jeremy Morse said that he always felt that Frankfurt was the right location for the EMI but that London would remain the main market. We should, therefore, focus on that by continuing to promote London's financial expertise. He suggested that the Central Bank Governors might consider holding occasional board meetings outside Frankfurt or wherever the ECB was eventually located, and that some of these meetings might, therefore, take place here in London where the main markets were. In response to Mr Laird's suggestion that the Bank should use the occasion of the Tercentenary celebrations to raise the profile of the Bank of England in Europe, the Governor said that our preferred approach was very much to use the occasion to promote London.

Sir Roland Smith enquired if the European Central Bank were located in Germany, whether it would be staffed entirely by Germans? In response the Governor said that this would not be the case and we would expect to be well represented on the staff of the new ECB.

Rupert Pennant-Rea

[illegible] Assistant Secretary
29th July 1993

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A COURT OF DIRECTORS AT THE BANK

THURSDAY 29 JULY 1993

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Sir Colin Ross Corness
Andrew Duncan Crockett, Esq
Mrs Frances Anne Heaton
Sir Christopher Anthony Hogg
Sir John Chippendale Lindley Keswick
Mervyn Allister King, Esq
Gavin Harry Laird, Esq, CBE
Sir Christopher Jeremy Morse, KCMG
Brian Quinn, Esq
Professor Sir Roland Smith

Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The Minutes of the last Court, having been circulated, were approved.

There being no comments on the weekly figures, Mr Plenderleith spoke about the foreign exchanges and the state of the domestic markets.

At the Governor's invitation:-

1 The Deputy Governor introduced a paper he had written on Independence and Accountability. Drawing on the military analogy that generals were free to fight battles but not to declare war, how did one make the generals answerable

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to the politicians? Should the Bank be accountable to government or should we have a direct link with some form of Parliamentary Committee? The Deputy Governor said he had concluded there were two options which were not mutually exclusive. In order to satisfy all parties the answer might be in a hybrid solution. One further point he wished to emphasise was that many of the proposed changes would require the process of monetary policy to be much more transparent. The real test would be to ensure that the process of achieving and maintaining accountability involved the necessary degree of transparency.

In opening the ensuing discussion Sir Christopher Hogg said he found the paper lucid and helpful. From his own selfish viewpoint he felt it would be beneficial to revisit two issues from the previous discussions on the subject. Firstly, the appropriate function for an independent Bank and, secondly, what should the Non-Executive Directors be doing. At the end of the day the Bank would emerge with a woolly remit or a tight and clearly defined one, with consequent implications for Non-Executive Directors whichever one materialised. He concluded that he would be more comfortable with an evolutionary route, seeing it as undesirable for the government to have any conflict with the Bank.

Sir Colin Corness saw the main point as being, should the Bank be accountable to government or Parliament? He felt there was no other solution but that the Bank should be accountable to government. The present government would not agree to anything else. The government was elected to govern and monetary policy was a crucial aspect of government. Ministers would not hand such a responsibility to a joint form of parliamentary control.

In response to a question from the Governor asking if he would be content if the remit was precise, and the Bank's mandate contained in a statute, Sir Colin Corness said he

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could envisage the principles under which the Bank would be required to operate being clearly defined by statute. He felt it would not be possible for the detailed objectives to be similarly enshrined. He added that he would be unhappy with any set of policies that did not make reference to the position of employment and spoke only about inflation.

For her part, Mrs Heaton found it difficult to see the Bank as being accountable only to Parliament. If that were to happen, the government would be giving up a further tranche of control. She felt it would be preferable if the Bank were able to negotiate with ministers as opposed to a Committee of MPs.

Sir Jeremy Morse said he found the paper an excellent one. On the issue of accountability to Parliament, he would prefer this course but it was essentially a theoretical point. He felt it was right to go for a hybrid solution. Logically, accountability was not necessary although this was something to which we might have to doff our cap. He found the desirability of giving government or Parliament some right to override convincing. The basic reason Sir Jeremy Morse said he preferred Parliamentary accountability was that it had been proven that governments were weak on price stability. For the Bank, the real choice at present lay between staying with its traditional position, which was now only advisory, or going for a more public role in the field of monetary policy. Sir Jeremy Morse said he strongly favoured the second course. This could be achieved by our inflation report; by a campaign for a change in our status; and both internally and externally, by getting across the idea that we were a Central Bank and not a government department.

Sir Adrian Cadbury commented that the point that he felt should be reflected on was what powers the Bank would need. This would colour the shape of everything.

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Taking up this point, the Governor said it went back to what mandate the Bank was given. There was no scope for any compromise on price stability. It was very important that it was quite clear to the Bank what powers it was being given to achieve price stability. The Governor said he would not wish to be party to an arrangement that did not mean anything. Monetary policy in the long term affected prices, not real variables. It was essential for the Bank to have control of monetary policy and short-term interest rates.

Sir Colin Corness acknowledged the Governor had a difficult task. If the question was what our remit from the government should be, the government would have to acknowledge that growth was needed in the economy to pay for the burgeoning social security bill. More people were needed in work. He was not arguing for price stability on its own.

The Governor reiterated that if price stability was not the objective of monetary policy in any mandate the Bank was given, he would not accept the mandate. It must be clear that monetary policy was concerned with financial stability.

Gavin Laird endorsed the sentiment that the Bank must obtain clear guidelines and that these should give priority to price stability. He was all for accountability, and for the existence of an override power.

The Governor having obtained general support for the premise that there should be a clear mandate, the Deputy Governor went on to ask if Court would be satisfied with a narrow definition of the Bank's role providing - whether it be government or Parliament - they had some right to override. There was no objection to this suggestion. The Governor added that opinion in the Select Committee, and among Members of Parliament generally with whom the Bank

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had been in contact, was running in favour of an independent Bank, which might perhaps be achieved by the end of the decade.

Mr Crockett said he was in favour of accountability to Parliament. If it were to government they could find themselves in a difficult position and be tempted to exercise their override powers. He said he would look at ways accountability was achieved in other countries, for instance, in Scandinavia, where the governing bodies of their Central Banks had many operational similarities to our own.

Sir Chips Keswick considered the question of accountability a red herring. What mattered was the remit given to the Bank. The Governor, in identifying the line for the Bank to take, found arguments in favour of accountability to Parliament; but if the price to be paid for this was a contract with government, then it would be a price we would have to pay. Naturally, Court would have to look hard at any such contract.

Mr King commented that fundamental to all this was that there is no trade off between inflation and employment. Any government that accepted the existence of such a trade-off would not want to give a Central Bank responsibility for monetary policy. So far as accountability was concerned, Mr King felt there were arguments either way but that it was not a decision that needed to be taken immediately. There was no reason why we should not have either arrangement, but when we did decide it should be a common sense judgement.

Sir Roland Smith considered the public perception of the Bank was underplayed. He thought there was a view that the Bank should be moving towards independence. He felt accountability to Parliament would give the Bank far more transparency than to government.

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Sir Christopher Hogg felt the question of accountability was secondary. In his perception the main question was how the independence of the Bank lay, for instance, with its responsibility for Banking Supervision.

As a procedural suggestion, Sir Jeremy Morse asked if some recent cases could be identified where governments had given away responsibilities to Central Banks and why. This had been happening in many instances and for a whole variety of reasons.

2 With the agreement of Members of Court, a Senior Adviser in the Developing World Division part of International Divisions and co-author of the paper on The New South Africa, attended for the discussion. In introducing the paper, Mr Crockett explained that the paper concentrated on some of the specific issues faced by the UK, and in particular the Bank, as regards South Africa.

South Africa was undergoing a drastic transition which we all wanted to succeed. The UK generally, and the City in particular, were more involved than most. There was a reasonable chance of negotiated transition, assuming the coalition Government's policies were sufficiently pragmatic to maintain the transition on track. Much depended on how durable the ANC's own transition would prove from its previously Communist inspired beliefs.

Mr Crockett said it had been assumed there would be relatively little lending to South Africa from commercial banks or inward investment generally. The country's relationship with the IMF would also prove very important. Other countries in Africa were perhaps over optimistic about the amount of growth South Africa would generate in their own countries.

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One further point made by Mr Crockett was that the Bank would continue with the initiatives it had taken in the field of training.

In opening the discussion that followed, Mr Laird said he considered it a good report. From contact he had had with trade unions in South Africa, he felt that transition would work providing the violence did not get out of hand. He felt it was most important for the Bank to continue with its training initiatives and for ECGD to be encouraged. We should not lose our foothold in South Africa.

Sir Adrian Cadbury said he had been in South Africa 4 weeks ago. He had noted that the large South African conglomerates were looking at breaking themselves up. This was true more of the Afrikaner companies than the English speaking ones. He had been impressed by the way companies were prepared to push their plans forward. He made two other points of interest. Firstly, the surprisingly good relationship that existed in many cases between those who had been put in jail, and those that had placed them there; and, secondly, the total lack of stake that ANC members had in the economy.

Sir Christopher Hogg wondered if the Bank was operating within overall UK government policy, or whether it was in a position to make a contribution on its own. In reply, Mr Crockett said the Bank was close to HMT and the Foreign Office, and was looked to for a banker's view. We would offer this advice in the context of ECGD exposure for example. In other areas, we were very much in the role of honest brokers, with our views being persuasive in gathering support for South Africa. Our contribution to training future central bankers was vital; no one was in such a good position as ourselves.

In response to Sir Christopher Hogg's question of whether or not our involvement was welcome in South Africa,

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Mr Crockett said it was. The Reserve Bank was appreciative. In a broader context Mr Laird said there was wide respect and affection for British institutions. There was no anti-British feeling.

Under the weekly executive report:-

1 Mr Quinn said that today was D-day for the signature of a rescheduling agreement in respect of the FNFC group. The group had been struggling under liquidity and solvency pressures for many months. They were down to the wire today. If the agreement were signed, it would probably be the last of the small bank emergency cases with which Banking Supervision had been dealing. If it were not signed, there was a good chance the whole group would go under. If this did happen, the question arose of whether or not the Bank should contemplate intervening; but as there did not appear to be any risk of systemic problems, such a course would not be pursued.

A further issue was whether the Bank should be active in encouraging the 108 banks involved in lending to the group to sign the agreement. It was hoped it would not be necessary for the Bank to exercise any overt intervention. There was one bank that was holding out against signing and it might come round. If not, the rescheduling agreement would fail, and the Bank might well approach the relevant bank to see if it could be brought round.

FNFC's liabilities were to other banks in the main and not to the public. The size of public deposits had diminished steadily during the period in which the group was under pressure.

The Governor commended the efforts of Mr Quinn in trying to save the bank, adding that getting so close to saving it would not have been possible without the efforts of Banking Supervision.

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2 Mr Kent briefed Members on the latest developments concerning Eurotunnel. He said that agreement had been reached between Eurotunnel, the contractors and the agent banks on the phased opening and financing arrangements. The agreement had been signed in the Bank the previous Tuesday on behalf of the British and French counterparties. Mr Kent added that the Bank had acted as a catalyst in the matter. We had recognised from the start that a lack of City support for the funding of undertakings of this kind was a City issue. There were no other sources and, therefore, we had felt the City should be encouraged. We consequently had a relationship with all the parties involved and it was thus natural for them to turn to us for help in sorting out problems. The agreement that had been reached represented an act of faith by all parties.

In response to Mr Laird's enquiry as to whether or not the Bank should have been involved, the Governor said he was unsure whether we should have got involved at the start, but that was now history and it was right that we should now continue to run with it. The agreement was a great achievement on Mr Kent's part and was very good for the Bank and its reputation. Mr Laird asked that Court record their appreciation of the Bank's role in general and Mr Kent's in particular.

Rupert Pennant-Rea

Mr Hoffmann
Assistant Secretary
5th August

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A COURT OF DIRECTORS AT THE BANK

THURSDAY 5 AUGUST 1993

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Sir Colin Ross Corness
Mrs Frances Anne Heaton
Sir Christopher Anthony Hogg
Sir John Chippendale Lindley Keswick
Mervyn Allister King, Esq
Gavin Harry Laird, Esq, CBE
Sir Christopher Jeremy Morse, KCMG
Brian Quinn, Esq
Sir Colin Grieve Southgate

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The Minutes of the last Court, having been circulated, were approved.

There were no comments on the weekly figures.

The Governor gave an account of events of the previous weekend in Brussels when the future of the ERM was discussed. The Germans had begun by saying that they had called the meeting of the Monetary Committee because they felt they had arrived at the limits of the system. They had reduced interest rates despite doubts as to whether this was appropriate for their domestic economy; and the intervention they had undertaken had gone beyond their obligations. The Governor said there were

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two points worth explaining on intervention. Firstly, the value of the ECU is reduced if an ERM currency devalues or floats down out of the system. In that event a country that lends heavily in ECU-denominations to finance intervention (as Germany did) suffers a sizeable financial loss. Secondly, the impact of massive intervention is to boost liquidity in the country whose currency is sold into the market. It was therefore understandable that Germany should have called the meeting. Their solution was to propose widening the ERM margins to 6%. However, the French had been anxious to carry on; they felt their central rate was sustainable and, if necessary, they were prepared to intervene on a larger scale with Germany too undertaking (unlimited) intervention for their own account. Failing that the deutschemark should itself float out of the system. The Spanish considered the best solution to be generalised floating. These were the main positions in the Monetary Committee, where there had been two further proposals: carry on as before with an accelerated timetable for the move to full monetary union; or a solution involving "variable geometry" for wider bilateral margins. These six options were presented by the Chairman of the Monetary Committee to the ministerial meeting, the Chairman himself saying he thought the right solution would be for Germany and Holland to float out of the system. This was the principal option explored by the Belgian Presidency in protracted bilateral discussions. It failed for two reasons. The first was quasi-political: the Belgians' monetary policy was anchored in narrow margins against the Germans and Dutch and they would be unhappy if they were not part of the joint float. They insisted upon joining the deutschemark bloc rather than the franc bloc. The Danes and the Irish then said they were in the same camp. This threatened to leave the French on their own or in a small residual ERM bloc with Spain and Portugal. The second, more technical, difficulty was that there would need to be an agreed approach to the conduct of monetary policy in the remainder of the bloc. If one assumed the French adjusted their monetary policy to suit their own domestic situation this would not suit the Irish for instance, who were happy with their link to German policy.

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After 6 hours of these bilateral negotiations the ministerial meeting reconvened without any solution having been found. The Chairman suggested that the only practical option was a general suspension of the ERM. At this stage the Chancellor of the Exchequer expressed his disappointment, suggesting it was still far too soon for participants to give up. He proposed that the two main alternatives, wider margins and a DM/Guilder float should be looked at again. Another adjournment then took place during which attention focused on wider margins with a number of detailed approaches being explored. The two main ones were a band structure in which the 6% margin should be extended to 9%/10%; or simply that the 10% margin should apply to everyone. The latter suggestion did not find favour with the Spanish or Portuguese as they felt it did not give them sufficient flexibility. They favoured even wider margins and, after a succession of enlargements, a 15% margin was eventually agreed. Two particular advantages were seen in this solution; it would maintain the existing framework at the same time as providing a broad limit within which the scope for predatory exchange rate behaviour would be constrained.

Despite the pressures the tone of the meetings had been civilised. The only occasion on which German monetary policy had been mentioned was by the French. They said that if the Germans could have reduced their interest rates more aggressively the existing arrangements could have been maintained, but they nevertheless understood why that was not possible.

The Governor commented that what had happened since the weekend was equally interesting. There had been a body of opinion at the meetings that had wanted to punish the currency speculators or at least limit their profits. This thinking to some extent accounted for the fact that interest rates had generally not been lowered subsequently. But in addition there was a concern to preserve the counter-inflationary credibility of policy; that there should be no apparent shift from monetary stability to "going for growth" - a point that had been underlined in the Communique of the meeting. The Governor said he thought it was

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an open question how policy would in fact now be conducted, and one that would be at the centre of the Basle agenda in September.

In opening the ensuing discussion, Mr Laird asked where we went from here. He had been surprised by the muted voices of those who had advocated the ERM, such as exporters. He wondered whether or not the debate would return. The Governor said that he was sure it would continue. It had been too much to look beyond the immediate situation over the weekend. It would take time for matters to settle down. He could not predict which way the debate would go but it was important to recognise the emphasis which had been put on the temporary nature of the new regime. There was a clear hope that the pre-existing system could be reconstructed with pre-existing central rates and, some hoped, margins. That might not prove possible in practice; and in the meantime countries would find their own solutions.

Sir Jeremy Morse echoed Mr Laird's question. He noted that the question of accelerated progress towards monetary union had been dismissed, but he felt there was scope for going for a single currency amongst a small group of countries. Nevertheless, he accepted there were difficulties with this concept and that it might not be on the agenda for some time. Whilst the general view was that the ERM was only being abandoned on a temporary basis, in this country it was seen as the end of the movement towards such a system. He wondered what the official view was and where the Bank stood. Should the Bank press for more integration? In responding, the Governor said that the accelerated timetable of movement to EMU, suggested by Luxembourg, was generally regarded as unrealistic. Most people at the meeting put the emphasis on a temporary setback with the possibility of getting back on course to EMU in due course, once convergence had returned. The Governor himself thought there were two possible approaches: one, focusing on internal stability, with the exchange rate left in a wide band, pursuing the Maastricht convergence criteria gradually and achieving de facto exchange

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rate stability. The other, resurrecting something very like the ERM focusing on exchange rate stability and seeking to force convergence by that means. Most people in the Bank, he thought, would incline to the first approach.

Sir Christopher Hogg returned to the question of speculators and the feeling they should be punished. He wondered if central banks were lining up against the speculators. The Governor responded by saying there had been no serious suggestion of the re-introduction of exchange controls. What had been clearly demonstrated by the ERM tensions was that if the divergence was sufficiently severe, it could overwhelm the mechanism as it had developed, even where there was no question about the soundness of the "fundamentals". Sir Chips Keswick thought the problem lay with the number and complexity of market mechanisms in different member-states and a lack of understanding of how the market as a whole operated.

Mr Quinn expressed surprise that there had been no discussion to bring Italy and the United Kingdom back into the ERM framework. The Governor said that Portugal had raised the question in a teasing way, but others readily recognised the political unreality.

Sir Colin Southgate wondered if the reduction in German interest rates had been orchestrated. The Governor said it was hard to say. The Germans had said they could be more flexible on interest rates if ERM margins were extended but that the present level of their interest rate was appropriate domestically. This had not been pursued. It was fascinating, however, to see what had happened since the previous weekend. Bond yields had declined from last week to this. Taking this up, and the affect on the markets as a whole, Mr Plenderleith said the pattern of rates of the weaker currencies was a matter of the "fall that did not happen". Currencies had recovered since. The French and the Danes had not made use of the flexibility available from the wider bands and the Germans had helped by again easing their rates. All this could be interpreted as an attempt to squeeze speculators. He went on

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to say that the substance of the negotiations had been to preserve the position of the franc, and give the Germans the opportunity to deal with their domestic problems. The French and Belgians did not want their currencies to depreciate. It would be interesting to see in the short run if this position was sustainable. The effect on our own markets had been small with little movement in sterling and money markets calm. The rally in the bond markets had arisen from the market view across Europe that interest rates would be brought down.

Sir Colin Southgate commented that with unemployment running at 11½%, the French would find it very difficult to sustain their rates.

In conclusion, and in response to Sir Jeremy Morse's enquiry about the programme for the European Monetary Institute, the Governor said that there would now be even greater pressure to reach early decisions on the site and the President.

At the Governor's invitation, Mr Harris presented the Report and Accounts of BE Museum Ltd for the year ended 28 February 1993, which were laid before Court.

Under the weekly executive report:-

(i) The Governor invited the Deputy Governor to speak briefly about Public Affairs, mentioning that there would be a longer Court discussion on the topic in September. The Deputy Governor said there were 3 strands to the Bank's approach to its relationship with the public. Through relations with the press; through its dealings with Parliament and its members; and in its attempt to answer questions from the public in a uniform manner. How we answered these questions moulded the public's perception of the Bank. It was important for the Bank's image and stature that responses were made promptly and that serious answers were given to serious questions. The arrangements for answering letters had recently been streamlined with an initial response

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required in 48 hours and a more substantial letter sent within 10 days.

This approach was welcomed. Mrs Heaton emphasised the need to maintain our contacts with both the City and Industry. The Deputy Governor said the Bank had done so for sometime through meetings, lunches/dinners and press releases. Mr King mentioned that some 140 letters a day were received addressed to the Bank and 100 from members of the public to individuals in the Bank. Not surprisingly some contained complaints which were wide ranging.

(ii) Mr Kent gave a progress report on the Bank's efforts to identify the current financing situation for small businesses, mentioning that a long Court discussion on the topic was scheduled for 14 October. He said that the then Deputy Governor had hosted meetings earlier in the summer, one with the CBI and with other representatives of small firms' lobby groups and academia. Continuing the process the Governor and Deputy Governor were holding meetings with the clearing banks to discover their response to the questions raised by small businesses. The price of finance available was not the main issue; it was more one of relationships with the banks, the mix of different facilities available, and how small businesses handled themselves.

The results were so far encouraging. The banks were all committed to the small business sector, but were developing individual and distinctive services. This should encourage competition. The plan was to prepare a note for Court in October, and send it afterwards to the Chancellor. If the overall picture was constructive, another exercise on bank lending margins would not be necessary.

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In response to Sir Christopher Hogg's question asking if banks understood the way they were viewed by small businesses, Mr Kent said the commitment to the small businesses from the top seemed genuine. However, there was an attitude problem. It was important that managers dealt with them in a proper way. In one of the banks the real decisions had been taken away from branch managers and had been placed instead with local business centres. These centres provided a more knowledgeable and professional service. All the banks were creating incentives for managers to deliver the service. Banks for their part realised that their lending officers needed to exercise better business judgement. The Governor added that mutual education would need to take place between bankers and small businesses but this would take some time. It was difficult to speak to small businesses in a collective way. Our understanding of the way small businesses viewed banks left something to be desired but extensive surveys were being undertaken by the banks of small business customers. Mr Kent commented that the problem was not one of the supply of funds but rather a lack of demand.

(iii) Mr Plenderleith mentioned that at the time of the Annual Report to Court, Members had expressed interest in the Registrar's Department's initiative regarding "Investors in People". He said he was pleased to report that the Department had been awarded its national standard for "Investors in People" by Gloucestershire TEC. This reflected very well on the Department who had had to recruit and train over 300 people.

Mr Hoffman ... Assistant Secretary
12th August 1993

Eddie H [signature] 12th AUG 1993

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A COURT OF DIRECTORS AT THE BANK

THURSDAY 12 AUGUST 1993

Present

Edward Alan John George, Esq, Governor
Gavin Harry Laird, Esq, CBE
Anthony Laurie Coleby, Esq
Sir Colin Ross Corness
Sir Christopher Anthony Hogg
Sir Martin Wakefield Jacomb
Sir John Chippendale Lindley Keswick
Mervyn Allister King, Esq
Sir Colin Grieve Southgate

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The Minutes of the last Court, having been circulated, were approved.

Details of the weekly figures and graphs relating to the state of the foreign exchanges and the domestic markets were laid before Court.

At the Governor's invitation and with the agreement of Members of Court, Mr King's Personal Assistant, who had been involved in the production of the Inflation Report, attended Court for the ensuing discussion.

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Mr King spoke in detail about the final version of the Inflation Report, which was published on 10 August. In introducing the Report, he noted that the final version reflected more recent data and further work carried out since the previous presentation to Court of the draft version. He hoped his remarks would explain why the Report was structured in its current form and how the inflation forecast emerged from the economic analysis. At the same time he asked for comments on the Report's format and its appropriate target audience.

Section 1, recent price developments, was intended to establish what our recent inflation performance had actually been. It tried to convey the point that no single measure of inflation is sufficient. The RPIX measure, in terms of which the Government's target is specified, was not the best guide to underlying inflation at the moment, in particular because of the effect on it of changes in local authority taxation. Hence one needed to look at a measure excluding local authority and indirect taxes as well as mortgage interest payments. Also, it was important to look at short-run measures of inflation, producer output prices, and the behaviour of the GDP deflator (for domestically generated inflation). In addition, Mr King reviewed various measures of 'core' inflation presented in the Report. The conclusion that inflation had fallen substantially and now showed no tendency to increase was robust to the choice of inflation measure.

In response to a question from Sir Christopher Hogg, Mr King explained how the data underlying the RPI were collected from a large representative sample of retailers and weighted each year according to the expenditure patterns identified by the Family Expenditure Survey, which was very thorough but did have some difficulties with the top 1% of the income distribution. They were probably as reliable as the best CSO statistics. The Governor pointed out that many of the alternative inflation measures were derived from the same survey data. Mr Coleby stressed that, although one had to choose one measure with which to define a target range, it was important to collect evidence about inflationary pressures from many sources. The

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GDP deflator, for example, was helpful with respect to domestic costs, although it was subject to greater measurement error and was available only quarterly in arrears. Sir Chips Keswick noted that the 'green pound' regulations had given a bonus to farmers recently, which illustrated that there were more distortions in pricing than was widely appreciated. Mr King agreed that the 'green pound' was relevant, particularly for food prices, but was a very complicated issue. Mr Plenderleith drew attention to the behaviour of producer output price inflation, which had dropped much less recently, although it had been low since the end of 1991. In response, Mr King stressed that the Bank's credibility required that all sorts of measures were presented, not just those which happened at the time to be most favourable to the Bank's objective. Mr Laird asked whether the Bank used the same tools as outside economists; do they accept our analysis? Mr King explained how outside economists had been brought into discussion of technical issues such as the Divisia index of money, and how the Bank had analysed responses to earlier Reports with care. Sir Colin Corness asked why the inflation rate for services had dropped so much in the last month. Answering the question, Mr Coleby said that this reflected the 'RPI minus X' pricing formulae used by many utilities, and the success of the Government's public pay policy in keeping down the price of Government services. Sir Colin Southgate asked if the Bank had compared UK food price inflation with that in other countries. This was an interesting question said Mr King, which could be addressed in a future Report.

Mr King then moved on to talk about Section 2, on monetary and fiscal policy. Measuring the stance of monetary policy was difficult. At present, M0 was increasing faster than the top of its monitoring range, while M4 growth was near the bottom of its range. The rapid growth of M0 was probably a temporary response to the falls in nominal interest rates to January and M0 velocity was likely to increase less rapidly in the future; this would be monitored closely over the coming months. M4's behaviour was likely to be a better guide to inflationary pressures at the moment, suggesting inflation would remain low.

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Mr King explained how yield curves calculated from gilt prices can be used to investigate what the markets expect the monetary policy stance to be in the future. A profile for the short-run annual interest rates expected can be derived from the yield curve. At the moment the numbers derived were difficult to reconcile with annual inflation remaining at around 3%. Markets were sceptical that the authorities would remain committed to the inflation target over the next ten years, but some headway had been made since last autumn in convincing them. Mr King then discussed fiscal policy, arguing that big deficits gave rise to fears that future Governments might monetise their debts. The large primary deficit of the UK was a source of concern.

The Governor felt that the Report was very clear about the relationship between monetary policy and inflation, but less so about the role of fiscal policy. Fiscal developments influenced expectations of future monetary policy, but this message could be made more explicit. Mr Plenderleith noted that large deficits by themselves need not be a problem; the Bank had been able to finance this year's deficit without stopping long-term interest rates falling. Mr Coleby argued that the country had reduced its debt in the past by indulging monetary vice; we needed to encourage more fiscal virtue in the future. Sir Martin Jacomb asked what the profile of implied forward interest rates would have looked like at dates in the past. Responding, Mr King said that these profiles had not been calculated, but that the question would be followed up; there was a problem in measuring the risk premia in market yields. Mr Laird mentioned that his experience as a pension fund trustee, suggested actuaries were rather good at making long-term forecasts of prices and so forth.
Sir Chips Keswick thought that more publicity should be given to the dangers of a high debt GDP ratio. Commenting, the Governor noted that the United Kingdom's low ratio derived partly from good fiscal behaviour in the mid-1980s, whilst Mr Plenderleith drew attention to the fact that the interest rates expected in the long term had only just fallen back to

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the level expected in May 1992. Mr King agreed that it took time to re-establish anti-inflationary credibility.

Mr King went on to review the issues covered by Sections 3, 4 and 5, which concerned the adjustment of inflation to its long-run level. Inflation was likely to fall while the output gap was positive, but the problem was measuring the gap. The difficulty was in estimating the true level of potential output. Similarly, it was difficult to measure the 'natural' rate of unemployment. Mr Coleby drew attention to the unpredictability of capital productivity, one factor in some estimates of potential output. Mr King reviewed alternative approaches to measuring the capital stock, and said that this was an area worth investigating further. Sir Chips Keswick stressed that business people were most concerned about the cash flows which would be generated by investments in physical capital. Moving on to Section 4, on the labour market, Mr King outlined the significance of short-term unemployment rates, relatively low regional mismatch, and falls in unit wage costs, which had permitted profits in manufacturing to go up.

Mr Plenderleith said he was worried that increasing profitability would be followed by higher wage increases; Mr King thought this would depend on bargainers' inflationary expectations failing to adjust. Mr Laird expressed surprise at the success of the Government's public sector pay policy in influencing the current round of pay bargaining.
Sir Martin Jacomb asked if inflationary pressures were simply being built up behind a dam; Mr King felt not.
Sir Chips Keswick regretted that the graph of the rate of return on capital was misleading because it did not adjust for risk; Mr King agreed that it was uncertain what the required rate of return on capital would be as recovery proceeded.

Turning to the prospects for inflation, Mr King outlined the three key factors. First, monetary policy was consistent with continuing low inflation over the next couple of years. Second, both unemployment and excess production capacity would continue to exert downward pressure on inflation. Third,

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attempts to restore profitability were unlikely to generate strong upward pressure. The Chart on RPIX inflation projections and outturns embodied our final judgment about the direction in which inflation was heading; Mr King stressed the large margin of error associated with any such prediction, and pointed out that the Bank avoided giving numerical point forecasts. Inflation measured by RPIX was heading towards the top of its target range but was not expected to exceed it; a better measure of underlying inflation was likely to remain level at just over 3%. The forecast was lower than it had been three months ago because unit wage costs had fallen faster than expected.

The Governor then drew attention to Sir David Lees's letter questioning the format and target audience of the Inflation Report. The Governor said that it was designed for an informed audience, a very important target market. This was not a broad audience. 'Bank Briefing' had been designed to reach a wider public; he thought that we should take another look at it to see if it could be a more effective vehicle for popularising the Inflation Report message. Sir Colin Corness thought the Report was a very good publication as it was, but did we know how many people it reached? Did it get into the right hands? Mr Laird said that he found the Summary and Sections 6 and 7 excellent; we should not consider changing the format until several more editions had been published. In response to an enquiry if more promotional work could be done for 'Business Briefing', the Governor agreed the Bank would look at this issue and into the present distribution of both the Briefing and the Report.

At the Governor's invitation and with the agreement of Members of Court, Mr Jarvis, the General Manager of the Printing Works attended Court for the agenda items that concerned the Printing Works.

Mr Laird presented the Annual Report of the Printing Works; his Report, in his capacity as Chairman of the Debden Committee -

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which included the Summary of the Audited Accounts of the Printing Works for the year ended 28 February 1993, together with a Summary of the Audited Accounts of Debden Security Printing Limited for the same period. These documents were laid before Court.

In the Deputy Governor's absence, Mr Kent introduced a paper produced by the Deputy Governor, on the future ownership of the Printing Works. In highlighting the issues mentioned in this paper, he said that for some time there had been rumblings emanating from the Treasury about the possible privatisation of the Printing Works. This had now manifested itself in a formal way in a letter the Governor had received from Sir Terence Burns in which he said that Ministers had asked the Treasury to discuss the possibilities of identifying candidates for privatisation.

Mr Kent went on to say that the Deputy Governor had produced a list of headings that the Bank needed to address, the outcome of which would form our response to the Treasury. He believed the Government expected to get the same benefit from any possible privatisation of the Printing Works as they had done from other privatisations. In considering this it was crucial to identify the difference between the Printing Works and other utilities. When other utilities are privatised it is the consumer that pays for increased costs. With the Printing Works it would be the Government and they would have to meet any resulting rise. If we could show that we keep costs as low as possible it would indicate they received value for money.

Mr Kent said he would bring to Court the papers put to the Treasury. The possible privatisation of the Printing Works posed a most serious threat to the Bank and resisting it would be a considerable battle.

Sir Christopher Hogg suggested that it would be difficult for the Bank to defend itself. It would be necessary to emphasise the factors of quality, security and cost effectiveness. Every possible means of comparison between the Printing Works and

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other comparable activities should be pursued with particular emphasis on the exchange of information and cost pictures.

Sir Colin Corness expressed concern that the more we demonstrated how efficient we were the more attractive the proposition of privatising the Printing Works became. This would be especially true if it became possible to tender for the printing of bank notes in the Common Market.

It was, the Governor said, a very difficult question. We could not pretend it was not possible for the printing of bank notes to take place away from the Printing Works. But it was very important to ensure the whole integrated process did not become distorted. We must not get into a triangle bounded by Treasury control of costs, our specifications and the notes printed by someone else.

Sir Martin Jacomb thought there was a strong argument against privatisation. It would be very difficult to sell, entering into any long term contract between a Commercial Printing Works and the Bank. If one did so you would have the situation of a monopoly supplier.

In responding to Sir Christopher Hogg's comment that the Bank's best defence was the efficiency of the operation, the Governor said that we had a clear responsibility to operate as efficiently as possible irrespective of how that affected the argument.

On conclusion of Court's discussion on the ownership of the Printing Works, Mr Kent presented a submission which sought Court's endorsement of the proposals for Phase II of the Printing Works Services Refurbishment and Retrenchment of the Returned Note Operations and Access Control at the Printing Works.

He returned to the metaphor of light bulbs that had been used earlier in proceedings during the discussion on the inflation

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report. If the average life of a bulb was, say, 250 hours, the services at the Printing Works had already lasted longer. They were still working but were unlikely to last for much longer. The equipment had been modernised and it was now the turn of the plant. A review of options carried out in 1990 examined three: relocation, rebuilding on site and refurbishment. When the relative costs were examined there was only one possible choice and that was a programme of refurbishment. This would have the added advantage of reducing the buildings used from three to one with consequent savings in revenue through a reduction in rates as well as the possibility of being able to sell some land which would be released as a result.

A long time had been spent on the preparation of the specifications. We had wanted to avoid as far as possible the traps that arose with the contracting industry through poor specification: or changes to specification; and the danger of unknown risks. The Printing Work's consultants, who were on fixed fees, were 95% confident of the costs providing no changes were made to the specifications. The Debden Committee had examined the proposals very carefully - a point emphasised by the Chairman, Mr Laird - and had concluded they were right and represented good value for money. Mr Kent asked for Court's endorsement of the proposals which would cost a further £31½ mn in addition to the costs expended to date on Phase I Refurbishment and Ink Section Retrenchment. There would be a further cost of £1¾ mn for access control where improvements were necessary as well.

The Governor said to Court that it was apparent that something had had to be done and he considered the general approach proposed was the right one.

Sir Colin Corness commented that it was important that prospective contractors were not presented with possible alibis through not being given sufficient opportunity to inspect the site, the scope of work and the security requirements.
Mr Jarvis, in responding, said he intended to obtain written

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assurances from contractors that they had been made aware of all security and health and safety requirements.

Members of Court expressed themselves content with the proposals.

Rupert Pennant-Rea

[illegible]
Assistant Secretary
2 September 1993

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A MEETING OF DIRECTORS AT THE BANK

THURSDAY 19 AUGUST 1993

Present

Edward Alan John George, Esq, Governor
Gavin Harry Laird, Esq, CBE

Hugh Christopher Emlyn Harris, Esq
Ian Plenderleith, Esq

The number of Directors assembled being insufficient to form a quorum, those present proceeded to the business, subject to ratification by the next Court.

The Minutes of the last Court, having been circulated, were approved.

There being no comments on the weekly figures, Mr Plenderleith spoke about the foreign exchanges and the state of the domestic markets.

There were no items for discussion under the weekly executive report.

[handwritten] ... Hoffmann
Assistant Secretary
... September 1993

[signature] Rupert Pennant-Rea

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A MEETING OF DIRECTORS AT THE BANK

THURSDAY 26 AUGUST 1993

Present

Edward Alan John George, Esq, Governor
Sir George Adrian Hayhurst Cadbury
Anthony Laurie Coleby, Esq
Andrew Duncan Crockett, Esq
Sir Christopher Anthony Hogg
Sir Martin Wakefield Jacomb
Sir John Chippendale Lindley Keswick
Professor Sir Roland Smith

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The number of Directors assembled being insufficient to form a quorum, those present proceeded to the business, subject to ratification by the next Court.

The Minutes of the last Court, having been circulated, were approved.

There being no comments on the weekly figures, Mr Coleby spoke about the foreign exchanges and the state of the domestic markets.

At the Governor's invitation, and with reference to a Minute of 24 June, Mr Kent drew Members' attention to the composition of the CREST Steering Committee and the Executive Committee. Membership of the Steering Committee had been chosen by the Bank to represent a cross-section of the equity industry while the Executive Committee was, at present, drawn entirely from Bank staff. It was possible that in due course other

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representatives from the securities industry might be seconded to the Executive Committee on a consultative basis. Iain Saville, the Project Controller was discussing this with the BMBA and others.

Mr Kent also mentioned that Touche Ross, who had a particularly good understanding of the equity market and who had not been involved with TAURUS, had been appointed to build a model of the market so that the Steering Committee and the equity industry would have a structure within which to test views about what changes would be necessary in an interactive way. On timing, Mr Kent said that the Project Controller was due to deliver a design specification for the CREST equity project, including an assessment of its feasibility, by 1 May 1994. Recommendations regarding future ownership, management and funding would also need to be considered later this year.

The Governor said that this was a particularly important project for the Bank which fell within the Bank's third core purpose, the promotion of the efficiency and effectiveness of the UK financial services sector. He said that he anticipated a considerable debate in due course over the ownership of CREST and noted that the Chancellor of the Exchequer was rather sceptical about central bank involvement in this project. Sir Martin Jacomb cautioned that some members of the Committee might take up rather entrenched positions as their particular interests may be adversely affected by the success of the project.

In conclusion the Governor mentioned that, following the earlier Court discussion about the equity markets, there had been a number of interesting meetings held within the Bank. He reiterated his intention to bring a further paper setting out the Bank's position, to Court in the near future.

With the agreement of Members of Court, Mr Clark, the Head of European Division and Mr Taylor, the Chief Adviser, both of whom had been involved in the production of the paper entitled

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'The ERM: possible ways forward', attended Court for the ensuing discussion.

The Governor, introducing the discussion, said that there remained considerable uncertainty about the monetary policy framework in the major European countries; and about the future of the Exchange Rate Mechanism as a vehicle for monetary integration in Europe. Neither of these issues would quickly go away. The paper was designed to initiate a debate with HMT before EC discussions in the autumn.

Mr Crockett noted the existence of two basic philosophies regarding the EMU process. In the first, economic convergence led to exchange rate stability and ultimately a single currency. In the second, exchange rate constraints brought about the convergence. The lesson from recent experience was that the latter probably did not work. He nevertheless warned that the rest of the EC was not ready to jettison the system in which they had invested so much for so long a time. Mr Clark endorsed that view, pointing to the virtual absence of slippage of exchange rates in the market since 1 August, and the indications that many States were seeking to get back to the previous structure. Summarising the paper, he said that the upset in the ERM and the earlier "fault lines" review had led us to two principal conclusions: firstly that parity adjustments had not been sufficiently flexible, and narrow bands had not been sustainable in the circumstances of German reunification, etc; and secondly that there was now a case for supplementing the existing convergence criteria-plus-15% bands with an absolute inflation criterion. The reference to the Hard ECU had been introduced in deference to the revival of the idea in the press. Mr Taylor said the paper raised an important issue about the role of the ERM as a means of achieving exchange stability in the Community. He thought an adjustable ERM with narrow bands might well have a place in the longer run, provided that it followed rather than preceded convergence, and that it did not require all participants to belong to the narrow band.

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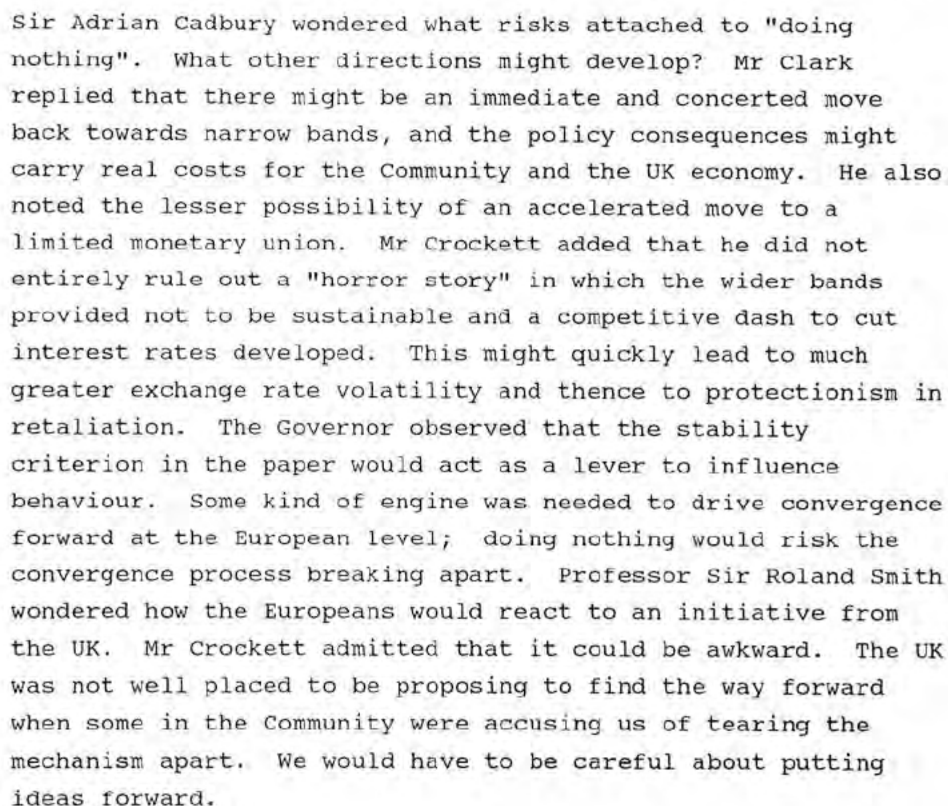
Sir Martin Jacomb wondered where the UK interest really lies. He thought it fruitless to search for a fixed exchange rate system without economic convergence. But for the time being the UK was in a weak position to urge convergence, given the vulnerability of our fiscal and external balance of payment positions. However, we should try to stay at the centre of the debate. Sir Christopher Hogg had enjoyed the paper and found it helpful. He nevertheless felt it a pity that the general debate had become so focused on monetary policy matters. What also mattered was the UK's poor competitiveness and lack of the flexibility required to survive in free international markets. The strains of belonging to a fixed rate system could be enormous if we did not develop more industrial flexibility. A breakdown would lead to an agonising reappraisal. We should not relapse into the old thinking.



Sir Adrian Cadbury wondered what risks attached to "doing nothing". What other directions might develop? Mr Clark replied that there might be an immediate and concerted move back towards narrow bands, and the policy consequences might carry real costs for the Community and the UK economy. He also noted the lesser possibility of an accelerated move to a limited monetary union. Mr Crockett added that he did not entirely rule out a "horror story" in which the wider bands provided not to be sustainable and a competitive dash to cut interest rates developed. This might quickly lead to much greater exchange rate volatility and thence to protectionism in retaliation. The Governor observed that the stability criterion in the paper would act as a lever to influence behaviour. Some kind of engine was needed to drive convergence forward at the European level; doing nothing would risk the convergence process breaking apart. Professor Sir Roland Smith wondered how the Europeans would react to an initiative from the UK. Mr Crockett admitted that it could be awkward. The UK was not well placed to be proposing to find the way forward when some in the Community were accusing us of tearing the mechanism apart. We would have to be careful about putting ideas forward.

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Sir Chips Keswick believed that there would be no shame in the UK doing nothing. We had to put our own house in order on matters like competitiveness; it was early yet to claim that we had achieved this. The Governor replied that this was a very salutary remark.

Professor Sir Roland Smith said that he had been struck recently, while reading a PHD thesis on industrial structure and economic growth, by seeing what enormous differences existed across countries in the industrial world. European industry faced a massive exercise of readjustment. Considerable changes in industrial scale had been taking place outside Europe, where scale of industrial organisation was frequently sub-optimal. The Governor noted that relative exchange stability would go towards solving that. How to establish this was the problem.

Sir Christopher Hogg, agreeing that price stability was a precondition for sustainable growth, asked whether monetary authorities were likely to be unduly conservative in their efforts to achieve it. Mr Coleby conceded that there was some short-term conflict between growth and combating inflation. In the UK, we had been trying to find a path to allow recovery without undermining the price stability objective. It remained to be seen how successful we would be. Sir Martin Jacomb remarked that the stability goal would be more easily achieved if short-term political considerations were removed. He hoped that such a removal could emerge from the present approach to the ERM and that we would concentrate on convergence. The Governor reverting to Sir Christopher Hogg's point, said that policy worked in important degree through affecting expectations. While it was true that undue caution could affect output adversely in the short-term, it was equally ture that an easier policy could affect prices rather than activity if it were thought that we were embarking on another boom/bust cycle. The real issue lay in judging where one was between the two positions of maintaining confidence in the recovery while avoiding rekindling inflation expectations. Sir Adrian Cadbury

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noted that uncertainty was indeed the great problem. Here our record had been appalling.

Mr Crockett observed that central banks had essentially two problems: firstly to decide upon and pursue medium-term price objectives, and we were all agreed on that; and secondly, on how to react to shocks. There needed to be discretion about the speed of returning to price stability after a disturbance. The Bundesbank decision to keep interest rates high had posed great problems for the rest of Europe. Outside the tight constraints of the ERM, countries had more scope to pick their own pace at which to return to the stability objective. The Governor noted the strength of EC States' concerns not be seen to backslide on their commitment to price stability. Agreeing, Mr Plenderleith said this was particularly notable in France, Belgium and many of the small countries which were contiguous with Germany. It was understandable that they are reluctant to give the ERM framework up and are nervous about a more discretionary approach.

Summing up the discussion, the Governor felt that Court had accepted Sir Martin Jacomb's position on the way forward. No-one wished to go back into a tighter regime, with the choice lying between staying where we were and adding a price stability commitment to the 15% margins. He noted that no-one had mentioned the Hard ECU. Sir Martin Jacomb said that he had been a bit in favour of that scheme but was persuaded by the case made against it in current conditions. The Governor agreed that it had served a useful purpose. He thanked Court for an interesting and helpful discussion.

Under the weekly executive report:-

(i) the Governor said that it would be announced the following day that Mr Jon Foulds, the Chairman of the Halifax Building Society, would be appointed as an independent member of the Board of Banking Supervision for a period of five years from 1 September 1993.

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(ii) The Governor also mentioned that Dr Schlesinger, who would be retiring from the Presidency of the Deutsche Bundesbank on 30 September, had accepted the Governor's invitation to join Members of Court for lunch on Thursday 14 October.

D. Hoffmann
Assistant Secretary
3.9.93

Rupert Pennant-Rea

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A COURT OF DIRECTORS AT THE BANK

THURSDAY 2 SEPTEMBER 1993

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Anthony Laurie Coleby, Esq
Sir Colin Ross Corness
Andrew Duncan Crockett, Esq
Sir Christopher Anthony Hogg
Sir John Chippendale Lindley Keswick
Mervyn Allister King, Esq
Gavin Harry Laird, Esq, CBE
Sir David Bryan Lees
Sir Christopher Jeremy Morse, KCMG
Brian Quinn, Esq
Sir David Gerald Scholey, CBE
Professor Sir Roland Smith
Sir Colin Grieve Southgate

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The Minutes of the Court of 12 August and the Meeting of 19 August were confirmed and those of the Meeting of 26 August, having been circulated, were approved.

At the Governor's invitation, Mr Midgley, the Head of Management Services Division, spoke to Court about the work of his Division. He said the Division had a wide range of responsibilities. There had been a change in emphasis and structure during the past year which would continue through the

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next two years. The two main examples of this were, first, the devolution of responsibility for secretarial and I&R staff to the user areas and, secondly, the restructuring of Information Systems (IS) to improve quality and reduce costs. It was the latter aspect on which his paper concentrated. Mr Midgley went on to say that IS provided services across the Bank. The only area into which it had not made inroads was Records Management Services and filing, although this was likely to change with a pilot project being undertaken to see how technology might assist in this regard.

The costs of MSD and IS over the next three years had been considered under two headings: investment and running costs. The reason for this was that there were very large on-costs and the only way to change such costs was by investing. A large part of the Division's investment programme was aimed at reducing running costs, the results of which had to be monitored closely. The aim of the strategy for reducing the remaining costs of IS by £4mn per year was still on target, although the investment required to achieve this would probably amount to some £4mn more than originally thought and take 18 months longer to put in place.

The savings that had been identified arose in the main from discontinuing the use of the IBM mainframe services. All the associated costs were now covered by the payment of one single fee to Hoskyns, which is responsible for our Facilities Management. The servicing costs of new networks are significantly less than those of the mainframe.

Mr Midgley then mentioned the various IS projects that were planned and also covered the savings that had been made in staff levels and costs as well as those projected.

In opening the ensuing discussion, Sir Colin Southgate asked Mr Midgley if he was happy with the fact that the actual numbers of staff in the Division were greater than those budgeted. Was this as a result of following Bank policy? Mr Midgley said he could manage in the current situation with

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surplus staff, so long as the number, as a proportion of the total staff, did not rise. In responding to Sir Jeremy Morse's enquiry on the state of morale, Mr Midgley said it had been adversely affected by the Facilities Management arrangements with Hoskyns, and also by pay. He went on to say that it was important to depress the morale of the right people - those of whom we would like to take severance. Those who had something to offer should be kept busy, whereas the others should not. This was true of those who had been involved with work in new development areas and the new settlements systems where morale was good, whereas those whose expertise lay in the old banking systems had lower morale. Generally morale was not good, but it was good enough for the area as a whole, especially where it was most needed. In answer to Sir Jeremy Morse's further question about the timing of reductions in the surplus staff, Mr Midgley said it was not an issue of numbers but more one of the distribution of talent - a problem which the staff realised. There were not enough good people about. Numbers had been built up to help with computerisation generally; this phase was now over. There was a need for analysts who were capable of looking at the Bank's business functions and not those who just concentrated on computer basics.

In the context of morale, Sir Chips Keswick said that in his company publicity was given to the percentage of overheads taken up by IS. He considered this was important: if people could not see what you were trying to achieve, it was difficult to lead them. It was helpful if comparisons could be made. Mr Midgley mentioned that in the Bank the figure was 16% but the aim was to get it down to 12%. Finding comparators, however, was difficult.

In answer to Sir Adrian Cadbury's enquiry about the training of those who used IS, Mr Midgley said that he tried to get people who could educate the user as well as installing the equipment. His staff made a point of ensuring that users were aware of the appropriate courses available and, subsequently, checking that these had been undertaken and had proved satisfactory.

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Sir David Scholey drew attention to the cost of the ISSP project for Banking renewal. The outcome had been appreciably greater than that anticipated. Also, he wondered if the Bank was over-engineered and equipped, and whether or not there was any scope for slimming down. In response to the first question, Mr Midgley said that the escalation in costs between the original guesses and the proposed projects arose in part because it incorporated a thorough review of work processes involving major changes in working practices, and also because the nature of central banking at its edges, which was important to us, was more complex than originally foreseen. On the second point, Mr Midgley said there was no major instance of over-installation, although there was a danger of too many PCs not being used. It was a difficult problem in the Bank, where we did not have profit centres.

Returning to the problem of morale and staff numbers, Sir David Lees asked if the planned reduction was realistic without a change in the Bank's policy on redundancy. Mr Midgley said this was a wider issue, but numbers had been reduced by a significant amount. However, he was more concerned about losing his good people than about those with less to offer not going.

Mr Harris, besides mentioning that the question of surplus staff was one that would be considered at the following week's Court, said that there was a system of looking at the cost of capital investment and deciding whether or not a charge should be made against a particular centre's current expenditure budget. It was up to the reviewing Director to decide if a reduction should be made in other expenditure to compensate for the costs of equipment.

Commenting on the staff position, Mr Plenderleith said that looking back over the past 10 years, the Markets area had been a major customer of MSD during the period and as a result had had links with markets outside the Bank. The quality of the product had been very good, and the projects very well run,

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producing good systems on time. In short, the area had an excellent track record.

Sir Christopher Hogg focused on the Bank's investment of £50mn in IS. He said its value was difficult to measure, but he was reassured by Mr Plenderleith's comments. In response to his question on whether in-house or out-house staff were used, Mr Midgley said in the 1980s it had mainly been the former but now had moved a little towards the latter. Sir Colin Southgate wondered if the Bank looked properly at the economics of an in-house as opposed to an out-house project. Mr Midgley said we did. We looked at comparators and priced internal projects on an external price comparison basis. Our daily rates were at the top end of agency rates.

The Governor concluded by thanking Mr Midgley for his presentation, which he said had been most useful.

There being no comments on the weekly figures, Mr Plenderleith spoke about the foreign exchanges, including the Official Reserves figures for August, and the state of the domestic markets.

At the Governor's invitation, the Deputy Governor spoke about a list the Bank wished to draw up of likely candidates for posts in various City organisations. This arose from the recent need to fill a vacancy on the Board of Banking Supervision. The Bank had considered various names, and had suggested some to the Treasury. There had been a slight disagreement with the Treasury over the names we had submitted. This had led us to conclude we should approach such opportunities more systematically. Besides appointments to the Board of Banking Supervision, the Governor had a formal role, for instance, in appointing the Chairman and other members of the Takeover Panel, the Chairman and three Deputy Chairmen of the Financial Reporting Council, nominating members of the Council of Lloyd's and the Chairman and members of the Securities and Investments Board.

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The Bank were looking for those with a wide range of relevant experience. We were familiar with people in the City, but needed to trawl further. The Deputy Governor went on to say that although the Bank would take responsibility for City sources it would be helpful if Non-Executive Directors, with their wider experience, could provide any names, on an informal basis, that might be appropriate to consider for such appointments - particularly fast risers or those who were about to retire. The Deputy Governor agreed to send a list of the jobs involved to Directors. In respect of those jobs where we had an interest with the Treasury, we would draw up a joint list of names that we would review every 6 months.

Sir Jeremy Morse enquired how this request related to the Bank's wider and traditional role of steering people into jobs. He wondered if the Bank was still active in this way. The Governor responded by saying that the Bank's experience over the previous few years was that, although we knew of people who were available, it had been difficult to find them appropriate slots. This had been true also of PRONED's experience. Mr Quinn endorsed the Governor's remarks, adding that there had been a danger of the Bank becoming an employment agency. Also, some had abused the Bank's role, suggesting they had the Bank's approval just because they had mentioned to the Bank they were available. Mr Laird entered a plea for the Edinburgh establishment, whom he felt had been unfairly treated. The Governor said the Bank would make an effort to contact them.

At the Governor's invitation, Mr Peddie, the Governor's Adviser in the Legal Unit, and the author of the paper 'Banking Act 1987: Possible Amendments', attended Court for the ensuing discussion.

In introducing the paper, Mr Quinn said that the Bank had been attempting to identify and agree with HMT those changes in existing legislation needed in the light of the BCCI affair and resulting Bingham Report. This was particularly true of the first two items on our "essential" list; but it applied also to other cases, both directly and indirectly.

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In some other instances, the need for change had arisen from changes in Community legislation. Some of these had been passed fairly recently, but their provisions did not anticipate the ramifications of the BCCI affair. They therefore unwittingly put obstacles in the way of supervisory authorities who, faced with another case similar to BCCI, would find their powers constrained in some way.

Finally, there were other proposed changes which, in the light of our experience of the Banking Act, which had been in operation since 1987, would improve our position as a supervisor or would enable us to help others to do their jobs, and might also indirectly assist us.

Mr Quinn went on to say that, as the paper made clear, some changes were more important to us than others. Perhaps the most important, and one that derived indirectly from the BCCI affair, was the first item. Without elaborating, legal advice we had received recently indicated that the current Act placed us in an impossible position as regards our responsibilities for branches of foreign banks in the UK. If left unchanged, it could lead to expulsion from London of many banks which had operated safely here for many years.

It had to be said we are facing some difficulties in persuading HMT of the importance and urgency of our need. This was partly due to the legislative log-jam, but also because HMG wished to avoid, if possible, controversial legislation in the financial services area. This made it important that we prepared our case fully and persuasively, and that we had the support of Court in bringing the case to HMT as the sponsoring department in the early autumn.

In commenting on the proposals, Mr Peddie said that some amendments would be possible only with amendments to existing directives, and one could not be certain such changes would be made. Bearing in mind Mr Quinn's comments on the avoidance of legislation if possible, Mr Laird said he was surprised at some of the technical amendments - some of which appeared

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lightweight. The Governor said that the point was valid and was one that had exercised the Executive when they had discussed tactics. Sir David Scholey said he supported Mr Quinn's opening comments. It would indeed be bizarre if the changes necessitated by BCCI were not accommodated.

Under the weekly executive report:-

(i) the Deputy Governor spoke about purdah arrangements. The question had arisen, and been formally dealt with in the Civil Service, in the context of those going to private sector jobs. The Bank had discussed the position and had drawn up the following rules to apply to anyone of Senior Official rank or higher:

(a) The Bank employee should inform his appropriate superior of any job discussions he has got involved in, and at the earliest possible stage. This should apply whether or not the Bank employee concerned is seriously considering a move. At that point, the senior Bank person should decide, in consultation with one or both of the Governors, whether the employee should be taken off particular types of Bank work.

(b) If a job offer is made and accepted, the Bank employee will, as a general rule, not be able to take up the appointment for three months after leaving the Bank. However, this rule may be waived by the Governors if there is judged to be no conflict of interest, of if there are judged to be overriding reasons why an earlier appointment is essential.

(ii) Mr Plenderleith:

(a) spoke to Court about the European Settlements Office project, which was one of the range of settlements facilities mentioned earlier in Mr Midgley's report. The first full day of

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trading in this new settlement system for ECU - denominated securities had taken place the previous day, and the system was operating successfully. It offered real-time same-day settlement for ECU-denominated bonds and money market instruments against assured payments in ECU. The Bank had developed this new service in response to market requests, following the success of similar systems for settling gilt-edged stock and sterling money market instruments. The system would be running in parallel with the established Euroclear and CEDEL Settlement Systems for the Eurobond market; it would be complementary to them, as we would be providing real time settlements as distinct from their batch processing. The new settlement system would make a particular contribution to the development of an ECU repo market. This would be good for the London markets generally, and especially if the ECU ever came to have a wider role in the process of European Economic and Monetary Union.

(b) reported that settlement had now been reached with Tarmac on the contract for their construction of Southgate House, Gloucester. A dispute had arisen over the original contract price of just under £14mn. Tarmac had incurred some additional costs, over the need to replace the roof and through their own poor organisation of their work, which they had tried to pass onto the Bank. The Bank had resisted, as the project had been managed on our part very tightly. Settlement had now been reached at £14mn, which represented a satisfactory outcome for us in that we have successfully resisted virtually all the excess claimed.

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(iii) Mr Crockett spoke to Court about reports that had appeared in the press mentioning the names of the Bank and the IMF in connection with concerns over the Saudi Arabian economy. No public statements had been made and the Bank was very sensitive to the difficulties that could be created by such statements.

The Saudi fiscal and balance of payments situations were not sustainable at the moment, and the Saudis would have to reduce expenditure on subsidies - a step the King was reluctant to take. A number of countries had shown concern and it had been agreed to bring friendly pressure to bear in the hope that this might produce results. The IMF were in the lead.

The Bank had shared its concerns confidentially with the Federal Reserve Board, and it appeared the leak had arisen in the United States. Mr Crockett said he would try and ensure this did not happen again.

Rupert Pennant-Rea

John Hoffmann
Assistant Secretary
1st September 1993

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A COURT OF DIRECTORS AT THE BANK

THURSDAY 9 SEPTEMBER 1993

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Anthony Laurie Coleby, Esq
Sir Colin Ross Corness
Andrew Duncan Crockett, Esq
Mrs Frances Anne Heaton
Sir Martin Wakefield Jacomb
Sir John Chippendale Lindley Keswick
Sir David Bryan Lees
Sir Christopher Jeremy Morse, KCMG
Brian Quinn, Esq
Professor Sir Roland Smith
Sir Colin Grieve Southgate

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The Minutes of the last Court, having been circulated, were approved.

Details of the weekly figures and graphs relating to the state of the foreign exchanges and the domestic markets were laid before Court.

The Governor, having declared his potential interest in the Court Pension Scheme, together with those of the Deputy Governor, Messrs Quinn, Crockett and Coleby, invited

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Sir Adrian Cadbury to present a Report of the Trustees of the Court Pension Scheme, together with the Annual Report and Accounts for the year ended 28 February 1993.

Sir Adrian explained that the Trustees had recommended in their report that Court accept the Actuary's suggested annual contribution rate to the Court Pension Scheme, for the year beginning 1 March 1993, should be set at 30% per annum of pensionable remuneration on which pensions can be provided from the Scheme. Members of Court approved this recommendation. The Annual Report and Accounts of the Court Pension Scheme, for the year ended 28 February 1993, were laid before Court. In response to a question from Sir Colin Corness on the expenses incurred on discontinuance, Sir Adrian Cadbury said he would revert to Court with the answer.

Mr Harris presented a Report of the Trustees of the Bank of England Pension Fund, together with the Annual Report and Accounts of the Fund for the year ended 28 February 1993, which were laid before Court.

Court gave their approval to Mr Laird joining the Advisory Committee of Murray Johnstone Private Acquisition Partnership.

Before asking the Deputy Governor to introduce a series of papers relating to internal matters, the Governor invited, with the agreement of Members of Court, Mr Rumins, the Head of Finance and Resource Planning Division, and Mr Sweeney, the Officials' Development Adviser, to attend Court for the ensuing discussion.

In introducing the papers, the Deputy Governor said those on the Administrative Framework: Review of Priorities 1994/95, and, the Budgetary Framework 1994/95 and the outline years, were closely related. The paper reviewing priorities for 1994/95 in the main looked back at the past year and examined where progress had been made. Reference was also made to a number of elements that had arisen after the budget had been set, some of which had proved expensive. In considering the

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new priorities, those with a Bank-wide significance had been listed. The changes of emphasis in many areas of the Bank had an importance and significance for the Bank as a whole. The Deputy Governor then invited each Director to speak about the changes envisaged in their Departments.

Mr Quinn said he wished to draw attention to three points. The first, and to some extent the least important, concerned the work that would be needed to ensure appropriate liquidity policies for banks were in place. This would be a major exercise in its own right and read across to work in the Markets Division, with whom Banking Supervision would continue to work closely. The second point stemmed from a recent legal opinion which would lead to extra resources being needed for supervising branches of overseas banks, especially those with relatively weak home supervisors. Much would depend on the outcome of negotiations with HMT on post-Bingham amendments to the Banking Act, especially in the area of the supervision of foreign banks. The third point focused on steps to improve the effectiveness of supervision arising out of our experiences during the last cycle. In particular, we were unhappy with the arrangements between supervisors and banks' auditors. It had proved unsatisfactory to rely on Audit reports as a good indicator of asset quality or on the adequacy of Reporting Accountants' reports on records and systems under Section 39 of the Act. They had not always delivered what we wanted and, as a result, we were not always given the advance indications of difficulty we would wish. We were keen to enhance the quality of Section 39 reports and would be discussing this with the principal accounting firms.

In this context, Mr Quinn went on to say he was keen that more resources should be devoted to routine on-site visits. These would not take the form of inspections but visits spread over four or five days, talking to management, and, looking at a sample of files. Such visits had proved their worth in the past and, in some instances, had led to Section 41 investigations. He would be seeking more secondees from other banks to help increase the number of such visits. Mr Quinn

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added he would be discussing his proposals with representatives of accountants before going firm, and would mention the outcome to Court later in the year.

With regard to the Banking Department, there were two major exercises. First, the implementation of real-time gross settlement - the transformation from end-of-the-day settlement to real-time settlement - in the large value sterling payments system and, secondly, work on BITS. This was a new system for the conduct of day-to-day banking operations. It could involve a radical change in working practices and produce a long-term reduction in costs.

Speaking in respect of the International Divisions, Mr Crockett said that so far as the European Division was concerned, much had happened during the past year leading to a change in the landscape. These changes, however, afforded the Division considerable scope - which in turn would lead to much work - in influencing the reconstruction of a framework for Europe. This would be particularly true of work in connection with the EMI, due to be established on 1 January next year, especially with regard to designing a structure and the administrative arrangements.

The Developing World Division would continue with its on-going responsibilities. It would be looking at the financial management of International Financial Institutions, something HMT were keen that they do. Also, they would be considering the work they did for BSD on the provisioning matrix, which it might be possible to adapt and perhaps reduce. As well, the Division would be looking at the situation arising from the break-up of the former Soviet Union and would involve itself in the debate to produce a lasting settlement of the problems.

The Industrial World Division would be focusing on global economic management issues. Central Banks were becoming more involved in G7 Deputies' meetings and there was scope for making a better contribution to policy co-ordination.

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The expansion of the Centre for Central Banking Studies had reached a plateau. Concentration here would focus on how to involve neglected countries, of which a recent course for black South African Central Bankers provided a good example.

Mr Coleby said he had only two points of emphasis to add to what the Annex said about the Markets area. The principal items of new work arose from the need to give effect to EC Directives, notably the Investment Services Directive and the Capital Adequacy Directive. The latter would require completely new tests of capital adequacy to be put in place for the supervised institutions in the money and gilt-edged market. The former would make formal, through the need to decide which markets were being "regulated" and who had the "competence" to do it, many of the existing informal arrangements for supervision. The second point to note was the work being undertaken on the structure of the markets in which the Bank operated. We were planning to improve operational methods in the money market, and listening to views from the gilt-edged market about the pros and cons of developing the means of trading gilt repos. It was hoped to be able to carry out these tasks without adding to budgeted resources, but they underlined the need for actual numbers to be fully up to budget, which was proving hard to achieve given the scarcity of some types of staff.

Mr Harris, for Corporate Services, said he would deal with the main issues involving the Personnel area later in the meeting. However, they would also be involved in co-ordinating the Bank's contribution on staff issues during the establishment of the EMI. Elsewhere, Health and Safety issues would also be dealt with later and the IT area had been covered at Court the previous week. 1994 would see the Bank's Tercentenary and members were aware of proposals in this regard.

Mr Kent, covering Finance and Industry, said that their most public operational activities during the past year were CREST, the Channel Tunnel, Canary Wharf and the Jubilee Line. However, none of these had been foreseen in the priorities

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exercise a year ago. It was a continuing priority, therefore, to ensure his staff built on their expertise in the financial sector so they could swing into action whenever needed. Their philosophy was first to let the market get on and find solutions to problems, and only to get involved when the market was failing.

As to future areas which might require action, Mr Kent mentioned Lloyd's and the insurance market; the relationship between the Government and the private sector in joint projects; the situation at the Stock Exchange, both with regard to the present management vacuum, and to its future role; the privatisation of PRONED and, lastly, revisiting the role of British Invisibles, in an area where there were a number of overlapping institutions.

So far as the Printing Works was concerned, there were two preoccupations: resisting privatisation, and carrying out the major refurbishment. We knew from our experiences at Gloucester and New Change that the latter could prove very difficult. This would especially be true of the Printing Works, because of the security factor.

Speaking in respect of the Registrar's Department, Mr Plenderleith said that now relocation had been completed, there were two main tasks alongside the continuing operation of the register. These were, first, to restore the level of efficiency achieved in London prior to relocation; on this, substantial progress had already been made. Secondly, with regard to the size of the operation, to let the remaining space in the building; to review the size of the computer system; and to plan staff resources on a medium-term view of the volume of gilt work and the possible quantity of work that might be relocated from Head Office on a lower costs basis.

In Mr King's absence, the Deputy Governor said that the nature of the Economics Division would be conditioned increasingly by the development of the Inflation Report, which, in turn, would lead to a need for an increase in resources.

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The Financial Statistics Division was in the final stages of moving off its mainframe and would be using its local system more fully in the future.

Opening the ensuing discussion, and commenting on the proposed reforms to improve the effectiveness of reporting accountants, Sir Chips Keswick said the core purposes of the Bank were far more important than any underlying legislation. The Bank underplayed its qualities; the quality of staff in the Bank was more important than getting Auditors into line. Mr Quinn responded by saying that Section 39 investigations had shown that we could not rely too much on Auditors or their accounts and reports.

Moving onto the framework of the priorities, with its mixture of some internal and some external, Sir Jeremy Morse enquired how it had worked; had we the balance right; were we in a position to pass judgement? The Governor felt it was still early days. The reason for introducing the framework had been to identify in a more focused way what we should be doing. Then, during the year, we would look at the main external influences on the Bank and, subsequently, the internal consequences. Once a year it was advantageous to stop and consider where we were. For instance, in some areas, such as with the CCBS, we were a little further ahead than we might have been. Also, it was helpful in shifting financial and staff resources in a more conscious manner.

Sir David Lees said he found the paper useful. The flavour that came through to him was that the Bank was constantly undertaking new projects and tasks whereas, in reality, we were stopping doing some things. He asked if next year a list could be provided of major tasks that had run their course. In response, the Deputy Governor said that very few things stopped completely, although some tapered off.

The Deputy Governor then moved on to the paper covering the Budgetary Framework for 1994/95. The exercise was based on three assumptions; a full recovery from HMT for cash limited

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services; an adequate return on capital; and a gradual reduction in the real level of cash ratio deposits placed with us by banks. It was necessary to review the last two, which might need to be changed.

Going through the paper, the Deputy Governor said the budget showed one of declining spending, down 14% in the last 3 years and a further 8% planned in the next 3 years. There was, however, a lot of uncertainty in this year's exercise. It was difficult to put hard figures on the costs of the consequences of legislation arising from the Bingham Report or from the costs involved with RTGS and CREST. The new aggregate baselines showed little change from those tentatively agreed in February. They did not take into account, however, unquantifiable expenditures or the possible net impact of contingencies. These combined could lead to additional expenditure of between £5mn and £7mn in 1994/95 and a broadly similar amount in 1995/96. It was hoped in the next few months to put hard figures on these aspects.

In looking at long term considerations, it was evident that in real terms the Bank's real free capital and reserves had fallen from their position of 20 years ago. There was a prima facie case for building them up.

The Deputy Governor went on to say that in seeking savings in present expenditure plans, he wanted to emphasise that it was not the intention to make across the board cuts. They would not be appropriate; it might be that some areas could no longer justify their resources whereas others needed to be expanded. A large part of the Bank's costs were staff costs. It was difficult to achieve financial cuts without cuts in staff, especially when there was a policy in operation of no compulsory redundancies. There might be a possibility of making savings, however, through relocating jobs to Gloucester or the Branches.

Finally, the Deputy Governor mentioned that we had an agreement with banks to keep the CRD ratio at 0.35% until Spring 1996,

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after which it was due to revert to 0.4%. We would look again at the agreement. Any reduction in the ratio from 0.35% would, however, have severe implications.

Sir Colin Southgate opened the following discussion by asking why the Bank bore the cost of CREST instead of passing it back to those who used it. The Deputy Governor said the intention was to try and pass back the running costs and achieve a full cost recovery as we had with the CGO and CMO projects. Mr Kent said we were considering turning CREST into a subsidiary of the Bank, recovering costs through a fee structure or by royalties. Sir David Lees said he wished to pursue the same point. He thought the role of the Bank had been to facilitate the new system; he had not realised the Bank was taking on an investment which it hoped to recover. The Governor replied that, in principle, any investment would be recovered. In practice, it depended on the progress of the system. The exploratory work had cost money and this we had met, as we wished to encourage the system. As had been mentioned, we had recovered the running and investment costs of the CMO and CGO projects.

Sir Colin Southgate asked if the Bank had taken a lead role when the CHAPS system was set up in 1969. The Governor said that the Bank had not done so in the same way as it had with the ECU and Gilts Systems. In the case of the CHAPS project, there was a clear focus by the clearing banks, who were accustomed to running the clearing. In the case of the subsequent projects, the City interests were more diffuse. The Gilts and Money Markets systems, as with TAURUS, had been very complicated because of the multitude of interests. Because of the difficulty arising from conflicting interests, we had seen there was a role for us to take the lead with CREST. Mr Kent added that the Stock Exchange was the natural candidate to set up CREST, but it was still recovering from trying to set up TAURUS.

Changing direction, Sir Jeremy Morse said there was a fundamental budget point about the relationship of the Bank

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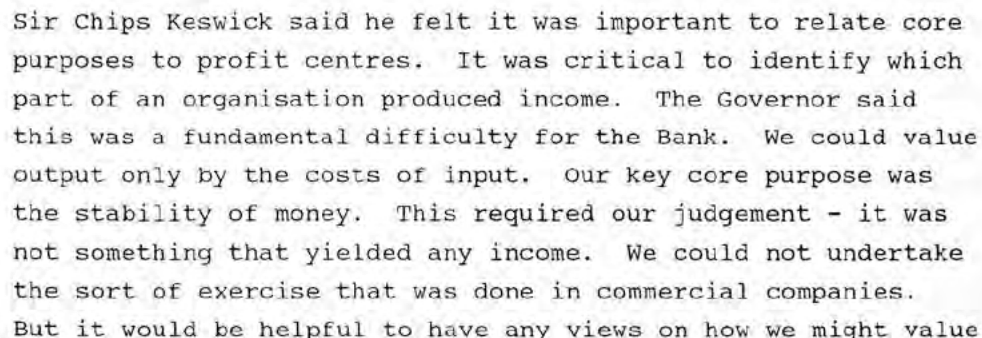
with the Markets as opposed to the Bank with Government. The Government received a dividend. Our relationship with the markets was not so well ordered. However, there might be something coming back from the markets. This was the case, the Governor said, in respect of settlement systems.
Sir Martin Jacomb said he considered the Bank's involvement in the settlement of securities transactions was vital - especially with monetary union likely to be a long way away. The position of London required that cash and security settlements should take place here. It was necessary that London kept ahead of other centres. But, Sir Martin Jacomb acknowledged, it was difficult for the Bank to exercise leadership against a background of recovering development costs.

Sir Roland Smith focused on the shortage of good people in the Bank and the fact we were not looking for across the board reductions in costs. Did the statement that we were going to look closely at our policy on redundancies, and consider whether any changes might now be appropriate, mean that the policy of no redundancies was to be abandoned? The Deputy Governor said it was the intention to look at the policy again. Mr Harris commented that we could make people compulsorarily redundant, but we had pursued a course of voluntary severance. By this method we had reduced staff numbers over the years from some 7500 to 4500. Sir Colin Southgate felt that it was time to go back to the drawing board, with a completely new look at pay and grading structures. This, the Deputy Governor said, he intended to do.



Sir Chips Keswick said he felt it was important to relate core purposes to profit centres. It was critical to identify which part of an organisation produced income. The Governor said this was a fundamental difficulty for the Bank. We could value output only by the costs of input. Our key core purpose was the stability of money. This required our judgement - it was not something that yielded any income. We could not undertake the sort of exercise that was done in commercial companies. But it would be helpful to have any views on how we might value

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output. Sir David Lees wondered if the question of return on capital was relevant in the Bank. Should our prime objective be efficiency? The Governor said the target return on capital and the target reduction in the level of CRDs were financial objectives against which we could judge the level of overall Bank expenditures. The whole emphasis of our budgetary processes concentrated on the cost control side.

Moving on, Sir Colin Corness asked if the economic case for the relocation of Gloucester had been validated. If so, should we consider moving other areas of operation? With the decline in London rental values, was there still such a strong case for relocation? Mr Plenderleith responded by saying that relocation had achieved a 45% reduction in costs. This had covered not just floorspace but staff costs as well. Mr Harris said that the Registrar's relocation had brought about a change in culture, and organisational and working practices. The Governor added that it was not clear we could relocate others to the spare space in Gloucester, as we would be unlikely to be able to achieve similar savings in staff costs.

Sir Colin Southgate then drew attention to the costs of seconded staff and Health and Safety. Mr Harris said that the figure for the cost of seconded staff was misleading as it did not include payments we received as a result of some of these secondments. Although some secondments were to help the community, others were of a more vital nature such as the financial secretary at the Tokyo embassy where we shared costs with the Foreign Office. He undertook to provide a breakdown of the costs of the various types of secondment in the future. On the point regarding Health and Safety, we were currently employing a firm of consultants to advise on this.

Sir David Lees felt it was important that Members of Court understood the detail contained in the paper, otherwise it was possible to draw the wrong conclusions. He instanced the figures shown for the costs of the Sports Club and catering.

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He wondered whether the staff would prefer to receive extra salary rather than more fringe benefits. He considered this an important issue which should be reviewed.

The Deputy Governor then moved on to the Bank's Purposes, Responsibilities and Philosophy statement. He said he had made some changes to the new version, of which the obvious ones covered sterling's departure from the ERM and amendments that had been proposed by Court last autumn. Also, he had taken the opportunity to tighten up some of the language, making it in some instances more direct. Having gone through the statement, he felt it would be beneficial if a paper were put to Court on how we see the role of manufacturing in the economy. The new PRP Statement could then be looked at in this light. A number of Members of Court had points on the statement and it was agreed they would take these up with the Deputy Governor directly.

At the Governor's invitation, Mr Harris introduced papers on Staffing Policy for Banking Staff, Health and Safety and the Environment and a progress Report on Opportunity 2000. He said the latter two papers were, essentially, for information only. So far as Health and Safety was concerned, he was now responsible for this on a Bank wide basis and, also, responsible to Court. It was a subject that had to be taken seriously. The paper set out what we had been trying to achieve during the year in developing a policy which would apply across the Bank. There were difficulties, however, as we had both offices and a factory. On the environmental front, we had focused initially on the Printing Works which had taken a lead by calling in a consultant to advise on best practice in such fields as energy and water management and the handling of waste.

The Report on Equal Opportunity had been constructed in the context of the Opportunity 2000 campaign, in which we were taking a full part. It showed what steps we were taking, not least in increased flexibility of work patterns.

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Mr Harris then introduced the Report on Staffing Policy for Banking Staff. He said that although there was in the Bank a very wide range of activities and skills, we looked at everything on the basis of a "one Bank" philosophy. However, the report itself excluded reference to the Printing Works, but staff of the Registrar's Department were included where specifically mentioned. He then took Members of Court through the Report. At the end, Sir Martin Jacomb asked if there had been any external reaction to the success of our Equal Opportunity initiatives. Mr Harris said there had not as we were part of a group of over 100 companies pursuing a similar course. The Governor said that he had had a favourable reaction from the new Chair of the Equal Opportunities Commission.

Sir Adrian Cadbury enquired why it had been possible to achieve an Investors in People standard for some parts of the Bank - such as Registrar's Department - and not others. Mr Harris responded by saying this was because they were a single product business and easier to look at as an integrated operation. We would explore with the IIP authorities to see whether other parts of the Bank could be assessed on a discrete basis.

Under the weekly executive report, Mr Harris reported that Mr P A C Smout (37), an Official and a Manager in the Banking Supervision Division, would be appointed a Senior Official, Point F, and a Deputy Head of Banking Supervision Division, with effect from 27 September 1993.

Rupert Pennant-Rea

G. A. Croughton.
Secretary 23rd September 1993

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A MEETING OF DIRECTORS AT THE BANK

THURSDAY 16 SEPTEMBER 1993

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Andrew Duncan Crockett, Esq
Brian Quinn, Esq

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The number of Directors assembled being insufficient to form a quorum, those present proceeded to the business, subject to ratification by the next Court.

The Minutes of the last Court, having been circulated, were approved.

There being no comments on the weekly figures, Mr Plenderleith spoke about the foreign exchanges and the state of the domestic markets.

Rupert Pennant Rea

G. A. Croughton

Secretary 23rd September 1993

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A COURT OF DIRECTORS AT THE BANK

THURSDAY 23 SEPTEMBER 1993

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Anthony Laurie Coleby, Esq
Andrew Duncan Crockett, Esq
Mrs Frances Anne Heaton
Sir Martin Wakefield Jacomb
Sir John Chippendale Lindley Keswick
Gavin Harry Laird, Esq, CBE
Sir David Bryan Lees
Sir Christopher Jeremy Morse, KCMG
Brian Quinn, Esq
Sir David Gerald Scholey, CBE
Professor Sir Roland Smith

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq

The Minutes of the Court of 9 September were confirmed and those of the Meeting of 16 September, having been circulated, were approved.

There being no comments on the weekly figures, Mr Coleby spoke about the foreign exchanges and the state of the domestic markets.

At the Governor's invitation, and with the agreement of Members of Court, Mr Clark, the Head of European Division, and Mr Collins, the Head of Industrial World Division, attended Court for the discussion on issues relating to operational autonomy for the Bank.

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The Governor explained that the paper "Accountability procedures under conditions of central bank independence" which analysed the methods of accountability in a number of countries, had been circulated by way of background to the discussion on the Deputy Governor's paper "Issues on Independence - Statutory Mandate and Accountability".

In introducing his paper, the Deputy Governor said that he hoped that Members had found it helpful to have the earlier discussion paper and would agree that the paper now before Court captured the views expressed in the earlier discussion of this topic on 29 July. He proposed that a similar procedure be adopted for future papers, Functions of an independent bank, and Governance, which would be brought to Court later in the year.

The Deputy Governor said that in the earlier discussion Court had concluded that the power of override could be exercised by Government in two ways. Specifically, Government could choose to change the nature of the contract or could override a particular interest rate decision taken by the Bank. Since that earlier discussion, the Deputy Governor said that he had had an opportunity to discuss the "independence" issue with Gordon Brown, the Shadow Chancellor. Mr Brown had said that he would not feel comfortable with Government being in a position to choose to override a particular interest rate decision, because it would imply that if the Government chose not to override it was in full agreement with the action that the Bank had taken although, in practice, this might not be the case. He would prefer to keep these sorts of decisions at arms length. The Deputy Governor said that this was perhaps one issue that we needed to consider again.

Before developing that discussion, the Governor suggested that Members might focus on the question of the statutory mandate in the first instance, as this was an area where he felt there would be general agreement. In response to Sir Jeremy Morse's comment about the tactical advantage of focusing on a single price stability objective, the Deputy Governor said

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that although we would prefer a simple mandate, as expressed in his paper, we had to accept that we may need to offer an alternative version for discussion with Government. It was in that context that he had produced what he hoped was an acceptable alternative.

In response to Sir Jeremy's enquiry about whether any progress had been made with HM Treasury on this issue, the Governor said that this was not the case, we were preparing our ground in anticipation of the Report of the Treasury and Civil Service Select Committee which was expected in November. He hoped that the Report would indicate that a majority of Members were in favour of an independent central bank and if so, Government would have to respond to that conclusion. This response might be in the form of a green paper and it was necessary, therefore, for us to prepare for that eventuality.

Moving on to the issue of the mandate, Mrs Heaton enquired whether the contract with Government should cover any issue other than that of price stability. The Deputy Governor said that, given the statutory background, we may need to accept that emphasis would be put on other economic objectives but there should not be specific targets for other economic variables. We would argue that these were subordinate to price stability.

In response to Sir Roland Smith's enquiry about the proposed length of the contract, and what action would be taken if we failed to meet the target set in the contract, the Deputy Governor said that the only example that he could draw on was that of New Zealand. In that instance the contract ran for the duration of the Parliament [in fact now clarified to be any period up to the end of the term of office of the Governor], and it would seem undesirable for a contract to be of any shorter duration. So far as sanctions were concerned, again the New Zealand example was that if the central bank failed to meet the target, other than on grounds beyond its control, then the Governor would be removed. Sir David Scholey said that the Board structure of the central bank in

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New Zealand was not the same as the Bank, and in his view any contract with the Government in the UK should be negotiated with Court not the Governor. He questioned what the situation would be in the event of a new Parliament being unable to come to an agreement with Court on the terms of the contract: in these circumstances would Court be dissolved? So far as the override on specific decisions was concerned, Sir David said that it would have many disadvantages, not least because it could seriously damage relationships between Government and the Bank if used on any regular basis.

The Governor said that he could not imagine Parliament discussing whether an interest rate decision that the Bank had taken should be reversed. The Deputy Governor said that in the Netherlands the government had that power of override, but had never exercised it. Sir David Scholey suggested that whilst this might be a nuclear deterrent in the Netherlands it would be meat and drink to the House of Commons. Mr Crockett said that in practice there was no middle way with the use of an override. Either it was never used, and effectively became unusable, or it was used all the time and the power effectively rested with the overrider. The Netherlands and Germany were examples of the first, and the UK of the second, with Government as the overriding authority. The Deputy Governor said that he went along with Gordon Brown's comments about the override, and the need for the emphasis to be on changes to the contract and not on individual interest rate decisions. Sir David Lees said that the negotiation of the contract was really a question of the governance of the Bank. The Deputy Governor said that under situations such as the present, with low inflation, there would be no difficulty in negotiating a simple contract. Sir Chips Keswick was unhappy with the notion of a contract. He said that the Governor should be appointed and not be subject to a contract. What mattered was the mandate that the Bank was given and the Governor should be appointed to carry out that mandate.

The Governor said that the dilemma was whether the relationship should be between Parliament and the Bank or

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between Government and the Bank. If there was an implicit mandate from Parliament appointing the officers of the Bank there would be no role for Government - was this a realistic prospect? Sir Jeremy Morse said that he agreed that Government must come into the equation somewhere, but he did not like the idea of the Governor being on a contract with the possibility of being sacked.

Sir Adrian Cadbury said that the relationship between the Bank and Government was crucial. When the Bank made a decision on interest rate changes, it would need to give this information to someone in Government. He asked what period of notice would be appropriate in the context of good governance, and suggested that it should be as little as possible in order to avoid interference. In this context the Deputy Governor said that if we could remove the override on individual decisions we might put in its place a provision whereby we would inform Government that we were about to make an interest rate change, but without being specific. This would alert Government and avoid any embarrassments. Sir Adrian Cadbury suggested that this would be good if we could achieve it, but doubted whether Government or HM Treasury would accept it.

Sir Martin Jacomb said that the objective should be for the contract to distance Government and Parliament from the tactical execution of policy. If they did not like it, then the override that they could impose would be to terminate the contract. The Deputy Governor said that the override could be used to change targets in the contract, but it would not be feasible or desirable for Government to terminate the contract because they did not like a specific decision.

Sir Roland Smith said that in negotiating the contract we should build in the opportunity of negotiating the target ranges etc with a clause that they could not change in, say, less than one year. The Deputy Governor agreed that it would be appropriate to have such a clause in the contract and accepted the valid point about a specific "no change period". The Governor said that he was not sure that it would

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necessarily be advantageous to be so precise. He could imagine occasions when external events might leave either side wishing to change the terms of the contract. Mrs Heaton agreed about preserving discretion for the Bank and the need for flexibility in any contract.

Sir David Scholey said that it would be necessary for Ministers and HM Treasury to have considerable dialogue with the Bank on the conduct of monetary policy as a routine matter. The Governor said that this would be so, but the nature of the discussions would be different. They would make representations to us, and the final say would be on the other side of the table.

In summing up, the Governor said that there was general agreement that the role of Government should be strategic and that the terms of any agreement - he agreed that the word contract was perhaps inappropriate - should be drawn up in conjunction with the Bank and would then be subject to approval by Parliament. Subsequent changes, at the instigation of either the Bank or Government, should also be subject to approval by Parliament. The appointment of Governors and Directors by the Government for a fixed term of years would also appear to be acceptable, as were the proposals for reporting to the House of Commons. However, it was evident from the discussion that there were strong feelings against the provision of an override for specific individual decisions.

In commenting on the appointment of Governors and Directors, Sir Jeremy Morse suggested that the composition of Court might be crucial. If there was to be a Government representative on Court, this might affect the nature of the mandate. It was agreed that this issue should be deferred until the discussion on "Governance".

Sir David Lees, reverting to the issue of the override, said that it was not an appropriate term for changes to the contract, as these would be bilateral. An override could be

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imposed only in unilateral situations. In referring back to the earlier discussion, Sir Jeremy Morse asked whether strategic direction remained with Government, with the Bank agreeing and Parliament subsequently endorsing? In response, Mr Crockett said that the objective of the agreement would be price stability, and Government would be entitled to set out its specific requirements which, the Governor said, would have to be done in consultation with the Bank. In setting the strategic direction, however, Government would have to pay regard to the statute, which charged the Bank with achieving price stability. If agreement could not be reached with the Governor, he would have to resign. In that sense the power remained with the Government.

The Governor thanked Members for their contribution and said we would now make some small changes to the paper.

With the agreement of Members of Court, Mr Foot, the Head of Banking Supervision Division, joined Court for the discussion of the Report to the Treasury and Civil Service Committee which set out the changes made by the Bank in its supervisory approach following the recommendations made by Sir Thomas Bingham in his BCCI Report.

By way of introduction, the Governor said that the Report had already been sent to the Committee in order to meet its timetable for the meeting on 2 November when the Deputy Governor and Mr Quinn would be attending.

Mr Quinn said that the paper, which had been drafted by Michael Foot, was deliberately factual and set out to show how the Bank had responded to Sir Thomas Bingham's proposals. The origin of the Report had been the comments by Mr Radice during a visit by Labour MPs some three months ago. His impression had been that we were still resistant to any changes post-Bingham but, having told him what we had achieved since then, he suggested that we should inform the TCSC formally.

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Mr Laird said that it was a very good paper, but he had one mild criticism in that the paper may have overstated how much had changed since the Bingham Report. Sir David Lees agreed with this point and suggested that the conclusion to the Report was perhaps a bit over-apologetic. Sir Roland Smith endorsed this view, suggesting that the text of the conclusion could well be used to advantage by a lawyer acting for BCCI.

In response, the Governor said that the Report had been discussed at some length in the Executive Committee and by the Board of Banking Supervision. The paper should be seen in the context of the earlier correspondence with the TCSC, where they had thought we had been too complacent about our past activities. There had therefore been a shift of emphasis, and he was confident that the Deputy Governor and Mr Quinn would have the opportunity to strike the right balance when they made their oral presentation to the Committee.

Sir Jeremy Morse said that he thought that the Bingham Report had generally been favourable towards the Bank, although he recalled that it contained a comment that the Bank had been reluctant to use the powers it had for fear of judicial review. The Governor pointed out that we were currently facing two such reviews at the present time.

Sir David Scholey said there had been an earlier discussion about Court's relationship with, and responsibility for, the Board of Banking Supervision. Since then, however, Court had not been informed of the Board of Banking Supervision's activities, and he suggested that it might be useful in future to have regular reports at Court from the Board of Banking Supervision. In response, the Governor said that the review of the workings of Court had identified that Court was under-informed on supervisory issues and we now had two long Courts a year on supervisory matters. We would certainly use these occasions to account for the work of the Board of Banking Supervision.

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The Governor said that Dr Helmut Schlesinger was now unable to join Members of Court for lunch on 14 October. However he would be lunching at the Bank on Tuesday, 2 November when he would be accompanied by HE Dr Peter Hartmann, the German Ambassador. Although the lunch would now take place on a Tuesday, the Governor said that the Non-Executive Directors would be most welcome at lunch on that day.

G. A. Croughton.
Secretary.

Adrian Cadbury
30th Sept 1993.

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A COURT OF DIRECTORS AT THE BANK

THURSDAY 30 SEPTEMBER 1993

Present

Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Anthony Laurie Coleby, Esq
Sir Colin Ross Corness
Andrew Duncan Crockett, Esq
Sir Martin Wakefield Jacomb
Sir John Chippendale Lindley Keswick
Sir David Bryan Lees
Sir Christopher Jeremy Morse, KCMG
Sir David Gerald Scholey, CBE
Professor Sir Roland Smith
Sir Colin Grieve Southgate

Hugh Christopher Emlyn Harris, Esq
Ian Plenderleith, Esq

The Minutes of the last Court, having been circulated, were approved.

There being no comments on the weekly figures, Mr Plenderleith spoke about the foreign exchanges and the state of the domestic markets.

Court gave their approval to Sir Martin Jacomb joining the Board of Delta plc.

At the Deputy Governor's invitation, and with the agreement of Members of Court, Mr Footman, the Head of Information Division, attended Court for the ensuing discussion.

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In introducing his paper, "Press and Public Relations", Mr Footman said that the Bank's public image after the BCCI affair had taken a serious knock, and considerable thought had gone into considering ways in which we could improve our image; initially this was concentrated on press management but now we were thinking about our wider public reputation.

The key thing in Bank PR was to maintain our reputation for technical excellence. With the impressive building, fine furniture, and resplendent messengers, the Bank was an obvious target for criticism; this made it all the more important that the Bank should not allow itself to slip technically.

Beyond this, our aim was to be clear, consistent and relevant in our relations with the press and the public. Mr Footman said that, in his view, the publicity surrounding the recent appointment of the new Governors had been well handled, and had been well received by the press and public. We were now building on this by producing a systematic speaking programme for the Governors and Directors, with topics and opportunities for delivery identified and planned well in advance. It was important that in every area where we were exposed to the public, the press, the City, business or Westminster, we should be impressive and speedy in explaining our views and getting across what the Bank was for.

The specific changes in focus outlined in the paper were relatively small but, nevertheless, very important. The Press Office was gearing up to find out what others thought about the Bank and what was being said about us. The Bank had already made contact with some 70 Members of Parliament of all parties, and this would continue. Most of them had found the contact helpful, and we believed that we had already made a number of friends.

We were also developing our capacity to respond more positively and helpfully to letters from the public. In the past, our response had been rather haphazard, inconsistent and occasionally stuffy. Replies were now being co-ordinated in

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the Information Division, with particular attention being paid to the content and tone of our response. The Bank received letters of complaint about all manner of topics, some quite unrelated to the Bank; but it was important that we should get across to the public that we understood fully what they were complaining about.

In the coming months, there would be several opportunities for the Bank to get across, to the public and press alike, what our purposes and responsibilities were. The Tercentenary celebrations in 1994 would give the Bank much public exposure, which we would use to our advantage, and the publication of the report of the TCSC on Independence, to be published in November or December, was a further opportunity to make our position clear. The CREST project would also present the Bank with a valuable occasion to display its technical expertise and advance its image.

Finally, Mr Footman said that so far as the Bank's relations with the press were concerned, it had always been our policy to tread the middle path, between being too flashy and appearing rather amateurish. We would continue to provide the press with straightforward, responsible, and practical briefing.

In commenting on the paper, Sir Colin Southgate asked to whom Mr Footman and the Information Division reported. The Deputy Governor responded, saying that the Division was responsible to Mr King on budgetary matters etc. However, the Deputy Governor was co-ordinating the Bank's press and public relations programme at a monthly meeting. Sir Colin said that it was vital that "public relations" was directed from the top of the organisation. He also said that it was important to identify and aim at the real audience, and that we should not try to be too clever in this field. He was supportive of keeping this role in the Bank: PR companies were useful for giving advice, but not for action.

Sir David Scholey agreed that the capability for press relations should be within the Bank, but said that Mr Footman's

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presentation raised a number of questions in his mind. He felt that the Bank was woefully unaware of feelings about it in various parts of our constituency, and suggested that we should take steps to find out what people thought about us. He asked if we felt the grand building and pink coats were a handicap? If so, perhaps we should take the initiative and invite our critics in and get them alongside us. Sir David also asked what the status of the City Communications Committee was and whether it was still operative.

Picking up the point of establishing what others thought of us, the Deputy Governor said that he found Sir David's comments interesting and helpful. In his previous role, he had been pursued by polling companies, and it might be worthwhile for the Bank to seek their advice now.

Sir Jeremy Morse responded to Sir David's enquiry about the City Communications Committee. As its past Chairman, he said that it was no longer in existence, having been subsumed with British Invisibles.

Referring to the use of PR companies, Sir Adrian Cadbury recalled that the Bank had used an outside consultant and enquired whether that had been successful. He also commented on the quality of The Old Lady, the Bank's house magazine, and suggested that although it was rather different it might, nevertheless, be a helpful and useful PR vehicle.

Mr Footman confirmed that the Bank had engaged Angela Haylin, of Charles Barker, as a consultant for a period. She had been quite helpful, particularly at the outset of the engagement. She was no longer on a retainer, but was available, ad hoc, if we needed to use her.

Sir Chips Keswick said that he was concerned about the problems of the Bank losing ground to special pleaders, and he instanced some recent cases. The Bank needed to capture the high ground and not get sucked down to the lower levels. In responding to

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cases of special pleading, the Bank would invariably enhance their case and lose its ground.

In commenting on the public relation structure in the Bank, Sir Martin Jacomb said that the person in charge should be involved at the very heart of all discussions and decisions. The Deputy Governor confirmed that this was the case and that Mr Footman had instant access to the Governors whenever it was necessary, although he said that there was often a danger of responding too quickly.

Referring to the guidelines, Sir Colin Corness said that from his experience people wrote letters on a whole range of topics, relevant and irrelevant, and, if one responded to them all, the workflow increased enormously with the on-going correspondence. Conversely, a brief "no comment" letter could do much harm, particularly if forwarded by the recipient to their local MP. Sir Colin also wondered whether the Bank's readiness to be forthcoming in correspondence, which would inevitably cover a wide range of subjects, was consistent with the recent tightening of the Bank's focus.

Sir Colin Southgate endorsed Sir David Scholey's earlier comment and said that it would be particularly valuable to find out what was said and thought of the Bank, and who our critics were, before we embarked on our Tercentenary celebrations. He also suggested that it was good PR on occasions to admit that one may not have got it right.

Sir Jeremy Morse agreed that the PR role should be retained within the Bank and that the Deputy Governor should mastermind it. However, he saw the need to consult outsiders from time to time, particularly on political issues. Sir Jeremy endorsed the need for consistency in the Bank's press and public relations and said that he assumed that it was the Bank's three core purposes that were uppermost in Mr Footman's mind when spelling out "what the Bank was for". In commenting on the old and new aspects of the Bank, Sir Jeremy said that the Bank should turn its history to its advantage. The Museum was the

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best thing of its kind in the City and displayed admirably the Bank's transition from the old to the new. Moving on to the issue of independence, Sir Jeremy said that this was a particularly important issue and one on which we should make our position clear but without being pushy. The Deputy Governor endorsed Sir Jeremy's comment, saying that the Governors had made it clear to the TCSC that we were in favour of independence. However, we would not enhance our position by campaigning for it and certainly not by doing so in any devious way.

Mr Crockett said that he had every confidence in the excellent service provided by the Press Office but it was important that those at the centre who knew about the Bank, and the issues affecting the Bank, should be prepared to speak about them and they should take time to rehearse and prepare their presentation. Mr Coleby said that in practice there was less of a problem in dealing with professional commentators and financial journalists from, say, the Financial Times, than there was in dealing with the political writers.

In endorsing the comments of his colleagues on the need for the Deputy Governor to co-ordinate the PR function, Sir David Lees said it was equally important that the public should be aware that this was the case. The Press Office should be seen to report to the Governors, and the Bank's Annual Report should make this clear.

The Deputy Governor thanked Members for their helpful comments and said that he would return to Court on the question of the polling theme in due course.

In Mr King's absence, Mr Coleby presented the Economic and Financial Report for September. He drew Members' attention, in the first instance, to a number of changes in the way official statistics used in the Report had been prepared. These included the rebasing of the National Accounts from 1985 to 1990; a redefinition of the manufacturing sector; a new method

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of deflating output value to volume; and a new statistical source for trade with the EC.

Mr Coleby said that GDP had grown by 0.5% and 0.6% respectively in the first two quarters, and similar growth was likely in the third quarter, suggesting an annual rate of growth of 2-2½%. The recovery appeared to be more broadly-based with domestic demand, alongside exports, growing. Investment had not grown strongly, but that was normal at this stage in the cycle. The growth in consumption had been financed not by higher disposable income, but by lower savings. Income growth had been extremely moderate, enabling corporate margins to strengthen without increasing prices, which was a favourable development.

The outlook, however, had its uncertainties. The export market in continental Europe was weak, although the prospects elsewhere were better. Domestic demand might be dampened, either by actual increases in taxes or because of fears of future increases. Nevertheless, in the absence of any serious shock to confidence, growth was likely to become stronger as employment prospects stabilised and negative equity diminished.

Turning to inflation, Mr Coleby said that there had been some potentially disturbing developments, with the outturn for the RPI exceeding the short term projections. One possible explanation might be in the timing of the sales periods, which had started earlier than usual this year. The figures for the coming month would enable us to check this theory. There was evidence from the labour market of some tightening, but much of the increase in employment was part-time. Wage settlements and earnings generally had stabilised, but were not yet increasing. Producer prices continued to edge up year on year; after statistical revisions, unit labour costs now offset other input price rises less than had previously been thought, but this still supported the conclusion that profit margins were not under great pressure. Anecdotal evidence, including reports from the Agents, was less comforting. The most comforting statistic was the GDP deflator for the second quarter which, at

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only 1.5%, indicated that domestic costs were well under control. In summary, he suggested that we had probably seen the low points for the inflation indices in the current phase, and must be concerned not to let inflationary expectations redevelop.

Turning to the markets and financial indicators, Mr Coleby said there had been a weakening of the exchange rate since the beginning of August, with the ERI now below 80 compared with 82 earlier. This had occurred despite expectations of an appreciation as interest rates on the continent came down, which they had, but not to any great extent. Domestic politics had intruded in the foreign exchange market; the depreciation did not reflect monetary laxity, but nor did it help the control of inflation.

Monetary data continued to show much the same story as in previous months, with M0 above the top of the monitoring range and likely to remain so in September, with M4 close to the bottom of its range and M4 lending at an annual growth rate of around 3%. Currency circulation in the current month was again strong. The growth of M0 was an encouraging sign that the growth in retail sales had continued, but it was also possibly a warning of inflation pressures ahead. The reaction in the equity and gilt-edged markets from the recent high levels had reflected, in part, a more distant expectation of interest rate cuts in Europe. The implications as to inflation expectations were complex, but the evidence appeared to suggest a recent deterioration.

Mr Coleby summed up the policy implications as follows. Growth at 2½% was doing little to close the output gap, and we should not be afraid of growing faster than that for a period. That might argue for easing policy, but faster growth might also happen spontaneously as problems of indebtedness receded. The case against easing was that inflation expectations were not yet sufficiently settled and there were some warning signs of possible resurgence of wage inflation. Finally, any easing of monetary policy just ahead of the setting of the fiscal stance

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in the Budget would be seen to be rather odd. Mr Coleby also noted that it was necessary to anticipate problems once output began to grow faster than capacity, and to begin to apply restraint; but this was still some distance away.

Sir David Scholey asked why there was a concern about timing when we were still two months ahead of the Budget. In response, the Deputy Governor said that it would be unwise to move before we were aware of the Chancellor's intentions on the fiscal front. If he tightened fiscal policy, that might increase the case for easing monetary policy, but it would be only one of many factors to consider.

Mr Crockett said that most independent central bankers in our current situation would want to see what plans the Chancellor had for fiscal policy. Mr Coleby said that an easing of policy now would create a problem for managing inflation expectations. In response, Sir David Scholey said that the political pressures against any tightening of fiscal policy would be very great, so if there were scope for the Bank to present evidence of this need, it could be constructive.

Sir David Lees made three observations. Consumer demand continued to look fragile and, in his view, could get worse. On the labour front, he felt that employment prospects also continued to look bleak. Companies were still under pressure to lay off staff, so he felt pessimistic on that front. The other side of the coin, however, was that pay increases might remain modest. Finally, he said there was probably a pent-up desire to increase prices as soon as demand picked up.

In relating the independence issue to the forthcoming Budget, Sir Chips Keswick suggested that advance contact with HM Treasury on Budget issues would be helpful and might avoid the need for the Bank to have to respond adversely after the Budget announcement. In response, the Deputy Governor said there was still much work to be done before the Budget. The Treasury had this in hand but at this stage we did not know how it would link in with monetary policy.

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There were no items for discussion under the weekly executive report.

The Minute Book of the Sealing Committee was laid before Court for inspection, in accordance with the Committee's terms of reference.

Rupert Pennant-Rea

G. A. Croughton
Secretary
7th October 1993

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SC0097

A COURT OF DIRECTORS AT THE BANK

THURSDAY 7 OCTOBER 1993

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Anthony Laurie Coleby, Esq
Sir Colin Ross Corness
Andrew Duncan Crockett, Esq
Mrs Frances Anne Heaton
Sir John Chippendale Lindley Keswick
Mervyn Allister King, Esq
Sir Christopher Jeremy Morse, KCMG
Brian Quinn, Esq
Sir David Gerald Scholey, CBE
Professor Sir Roland Smith

Hugh Christopher Emlyn Harris, Esq

The Minutes of the last Court, having been circulated, were approved.

At the Governor's invitation, Mr Beverly, the Head of Financial Markets and Institutions Division, spoke to Court about the work of his Division. He said that he had been in the Division only since May 1993, after over 11 years in Supervision, and was still assessing the role of FMID and the resources required.

The work of FMID fell within the third core purpose of the Bank, namely, the promotion of the efficiency and effectiveness

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of the UK financial services sector. But to some extent, the Division was also involved in areas relating to the maintenance of the integrity of the financial system, the Bank's second core purpose. The Division's responsibilities covered all aspects of the City's activities and, principally, where other parts of the Bank were not involved either as operator or supervisor.

The Division developed close links with key people in the relevant market place or the acknowledged experts on particular issues and kept abreast of thinking, providing easy contact points in the Bank for the City when there were concerns to be aired. There were a number of substantial current and prospective challenges to the City. The City rightly looked to the Bank and FMID to provide an overview and, where necessary, to take a lead or co-ordinate on various issues. His initial impression was that contact with the Bank was valued. A measure of the Division's success was that contacts were keen to continue and develop the relationships, and at a senior level.

The role of the Division, therefore, was to seek out relevant information from these contacts and from other sources, to analyse it, and to brief the Governors and other areas of the Bank. From this base, the Division was in a position to take the initiative when it was judged appropriate, sometimes in response to a crisis, such as the post-Taurus Task Force. Another important aspect was in promoting and maintaining a dialogue, helping mutual understanding. The Division did not respond to every suggestion that the Bank should become involved, and on some issues the Bank was particularly keen to maintain only a watching brief. However, he sensed from some people in the City a feeling that the Bank should be willing to play a leadership role more frequently.

Turning to the organisation of the Division, Mr Beverly said that the discrete areas were Regulation and Tax, with topics of particular current concern being financial services regulation, implementation of the Investment Services Directive and a

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possible directive on withholding tax; Securities and Settlement, where a particular focus was on Stock Exchange trading approaches; Futures, Options and Commodities, currently involved with issues relating to ownership of the London Clearing House, although LIFFE's future was beginning to be an issue; Institutions, currently looking at the Goode Report; and City Competitiveness, with close links with British Invisibles and the City Corporation and concerned with City promotion generally. He explained that the CREST team was organisationally separate, though attached to FMID for administrative purposes.

On the staffing front, Mr Beverly said that it was important for an area such as FMID to have quality staff to ensure credibility with contacts outside the Bank. At present, there were a number of vacancies in the Division, created to some extent by releasing staff to work on the CREST Project.

In response to Mrs Heaton's enquiry about the role of FMID on derivatives, Mr Beverly said that a group chaired by Richard Farrant, in his capacity as a Deputy Chief of Banking Supervision Division, had produced a Report earlier in the year. As it contained a number of recommendations which would have an impact on Banking Supervision Division, Wholesale Markets and Financial Markets and Institutions Divisions, and others, he would be chairing a group to co-ordinate further implementation of this Report and to ensure issues were pursued as appropriate in the different parts of the Bank.

Sir Jeremy Morse felt that there was a certain fuzziness about the role of FMID and how it fitted into the Bank's core purposes. Sir Jeremy raised the question of why the Division maintained external relationships? The primary purpose should be to be well informed, but there was always a danger that in keeping the lines open, one could be drawn in too far. He suggested that there should be strict parameters to avoid this situation, and recalled a comment from his days as a commercial banker that he would "offer every kind of help, short of money". Sir Jeremy said that he was also unclear about the

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internal relationship of FMID with the rest of the Bank, and asked whether the former Discount Office work was now carried out by this Division. He also enquired about the morale of the staff.

In response, Mr Beverly said that the questions raised by Sir Jeremy were ones which he was asking of himself and discussing with Mr Kent, the Director responsible for his area. He felt that the Division's role clearly fell within the Bank's third core purpose. It was right that the Bank should keep itself well informed and that we should use the necessary resources to do so. He agreed that it did raise the question of how active one should be in pursuing this aim: in his view the Division was not always operational but it needed to be ready to act. So far as the internal relationships were concerned, Mr Beverly said that it was important to avoid treading on other Divisions' toes, but he was confident that issues were handled without duplication or rancour, and that there was a good working relationship between his Division and others. Co-ordination between Divisions was important to ensure that all were aware of each other's involvement with outside contacts etc. So far as the morale of FMID's staff was concerned, Mr Beverly said that it had stood up very well so far; but with the high volume of work, and vacancies occasioned to some extent by CREST, it was somewhat fragile. This has resulted in some of the tax work suffering and in his having to take on more regulatory work in the absence, through ill-health, of the Senior Manager.

Sir David Scholey said that the Division's responsibility in all the areas that Mr Beverly had outlined was implicit rather than explicit; but there was a point, particularly with the TAURUS and CREST projects, where it became explicit. The Division functioned by trading on its knowledge and influence rather than from any specific authority, and this raised in his mind the question of how Whitehall viewed the roving, watching brief that FMID had. Secondly, he enquired to what extent the Division attempted to talk to users of the City as well as to the providers of services.

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In response, Mr Beverly said that the Division was closer to HM Treasury than to the DTI. He sensed that the Treasury valued the role that FMID played, and it frequently approached the Division for advice. Relationships with other government departments were generally good. So far as Sir David's second question was concerned, Mr Beverly said that FMID and IFD, both reported to Mr Kent, and worked closely together. He had to agree, however, that the Division dealt more with the providers of services in the City than with the users, and agreed that more ought to be done with the latter.

Sir Roland Smith was concerned about the structure and staffing of the Division, and commented on the youth of the staff and their lack of experience. Mr Beverly agreed that the experience level was not satisfactory. There had been a number of staff changes recently. However, with the exception of one Senior Manager, who had joined the Bank quite recently, there was considerable depth of Bank experience at that level. A current concern related to the limited number of quality younger staff at Zone 1A level available to FMID and the Bank generally. Mr Beverly said that a number of new graduates joined FMID each year, but until they had some experience they lacked credibility with contacts outside. It was always helpful if they joined the Division with wider experience of the Bank.

Sir Chips Keswick said that the City looked to the Bank for protection and advice; the Bank should not underestimate the value that people in the City placed upon the role carried out by FMID.

Reverting to Sir David Scholey's point about relationships with government, Mr Quinn said that HMT and DTI used the Bank to pursue certain issues where they had no remit. But he did think that HMT were of the view that some of the work undertaken by the Bank should be done by the SIB.

Finally, Sir Colin Corness made a general point about the Reports of Heads of Functions to Court. He suggested that, to

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complete the picture, it would be helpful if these Reports contained an indication of the costs of the Division over a period of three years, together with an explanation of any change. The Governor agreed that this would be a helpful addition to these Reports for the future, and agreed that the appropriate figures should be provided in respect of FMID.

There being no comments on the weekly figures, Mr Coleby spoke about the foreign exchanges, including the Official Reserves figures for September and the state of the domestic markets.

The Governor explained that he would be writing to the Chancellor of the Exchequer early next week to set out the Bank's advice in advance of the Budget, and he invited Mr King to introduce the draft letter that was before Court.

Mr King said that the letter focused on three issues. First, what should be done about the medium-term fiscal position? Government had already announced a fiscal adjustment of some 2% of GDP by the end of 1995 but despite this, the ratio of national debt to income was likely to rise for several years. To be consistent with an inflation rate in the lower half of the target range, the deficit would need to be less than 3% of GDP. It was appropriate, therefore, for a further adjustment of a minimum of 1% of GDP to be made.

The second issue was the question of whether any adjustment should be immediate or phased-in gradually. There were advantages in phasing, because the recovery was less strong than might have been expected at this stage of the cycle. There was a case, therefore, for phasing-in the fiscal adjustment over 2 or 3 years rather than imposing an immediate fiscal contraction on the economy. It would also allow the Chancellor to introduce gradually any tax reforms that he might be considering. Among these reforms, Mr King suggested that further reductions in mortgage interest relief, the introduction of a low flat-rate tax on the investment income of pension funds, and the broadening of the VAT base were worthy of consideration.

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The third point in the Bank's advice concerned the related issue of monetary policy and the implication for interest rates. A further tightening of fiscal policy might create the conditions for further interest rate cuts, but these would have to be considered in the course of time and in the context of all the circumstances at that time, not least the levels of interest rates elsewhere and the evidence on the progress of inflation.

In commenting on the draft letter, Sir Colin Corness suggested that the reference to government's commitment to lower inflation should refer to this, rather than to any future government. He also questioned the proposal that government might consider further reductions in mortgage interest relief, on the grounds that the recovery remained very fragile and that new housing starts in particular fell in the last quarter.

Sir Jeremy Morse said that comments seemed to focus on the quantity rather than the quality of the recovery. He asked whether the Bank had any comments to offer the Chancellor on the quality of the recovery. He also said that he disliked any suggestion of interest rate changes being part of the Budget process - monetary policy was not a budgetary tool. Finally, he enquired whether the Bank's letter would be just one of many received by the Chancellor or whether the Governor would have an opportunity of discussing the letter with the Chancellor.

In response, the Governor said that the letter was sent in advance of the Dorneywood discussions and he believed that it would be influential in those discussions. In addition, he would have the opportunity of discussing the contents of the letter with the Chancellor at lunch the following week. The Bank chose not to put forward, detailed opinions in its advice, because they could be counter-productive, particularly as HM Treasury had greater expertise than the Bank on such issues. However, if in our opinion any particular area of the economy was thought to be out of line, we would certainly draw that to HM Treasury's attention. In responding to Sir Jeremy's comment on the quantity rather than the quality of the recovery,

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Mr King said that one of the reasons why the recovery was not strengthening very rapidly was because of the slow rate of growth in consumer expenditure. For this reason, it would be sensible to phase-in any tax increases so as not to hold back the recovery. In practice, the recovery was being led by exports and investment, which was a good thing.

Sir Roland Smith said that from his experience, consumer expenditure was running on the back of special deals and discounts. It was a matter of price versus value, and companies were cutting their margins and relying heavily on their marketing skills. Sir Chips Keswick agreed with this assessment, saying that consumers were not inclined to borrow to spend.

Sir David Scholey said that in the light of recent discussions at Court, he was surprised that the letter did not mention the possibility or necessity of increasing interest rates in the absence of any fiscal adjustment in the Budget. He suggested that might strengthen the Bank's case for fiscal action to be taken. Sir Jeremy Morse said that he had sympathy with Sir David's point.

Mr Coleby commented first on consumer spending, which had been dampened in the current recovery by the lack of confidence arising from uncertainty over jobs, and by the overhang of indebtedness concentrated in negative housing equity. Combining stability, or modest downtrend, in unemployment would ease the first problem; stability or modest uptrend in house prices - now 2½% above their trough, on the Halifax index - would ease the second problem. Consumption could be expected to grow more strongly, in the absence of any new shock to confidence. Responding to Sir David Scholey, Mr Coleby said the link between the PSBR and monetary policy lay in the effect of the former on inflation expectations. The point was covered in the draft Budget letter. Mr King commented that this also had to be seen in the context of the Chancellor having the opportunity to adjust the fiscal stance only once a year,

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whereas we were considering the monetary stance on a regular monthly basis.

Sir Roland Smith commented that the introduction of a low flat-rate tax on the investment income of pension funds etc would have an effect on corporate earnings - in practice it would be a tax on businesses: Mr King commented that, in the end, of course, all taxes fell on the individual.

Mrs Heaton was concerned that the terms of the Bank's letter generally, and the specific references to various taxes, were rather diffident. If they were being put forward in the Bank's name, she suggested that they should be expressed more forcibly. She also commented that from her position at the Takeover Panel, she would be concerned about the imposition of a tax on pension fund investment income, etc.

In response, the Governor said that the points made in the letter were issues that were part of the on-going dialogue with HM Treasury. But this was an opportunity, in advance of the Budget, of flagging various points that we had made previously. However, the points made at Court suggested that it might be helpful to have a general discussion on these tax issues in the future.

The two papers produced by the International Divisions "Quarterly International Developments" and "China - coming in for a hard landing" were left with Members for information.

Under the weekly executive report:-

1 The Deputy Governor said that the Government was undertaking a further series of fundamental public expenditure reviews, which would include HM Treasury and its cash-limited services. Accordingly, the Treasury was proposing that value for money audits should be carried out on the Bank's activities that came within that definition. It had agreed that this audit could be undertaken by our own external auditors rather than by

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the National Audit Office, and that it should be carried out during this coming winter.

2 In commenting on the IMF meetings which he had attended recently, the Governor said that in the context of the not very encouraging prospects for the industrial world economies, the most significant thing had been the general agreement that macro economic policy should be directed towards stability, and that there was a need for further deregulation and liberalisation of international trade. It was significant that the developing countries, having pursued these policies, had very largely escaped the worst of the world recession.

G. A. Croghan
Secretary.

Adrian Cadbury
14th Oct. 1993.

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A COURT OF DIRECTORS AT THE BANK

THURSDAY 14 OCTOBER 1993

Present

Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Anthony Laurie Coleby, Esq
Sir Colin Ross Corness
Andrew Duncan Crockett, Esq
Mrs Frances Anne Heaton
Sir Christopher Anthony Hogg
Sir Martin Wakefield Jacomb
Sir John Chippendale Lindley Keswick
Mervyn Allister King, Esq
Sir Christopher Jeremy Morse, KCMG
Brian Quinn, Esq
Sir David Gerald Scholey, CBE
Professor Sir Roland Smith
Sir Colin Grieve Southgate

Hugh Christopher Emlyn Harris, Esq
Ian Plenderleith, Esq

The Minutes of the last Court, having been circulated, were approved.

Arising from the Minutes, the Deputy Governor drew Members' attention to the note in folders which identified the costs of running the Financial Markets and Institutions Division and said that this information would form part of similar Reports to Court in the future.

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Details of the weekly figures and graphs relating to the state of the foreign exchanges and the domestic markets were laid before Court.

Court gave their approval to Sir David Scholey joining the Board of The London School of Economics and Political Science.

Court noted Mr Laird's involvement in a proposed employee buyout of the Manchester Passenger Transport Authority and agreed the proposal that, in the event of the bid being successful, Mr Laird should join the board of the new company.

The Deputy Governor introduced his paper on the functions of the Bank, which was the second of three papers on issues that arose from the independence debate. The paper focused on the Bank's involvement in matters other than monetary policy, and it was important for Court to consider whether it was appropriate for the Bank to retain any, or all, of these functions. In response to Sir Chips Keswick's comment that the Bank should not lose the high ground by offering a chopping list for negotiation with Government, the Deputy Governor said that the issue was being discussed, not in any sense of horse trading, but in the expectation that questions would be raised about the appropriateness of the Bank continuing with certain other functions and there was, therefore, a need to consider a response.

Sir Adrian Cadbury said that it was appropriate for the Bank to decide what, in our opinion, we as a central bank should do, and then to consider the arguments for and against the remaining existing functions.

Sir David Scholey said that he regarded the printing of bank notes as an optional extra which he would be happy to relinquish, but he had greater difficulty with giving up supervision. Banking supervision was an intrinsic part of the payments, settlement and credit systems. However, with the reducing differences between the banking, investment and insurance sectors as products and services were developed, the

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financial system was becoming more integrated. There could be a case, therefore, for all supervision to be correspondingly more integrated than at present. He suggested that the systemic risks now went beyond banks, particularly with the greater integration of, and connections between, financial firms, and the increase in disintermediation. The central bank should therefore be responsible for monitoring all threats to the financial system.

In referring to the supervision of the wider markets, Sir Chips Keswick said that the issue had been fudged when the Financial Services Act had been drawn up. There was a considerable overlap between the DTI, HM Treasury and the Bank, and this had never been resolved. Mr Quinn agreed that the financial system was now very different from the past, with risks increasingly common or connected as between different sectors, thus increasing the overall sensitivity of the financial system to external shock. Nevertheless, he was still of the view that banks were different from other institutions in that their liabilities were more liquid and volatile. These liabilities were essentially monetary in nature and therefore of direct interest to the central bank. This was not true for the financial assets and liabilities of other institutions. He would not wish to see the central bank responsible for supervising the whole system. Even if we wanted to, we did not have the necessary expertise. However, we might have a central role in monitoring or in surveillance of the system as a whole; but we should not be drawn into regulating financial institutions. Supervision could be done all under one agency, but it would not necessarily be done any better. Such a system operated in Canada and Denmark, and those examples did not demonstrate a clear superiority over the arrangements here.

Mr Quinn said that he had learned much in the past two years about the links within the banking system that helped explain where the Bank could safely draw the line of its supervision. There were a number of small institutions, many more than he would have thought two years ago, whose failure could have a big impact on the rest of the financial system. He could not

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see, therefore, that they could be easily separated from those that "mattered" for the stability of the system. Finally, he could not see the Bank supervising all financial institutions in the role of "City Policeman". Although he would be happy to see the Bank hive-off the regulatory side of banking supervision relating to deposit-taking, he would want us to keep responsibility for the supervision of the banking system and possibly have a wider monitoring role. But this would need better arrangements for exchanging information between different regulators and supervisors.

Sir Christopher Hogg asked whether the Bank agreed that the Financial Services Act was a fudge, with too many fingers in the pie, and a lack of co-ordination. Sir David Scholey said that a group, chaired by Sir Martin Jacomb, had been set up before the Financial Services Act to consider a number of these questions. They had identified potential problems of inter-agency rivalry, but Government had not seen it that way. Sir Jeremy Morse said that, before the legislation, supervision had been split. The DTI had responsibility for the insurance and securities markets, and the Bank of England for the supervision of the banks: the fudge, therefore, was a product of history.

Sir Martin Jacomb said that the Bank must remain responsible for systemic risk. This should include the risk of contagion from the securities industry, which was large and posed a potential risk to the whole financial system. He said there was a strong argument in terms of clear accountability for monetary policy, for a separate agency being responsible for the supervision of banks, separate from the central banking function.

In response, Mr Quinn said that he was not suggesting that the Bank should have responsibility only for supervising the banking system and having no role elsewhere. There were certain things that a central bank would have to do, and so the Bank had a particular, rather than an exclusive, interest in the banking sector. Only the Federal Reserve could deal with

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the 1987 stockmarket crash, and only the FRBNY could have dealt with the Drexel collapse; this was because they understood and had the overview of the whole system. In the banking area the Bank needed to know a lot about each individual institution, because any single difficulty could easily ripple out. It was a case of requiring almost day-to-day knowledge of bank's business and activities.

In response to Sir Martin's comment that there seemed to be a presumption within the Bank that banks cannot be allowed to fail, Mr Quinn said that the position was now quite different from what it was 20 or even 5 years ago. In recent years we had allowed a number of banks to fail, those that we had felt would not bring others down and create a systemic risk. Of course this was a very difficult judgement - and one probably best made within the central bank, because of the need for speedy and stealthy action and, depending on the circumstances, because of the possible impact on the payment systems.

Sir David Scholey said that his earlier comment was not meant to be doctrinaire. He was expressing concern that the established roles should not necessarily be preserved at the expense of the development of other financial markets, for example, by restricting certain areas because they were not part of the existing supervisory system.

Mr Crockett said the Bank should be prepared to consider the implications of shifts in financial structure in the future. To date, there had been relatively clear delineation between different types of financial business, but this may not be so clear in the future. This would make it hard to separate those categories of institution which might pose a systemic risk from those which did not.

In moving the discussion on to wider issues, the Deputy Governor posed the questions whether the Bank was doing too much; could we do less, and do it better?

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In response, Sir Christopher Hogg said that in the case of the conglomerate the most important thing was - did it make sense? Whatever you decided upon, you then needed to create the right conditions and engage the right staff to carry it through. So far as the Bank's other functions were concerned, two of the main problems were, first, that the Bank was subordinate to HM Treasury; and, second, the Bank's history, which inevitably generated a rather traditional approach. The issue was about the quality of the way we did things.

Sir Jeremy Morse agreed with Sir Christopher, saying that the functions were all reasonable ones for the Bank to undertake, but it was the way we approached them that mattered. We could not be competent to fulfil these functions unless we were well informed. Sir Jeremy, however, did not agree with Sir Chips about the chopping list. Sir Jeremy said it was realistic to draw up such a list and to identify the functions that we could not give up. Reverting to the discussion about supervision, Sir Jeremy said that there were tensions and conflicts in this area that should be resolved. The earlier discussion had omitted the issue of lender of last resort. This was central to the Bank. He agreed that the Bank should let some banks fail - the focus should therefore be on systemic risk, and less on looking after every bank by taking on the function of lender of last resort. He did not think the central bank should necessarily act as lender of last resort to securities firms. The Federal Reserve had not done so in the 1987 crisis, but had instead operated through the commercial banks. Mr Corrigan had made an immense contribution to this debate.

Sir Adrian Cadbury said that he found the conglomerate comparison a useful test. He cited the branches as an example where we were in danger of looking to see how we could use them, just because we had them. This was not right - we should establish what we needed to know and needed to do. He was particularly concerned about the Bank's accumulation of property.

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In response to the Deputy Governor's enquiry about the location of the branches and their impact on the clearing banks' note distribution arrangements, Mr Quinn said that these arrangements were some 30 years old. He could envisage all notes being printed other than at Debden, and being transported to the banks in a different way. There were several ways in which the banks' note centres could be serviced, but important issues of cost and security were involved. Nevertheless he agreed very much with Sir Adrian on how we should consider the issue of the branches.

Sir Colin Southgate said the Bank should make up its mind what functions it wanted to drop. He suggested that the Bank could dispose with the Printing Works, the branches, and the Registrar's function. The Bank could then talk with Government knowing exactly what we felt we should be doing as an independent central bank.

Mr King said that the key issue was accountability. The paper related to two questions. First, what functions would the Bank wish to retain? Second, from the viewpoint of the country as a whole, what functions should be allocated to which institutions? The answers to these questions were not necessarily the same. He was uncomfortable with the two reasons put forward for wanting to keep the functions that we had at present, namely to preserve our clout, and because it reassured the staff. In terms of the independence debate, it would not just be a matter of discussion and negotiation between the Bank and Government, it would be a public debate. It would be necessary for us to justify our position in the context of what would be best for the UK. All the activities identified in the paper were optional extras. Mr King suggested that it might be difficult for a single organisation to be responsible and accountable for such a wide range and number of objectives - was it possible to design a system of accountability for all of these functions?

Mr King reverted to the function of lender of last resort, and in recalling the stock market crash of 1987 suggested that the

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amounts involved were now so large that lender of last resort functions could be restricted neither solely to the banking system nor solely to the central bank. The Deputy Governor raised the question of how support operations could fit in with the role of an independent bank. Would support be on our own account or using Government resources? Mr Crockett suggested that we would have to make our own judgement, then make a case to get Government backing.

Mr Plenderleith agreed with Mr King on the question of accountability, and said we needed to ask the question whether these functions were better carried out by the central bank or by separate organisations. None of these functions was essential, and we should not pass up independence to keep any one of them. However, there were sensible arguments for retaining some functions, and for them to be retained within one organisation, with, in his view, the priority areas for retention being responsibility for systemic supervision, the payments system, and debt management. On debt management, the central bank had to be concerned about the financing of Government debt, because there were implications for monetary policy. It would be more efficient if the central bank were involved alongside Government in ensuring that fiscal deficits were financed in ways that did not have adverse monetary consequences. He recognised, however, that if a Government pursued totally irresponsible debt management policies, the central bank might at some stage need to step back from debt management and rely on pursuing a monetary policy that would aim to neutralise the weakness in debt management.

Mr Quinn said that, in Mr Kent's absence, he would like to make some points that he imagined Mr Kent might wish to make in support of the Bank continuing to do things that others might not undertake - he instanced CREST and Eurotunnel. Had the Bank not undertaken these, they would either not have been done, or not done so well. It had been good for the Bank. The Bank should continue to do some things that were not core for an independent central bank, particularly if they brought credit to the Bank, and were clearly in the national interest -

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ie they had external benefits that outweighed the costs to the Bank, measurable and non-measurable.

In reverting to the conglomerate issue, Mr Crockett said that he would be concerned about the impact that minor issues might have on management time. Managing monetary and foreign exchange policy were big responsibilities, and he could see no concern about dropping other functions in order to fulfil those properly.

In conclusion, the Deputy Governor thanked Members for their contributions and said that in producing a further paper it might be helpful to consider the Bank's wider roles, to identify the range from essential functions through to those that we could relinquish without concern and, at the same time, to identify the quality of the Bank's performance in each role.

At the Deputy Governor's invitation, and with the agreement of Members of Court, Mr Smith, the Head of Industrial Finance Division, and Mr Piper, a Manager in that Division, attended Court for the discussion of a paper entitled "The Financing of Small Firms".

In introducing the paper, the Deputy Governor said that it had been prepared following discussions with a number of interested parties and that it would be sent to HM Treasury the following week. It was possible that it would form part of the consideration for the Budget package. In the interim, it was proposed that the Bank should see if a programme of action could be agreed involving those parties who had taken part in the earlier debate.

In opening the discussion, Sir Jeremy Morse focused on the suggestion that bank lending to smaller businesses was currently constrained by lack of demand rather than by inadequate supply; in the aftermath of the recession, companies would be shy of borrowing for some time to come. He also said that late payment was a very prominent issue, and was an increasing habit both among individuals and in the corporate

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area. Sir Chips Keswick maintained that any form of Government intervention in this area, including introducing legislation covering late payment, was a very dangerous concept and would interfere with the normal operation of the markets. In response, the Deputy Governor said that, even with legislation, not everybody would pursue late payments through the Courts. The main contribution of legislation might be to help to promote a culture of prompt payment.

Sir Martin Jacomb said that the paper put too great an emphasis on the supply of bank finance, which was not the main factor. What small firms required was longer term finance, and he supported the role of "business angels" and the need for tax incentives to help in that area.

Sir Roland Smith thought the paper represented an excellent review of the present situation, but he had reservations about its lack of definite conclusions. The banks themselves needed to decide whether they wanted to continue to lend to small businesses, which represented a high risk sector of the market. Many small businesses overstretched themselves and in a recession they were bound to fail. Banks had adopted a more sophisticated approach towards big business, and were more geared to that sector. They had difficulty in communicating with small businesses, and personal relationships between bank managers and the smaller businessman had broken down. In many instances the banks were regarded as the enemy. Sir Roland suggested that it might not be possible for banks to lend profitably to both big and small businesses. In response, the Deputy Governor said that the Bank had established that banks did want to stay in the small business sector and they had developed a wide variety of financing options. Sir Jeremy Morse said that it was inevitable that the recession would hit small businesses and individuals more than big business, and that it would be the biggest area of loss for banks in a recession. Reverting to Sir Roland's point about the banks' ability to respond to the needs of both large and small businesses, Sir Jeremy said that in practice it was not the same people looking after both sectors. The banks had

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segmented the market and if they withdrew from financing small business, no-one else would step in.

Sir Colin Southgate said that the banks used to direct new businesses to other institutions, such as 3i etc, for startup finance. There was now too much short-term borrowing and, overall, the debt/equity ratio was wrong. He was also strongly against any form of Government involvement in this area, except to provide tax incentives and concessions to encourage "business angels".

Sir Christopher Hogg thought that it was an excellent paper. The banks had considerable social responsibility, and he was encouraged to read what the banks were doing now. He pointed to three important issues that had not been covered in the paper. There was no reference to the excessive bureaucracy that hampered small firms, or to the resulting black economy; moreover, there was considerable scope for accountancy firms to help on an educational front in the area of small businesses.

Mr King said that he was uncomfortable with the proposition that Government should keep out of this area altogether, but he agreed with Sir Christopher Hogg that bureaucracy and the cost of employment were a problem. The lack of equity finance was not because of lack of tax incentives. In the case of BES, these had been too generous and had led to its inevitable failure. He agreed that "business angels" needed to be encouraged. However, such people were probably already heavily invested in property and other investments, and so incentives would need to be in the form of tax exemption on income, rather than through subsidies. In commenting on Mr King's remark about institutional savings, Sir Martin Jacomb confirmed that the institutions were interested only in investing in big business, not in small firms. Mr King suggested that one possibility might be to extend TESSAs and PEPs to investment in small businesses.

In commenting on the discussion, Mr Smith said that he accepted Sir Martin's point about not placing too much emphasis solely

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on the supply of finance. It was essential to rebuild relationships between banks and their small business customers. In response to Mr Smith's remark that banks had commented on the lack of financial awareness among small businesses, Sir Roland Smith said that training and education were very important but small businessmen lacked the time to devote to these issues.

Mr Piper said that since the Governor's involvement in this issue had been publicised, some 50 or so letters containing various complaints against banks, and other suggestions, had been received. Interestingly, very few complained about the level of interest rates; the withdrawal of existing facilities and the non-availability of new loans were more prominent issues.

In conclusion, the Deputy Governor thanked Members for their comments, which had been very helpful. The Bank would now see what could be done to take the matter forward by involving the various parties.

Under the weekly executive report:-

1 Mr Quinn said that the Tribunal which had heard the three appeals over the Mount Banking Corporation - the first under the Banking Act 1987 - had delivered its judgement the previous day. The Tribunal had found in favour of the Bank on the main points of substance, and the appeals (by the liquidator and the owners) had been dismissed. The Tribunal had agreed with most of the Bank's findings and certainly the most important ones. However, the Bank had lost on the jurisprudential question relating to the scope of the appeal; the Tribunal had disagreed with the Bank's view that it should review only the reasonableness of the Bank's actions. Instead, it had substituted its own judgement. We would have to consider whether we would appeal on this point, and had 28 days in which to do so: we were taking Counsel's advice.

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So far as publicity was concerned, it was possible that the findings of the Tribunal could be made public, and the Bank did not propose to stand in the way of their publication. The result of the Tribunal was significant for the Bank, as it had taken place in the aftermath of the Bingham Report, which had encouraged the Bank to take a tougher line on supervisory issues: this judgement had therefore endorsed our action.

2 Mr Coleby reminded Members that there had been several references to problems in the conduct of the Bank's money market operations in the past. The fundamental problem had been the disproportion between the size of the stock of assistance needed, which was of the order of £15-£20 bn, and the size of the eligible bill market - the mainstream source of assistance - which amounted to around £20-£25 bn. The stock of assistance had grown sharply as a result of intervention in the foreign exchange market in September 1992. It had not fallen much since, largely because we had continued to overfund the PSBR. With such a large funding requirement, it had seemed right to take opportunities when they were available - a large amount of this year's funding was already tied up. Throughout this period the Bank had used additional temporary measures to provide assistance. The principal temporary measure was a facility to provide cash to banks, building societies and market makers by the repurchase of gilts and, in the case of banks, Government guaranteed fixed rate paper under the export and shipbuilding schemes.

It was now proposed to embark on discussions aimed at making that facility more permanent and systematic. It would be offered twice per month; and the terms adapted to encourage greater participation. The interest rate set would be more generous to our counterparties than at present. We would also explore widening the range of acceptable collateral, to include British Government Securities denominated in foreign currencies and, for

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longer maturity transactions, eligible bills. If the latter feature were adopted, discount houses would be invited to participate in the arrangement.

[illegible]
Assistant Secretary
[illegible] October 1993

Rupert Pennant-Rea

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A MEETING OF DIRECTORS AT THE BANK

THURSDAY 21 OCTOBER 1993

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Anthony Laurie Coleby, Esq
Mervyn Allister King, Esq

Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The number of Directors assembled being insufficient to form a quorum, those present proceeded to the business, subject to ratification by the next Court.

The Minutes of the last Court, having been circulated, were approved.

Mr Coleby commented on the weekly figures and then spoke about the foreign exchanges and the state of the domestic markets.

There were no items for discussion under the weekly executive report.

A Heffernan
Assistant Secretary
28th October 1993

Rupert Pennant-Rea

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A COURT OF DIRECTORS AT THE BANK

THURSDAY 28 OCTOBER 1993

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Anthony Laurie Coleby, Esq
Sir Christopher Anthony Hogg
Sir Martin Wakefield Jacomb
Sir John Chippendale Lindley Keswick
Gavin Harry Laird, Esq, CBE
Sir David Bryan Lees
Sir Christopher Jeremy Morse, KCMG
Brian Quinn, Esq
Sir David Gerald Scholey, CBE

Pendarell Hugh Kent, Esq

The Minutes of the Court of 14 October were confirmed and those of the Meeting of 21 October, having been circulated, were approved.

In commenting on the weekly figures, Mr Quinn said that note circulation was creeping up, showing an increase of 6% on the position at the same time last year. A discussion then ensued on the conclusions that could be drawn from these figures, particularly in the context of retail sales. The Governor mentioned that the Economics Division had produced a number of papers on this subject, which Members of Court could obtain from the Secretary, if they so wished. Mr Coleby spoke about the foreign exchanges and the state of the domestic markets.

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At the Governor's invitation and with the agreement of Members of Court:-

1 Mr Ware, a Senior Manager responsible for the Securities Markets in the Financial Markets and Institutions Division, attended Court for the ensuing discussion of the paper 'What the Bank believes about the Equity Market'.

Mr Kent said that the paper before Court, which was a follow on from the previous discussion of the equity markets on 8 July, crystallised into two crystals; the primary market and the secondary market. As far as the latter was concerned, there were two views within the Bank. The first favoured the retention of a unified market - the Stock Exchange or some successor body - whereas the second was content to see the emergence of rival or competing bodies. Those who supported fragmentation felt that there would be enough firms participating in the markets to ensure that arbitrage between the different channels served to unify prices. They also noted that there was in any case no unique market price to all market participants; price is partly a function of the type of bargain as well as of global supply and demand. Mr Kent mentioned that in France, when an institution wished to make a large transaction, it had to do it in penny packets. As a result many French investors preferred to use SEAQI in London. The considerable success achieved by SEAQI would clearly be an important determinant of the position the Bank would take if the Stock Exchange's role ever became seriously threatened. He mentioned that Jonathan Agnew was undertaking an exercise looking into market manipulation and related questions on behalf of SIB. Although he had not yet finished his consultations, his conclusions were likely to be very similar to ours. Mr Kent then went on to consider the Bank's position in relation to market makers. Whilst we certainly believed that liquidity was enhanced by

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market making, the Bank would not wish to take any specific action to promote or preserve the role of market making if the market itself wanted to adopt other ways of trading. The Bank recognised the need for a lack of transparency in publication of deals as a quid pro quo for the real liquidity which market-making provided. We recognised that if their current stamp duty exemption or their stock-borrowing privileges disappeared, market makers would be adversely affected. We would be content to allow market forces to determine their role in the market place. If market makers disappeared, we could end up with an order driven market; we therefore think that the Stock Exchange should have the capability to provide such trading arrangements as a fall back if market making ceases to be viable. Continuing, Mr Kent accepted that we had an inconsistent view on the desirable degree of transparency in the domestic and international markets. However, we accepted the intellectual inconsistencies because of the advantages we derived from the latter. If, however, the prospect of London formally becoming the European capital market ever became real, and the price of this was a different transparency regime, we might have to change our minds. On a separate subject, we were keen for the Stock Exchange to maintain a junior market as a successor to the USM.

In opening the ensuing discussion, Sir Christopher Hogg, having declared an interest, said he was not so much concerned with the content of the paper, more the light it shed on the Bank's attitude towards its third core purpose. It was difficult to see if the Bank was reacting to the rest of the City or taking a proactive role. Some would see a proactive role for the Bank as dirigisme, though he personally did not think that proactivism necessarily meant dirigisme. The Bank could act like a non-executive director rather than a Chief Executive Officer. A proactive Bank would have to make up its mind very clearly over points of

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principle for City institutions. It was a difficult role, but one that needed to be taken by someone. There was a place for an external voice, whether from the Bank or elsewhere. Sir Christopher Hogg emphasised that the paper reinforced the difficulty of the Bank being proactive - that two different points of view coexisted in some areas was not surprising. It would, however, be bad news if there was confusion about what the Bank was trying to achieve. The Governor agreed it was a dilemma; it was difficult to establish a definite position with regard to every part of the City. If one looked at the City as a series of concentric circles, it was easier for us to take a proactive line the nearer one was to the centre. It became more difficult as one moved out. The equity market he regarded as being about half way out. We were not proactive in the outer circles. Sir Christopher Hogg commented that if the Bank was left to clear up the mess (as was sometimes the case, for instance with Taurus), being proactive to prevent the mess in the first place might be the lesser of two evils.

Sir Jeremy Morse was concerned that the Bank might be approaching such matters from a negative viewpoint. For example, would we intervene in the insurance or securities markets simply because they were affecting the banking market, or for wider City reasons? Perhaps the answer was both.

Sir David Scholey, having also declared an interest, said he was worried by the paper. He felt it was very important that the Bank should have a long term view of the implications of various developments in the context of its third core purpose. What happened in the securities market not only in this country but world wide impinged on the banking system. He went on to say that he was increasingly appalled by the ineffectiveness of the Stock Exchange. It was very important, therefore, that the Bank took a view about the

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operations of these markets not only in the context of other domestic markets but also with respect to its international role. Also, the importance we attached to liquidity needed to be considered. He could make out a case for saying that the high degree of liquidity in London and the United States was a negative factor in long term industrial policy if investors were able to move in and out easily; a short-term view was automatically encouraged. The Bank should certainly have a view on this. While the paper made a good start on addressing these questions, he was concerned that it did not come up with views on the bigger issues.

Sir Martin Jacomb, having also declared his interest, said he agreed with the views expressed by Sir David Scholey, especially those with regard to the Stock Exchange. He felt the Bank had a very important role to play, and not only because of the current vacuum in Stock Exchange leadership. The securities market was interwoven with banking business, and one could not disregard the efficiency of settlement arrangements for securities transactions. Indeed, the Bank should be concerned with every aspect of the market, both now and in the future. It was important that large institutional and international business continued to be done in London. The Stock Exchange should not be enslaved by the small retail brokers. If we wanted business to succeed, we had to sacrifice transparency for the sake of liquidity. Sir Martin Jacomb added that he would be disappointed if the Bank saw no role in encouraging developments that it thought desirable, as well as protecting London from ill-judged legislation emanating from Brussels.

In responding to Sir Jeremy Morse's question about morale at the Stock Exchange, Mr Ware said that the staff had certainly been traumatised by the disaster of TAURUS, and some of this effect would remain until a new Chief Executive Officer was appointed. Names were now

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beginning to appear, however, and it would be very necessary for whomever was appointed to get an immediate grip on the reins.

Mr Kent took up the point of the intellectual justification for any Bank intervention. He said that central banks had an interest in the flow of finance between the providers and the users of capital. Our philosophy of letting markets evolve naturally because they are more likely to know better than any central authority had brought immense benefit to UK companies and investors. The model we had was viable and sustainable. He went on to say he did not accept Sir Martin Jacomb's point that the Stock Exchange was still captive of the private retail broker; market makers had far more influence in today's Exchange, though this might change if the way the Exchange was regulated were to change. The Bank's goal of letting markets evolve naturally meant that we were inevitably reactive, and therefore found ourselves mopping up accidents. Although our counterparts in Germany and France tended to take a long view, this often created rigidity, which was to the detriment of their markets. Our agnostic stance was the right one if markets were to prosper.
Sir David Scholey commented that it was not necessary to be dirigiste to have a long term view. The Bank had a very special position. Simply because it formed a view on something, it did not necessarily mean that it would happen, nor that we should take active steps to enforce this view.
The Governor said that the discussion had been very interesting and that we would need to return to and produce clearer definitions of how far we should proceed into the outer circles. We would, however, start from the position that Members of Court, as active participants in the markets, would tend to know more about them than the Bank.

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Taking up the Governor's point, Sir David Lees said the discussion had thrown up the need for the Bank to develop and articulate clearer strategies in relation to its third core purpose. A regular strategy document might be a good idea. The Governor agreed on the need to reflect in a more precise fashion on the Bank's third core purpose; however, if the Bank sought to do too much it might run the risk of weakening its central purposes.

In conclusion, Sir Chips Keswick agreed that trying to find intellectual justification for everything we do could be dangerous. The Bank had always been a paterfamilias to evolution. It was a role to which the Bank was well suited. It did not have to get bogged down by trying to be all things to all men. Fluidity was the key.

2 Mr Price, the Head of the Economics Division and Mr Bowen, Mr King's Personal Assistant, attended Court for the discussion of the draft Inflation Report, which would appear in the next edition of the Quarterly Bulletin to be published on 2 November.

Mr Price introduced the draft Inflation Report, which was close to the final version which would be published on Tuesday. He pointed out that various measures of annual inflation had turned up a little after reaching a low point in early summer. This reflected the rebound of prices after earlier-than-usual summer sales and unusually low seasonal food prices. The Central Statistical Office had been rewriting the history of real output. It was now clear that the trough of the recession was reached in 1992 Q1; the economy had picked up last autumn, but was still growing only at about 2% a year, which was roughly the rate of growth of potential output. Mr Price did not share the view that growth might easily come to a stop again, but it was true that the recovery was patchy. For instance,

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agriculture and construction were suffering particularly badly.

Statistics for trade with the EC, now compiled from VAT returns instead of customs declarations, were particularly unreliable at the moment. They appeared to be understating volumes and overstating prices. For instance, the apparent volume reduction in trade with the EC was not borne out by the volume of container traffic passing through Dover. The data were liable to further revision, which might reveal a stronger performance by manufacturing than we have yet appreciated.

Mr Price noted that corporate profitability was looking good for this stage in the cycle. The downward movement of wage settlements may have paused, but firms had been able to reduce unit labour costs because productivity growth had been remarkably favourable. He concluded that firms should not focus on gross margins or rates of return based on historic costs when setting their prices, but bear in mind the current relatively high level of profitability.

Sir Jeremy Morse recalled that the August Report had become more optimistic after the draft which Court had seen. He cautioned against adopting a general pro-government optimism; instead, the Bank's judgment should head for the middle, and not lend support to those claiming inflation had been defeated permanently. The conclusion of the Report should be less optimistic and stress the conditions necessary to ensure inflation remains low.

Sir David Scholey was surprised to learn that, in the Bank's view, markets were now convinced that the budget deficit would be steadily reduced. The Governor said that it was difficult to read the changes in yields any

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other way. Sir David Scholey wondered how firmly these expectations were held.

Responding to Sir Jeremy Morse, the Governor made it clear that the Bank did try to aim for the middle in assessing the risks attached to future inflation. Sir Jeremy Morse likened the Bank's role to a watchdog, in contrast to an arbiter. Mr Price noted that the Bank can already point to a balanced track record; the errors in short-run inflation projections published in the Inflation Report have been in both directions. The Governor agreed that the Bank should look again at the tone of the conclusions, but noted that excessively pessimistic projections could also damage the Bank's attempt to establish their credibility.

Sir David Lees commented that productivity often falls off when poor demand is anticipated. As we are now coming out of recession, was there more scope for future productivity growth in the whole economy than the Report allowed? Mr Laird noted that some British firms were still miles behind their international competitors, so there was plenty of room for productivity improvements. Mr Laird also remarked that it was odd to remove more and more elements from the Retail Prices Index; would we end up taking everything out? Mr Price agreed that productivity growth could continue, but explained that the surprise had been the remarkably high productivity growth maintained going into the recession. Sir David Lees thought this was the result of firms adjusting manning levels more rapidly. Mr Laird stressed that substantial spare capacity still existed, so that output could still be increased with little increase in employment if demand conditions were favourable.

Under the weekly executive report, Sir Adrian Cadbury mentioned to Court the progress being made with regard to the sale of PRONED. He reminded Members that the Bank had been central to the setting up of PRONED, which had had a campaigning role in

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the appointment of outside directors to the boards of companies, and then, in the placement of such directors on the boards. It had been decided earlier in the year that PRONED should cease to be partly sponsored and partly commercial, and should be floated off. Bankers had been appointed to look after this, and three formal bids had been received. They were due to be considered the following day by a panel of PRONED's sponsors, Lord Inchyra for the BBA, Peter Minchin of the Stock Exchange and Sir Adrian Cadbury himself.

Sir Adrian Cadbury mentioned that the lease of PRONED's premises was in his own name and that of Sir David Walker. The Bank had said it would stand behind them if there were any problems. There was a modest contingent liability on their behalf.

Sir Adrian concluded by expressing his appreciation to Mr Kent for helping to steer through the final phase.

Rupert Pennant-Rea

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A COURT OF DIRECTORS AT THE BANK

THURSDAY 4 NOVEMBER 1993

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Anthony Laurie Coleby, Esq
Andrew Duncan Crockett, Esq
Mrs Frances Anne Heaton
Sir Christopher Anthony Hogg
Sir John Chippendale Lindley Keswick
Gavin Harry Laird, Esq, CBE
Sir David Bryan Lees
Sir Christopher Jeremy Morse, KCMG
Brian Quinn, Esq
Sir David Gerald Scholey, CBE
Professor Sir Roland Smith
Sir Colin Grieve Southgate

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq

The Minutes of the last Court, having been circulated, were approved.

At the Governor's invitation, Mr Allen, the Head of Foreign Exchange Division, spoke to Court about the work of his Division. He said that his paper described the responsibilities of the Division and then went on, so far as it was possible, to go into the figures involved. The figures gave an idea of the scale of the operation and also gave an account of the costs as well as the profits that the Division

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earned for the Bank and HMT. It should be borne in mind, however, that in looking at the profits, which appeared bigger than the costs, the costs of other areas of the Bank, such as the Banking Department, which conducted operations on behalf of the Division, were not included.

Mr Allen went on to say that he wished to talk about three points not covered in the paper; non-measurable output, how the effectiveness of the Division could be judged, and management issues. Taking the first, he said that a large part of the Division's function was to acquire information from the markets, especially about sterling. Dealing operations in the Division were conducted to maximise information flows. They dealt with far more counter-parties than was necessary, whether it be banks overseas or banks in this country. All this helped with the supply of information. Another by-product was that the Division acquired information about the structure of the market and new instruments, such as derivatives. The Division also had good contacts with other Central Banks, through telephone conversations, visits and meetings at Basle. Again, useful information emerged from these sources, and the relationships that were built up also helped when it was necessary to organise practical operations.

Moving on to how the effectiveness of the Division could be measured, Mr Allen said this could be achieved to some degree by figures, although too great an emphasis should not be placed on them. But not all their functions could be measured in such a manner, of which obtaining information was a good example. Having said that, the more effective they were the better information they received. A more concrete way of measuring their effectiveness was to listen to the comments received from commercial banks on the performance of their dealers. The effectiveness of their Reserve Management operation could not be judged solely by returns. Their main objective was to maintain liquidity and security, and this they had done successfully during the events of the previous September.

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Mr Allen then dealt with two management issues. The first concerned staff. The operation of the Reserve Management function occupied high quality staff and offered direct experience of dealing in the financial markets within clear constraints and accountability. It was an attractive scenario in which many in the Bank were keen to participate. However, in doing so there were those who discovered they were good at it and then became attracted by opportunities outside the Bank. Many who left would have left in any case; but the best ones tended to stay on, attracted by the career the Bank offered.

The second management issue related to information systems. As Reserve Management became more sophisticated, so there were greater demands for management information, in order to measure risks and analyse returns: in the latter case the scope appeared unlimited. It was the most rapidly developing area, which was why, relatively, so many staff had been allocated to it.

In opening the ensuing discussion, Sir Chips Keswick commented that after a recent visit to the Division he had come away with the impression there were too few people to deal with such a complex operation, with a consequent lack of cover. Sir Jeremy Morse said he had the same concerns. How had the Division managed when there had been a real crisis - as last September? Mr Allen said they had coped well. The foreign exchange dealers, despite a period of intense pressure beforehand, had responded very well. The Reserve Management managers, who had been required to liquidate a large number of securities, at a time when others were doing the same, had been successful, and the cash that had been needed had been obtained from the market. On the question of resources, Mr Coleby pointed out that the work carried out by the Division in connection with the Exchange Equalisation Account was cash limited, with the costs recoverable from the government. Mr Allen added that there was a limit to the speed at which the numbers of staff could be safely increased without losing management control. Sir David Scholey, in saying it was an interesting and enlightening report, commented that so far as

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the dealing staff were concerned there was a distinct difference between Central Bank dealers and market dealers. They were different animals.

There being no comments on the weekly figures, Mr Coleby spoke about the foreign exchanges, including the Official Reserves figures for October and the state of the domestic markets.

In his capacity as Chairman of BE Property Holdings Ltd, the Deputy Governor spoke about the Report and Accounts of the company for the year ended 28 February 1993, which were laid before Court.

In introducing the revised version of the paper on the functions of the Bank, one of the series on operational autonomy, the Deputy Governor said it had been re-drafted in the light of comments made at Court on 14 October, when it had been discussed previously. The paper left open some issues, but he hoped it was now close to the consensus view.

Sir Jeremy Morse said he was happy with the detail, but would be more comfortable if the paper started more positively, stating what the Bank wished to do in the context of its third core function. Focusing on Debden, Mr Laird felt that the paper underplayed the disadvantages of privatisation. In this context Sir Christopher Hogg thought the Printing Works should seek to obtain more market exposure, by opening the range of its products to customers. The Governor commented that there were constraints on the amount of commercial activity which the Printing Works could take on: a point endorsed by Mr Kent. It would be seen as the public sector taking work away from the private sector. The Bank undertook work in this area only when asked to do so by the private sector. He added that when the Printing Works had tested their competitiveness, from the viewpoint of costs, the results had been very reasonable. The Governor made the further point that when looking at the commercial possibilities for the Printing Works, as we had done with both the Banking and Registrar's Departments, there was a danger of moving away too much from our core functions. Also,

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we had to be very careful about finding ourselves in competition with those who provided our income. It had got us into trouble in the past. Sir Jeremy Morse agreed, adding that we could not be seen to be competing with those we regulated.

On the question of the ownership of the Printing Works, Sir David Scholey pointed out that if it had been taken away from the Bank, it could have fallen into the hands of Maxwell or Lonrho. Sir Adrian Cadbury mentioned that there had, at one stage, been a possibility of forming a consortium with others in order to undertake foreign operations, but this had not materialised. He quoted, also, the conclusion he had drawn from his visits to the Bank's Branches. It was better either to become commercial or undertake no such activity at all. Dabbling caused trouble. The Governor concluded the discussion on the paper by saying further consideration would be given to the points made concerning the Printing Works.

Members then moved on to consider the second paper, on the governance of the Bank. Sir David Scholey opened by saying he found the description of a slightly detached board difficult to go along with; he felt the board should be attached. Also, he did not follow the logic of a monetary committee of only Governors and Executive Directors; he could see Non-Executive Directors being qualified members of the committee as well. The Governor commented that the assumption had been made that anyone engaged in an outside activity could not be a member of a monetary committee which determined the course of policy, as they would be in receipt of insider information as a result. Although difficult to find, it was possible to think of people who had the qualities necessary to sit on such a committee and who were totally detached.

Sir Adrian Cadbury saw a problem in the definition of the roles of the upper and lower tier. The monetary committee should be responsible for the implementation of monetary policy and not have sole responsibility for monetary policy. The bigger board, as an advisory board, had a role to play in this regard and this should be incorporated into their terms of reference.

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Sir Jeremy Morse expressed concern that a two board system would be a perpetuation of the existing unsatisfactory situation. In taking up this point, the Governor said that the recent Working Party on Court had looked into the way it operated, with a view to improving its role. However, Court was essentially a sounding board. We could take Court's views, but it was a one way glass. The Governor said he found the input made by the Non-Executive Directors very valuable and this would have to be their role. Sir Adrian Cadbury felt there should be a different start for a different system, and not a continuation. He envisaged a board that was interested in what was going on, but which did not take operational decisions. Such a role should provide worthwhile tasks for informed people of value. The Governor added that there should be a discussion and review of the mandate of the board, with a distinct role being identified.

Sir David Lees felt there was an omission in the paper, in so far as no attempt had been made to define the terms of reference for the executive committee, the monetary policy committee or the executives. He suggested that the more tasks the Bank undertook, the stronger the case for a two tier board; and the fewer the tasks, the more a council became the appropriate body. A fuller set of terms of reference for both bodies would be helpful. This would then enable consideration to be given as to who should be on them. Also, he noted that there was no reference to supervision. Did this mean that responsibility for this would change?

Sir Colin Southgate said he considered any board should spend time addressing key issues and setting long term objectives. They should not get involved in day to day business. The executive should report back to the board, so the board could consider how they had fared against the targets they had been set. Such a system could work in the Bank, although he appreciated it would be difficult to find appropriate people to sit on the board. From his experience, Mr Laird said he

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agreed. A part-time Chairman could bridge the executive and non-executive function. There need be no inhibitions from outsiders.

Sir Roland Smith saw the Bank as different from other organisations. It had a duality of responsibility. Much would depend on the role that was seen for the board. Should it deal with macro-economic policy or make use of its wide experience? Which role did we want? He considered Court was always reactive and not proactive. The Bank's Non-Executive Directors should be more strategic, and their talents put to greater use.

Mrs Heaton thought that, if the concept of independence meant anything, the Bank was in for a fundamental change. If the Bank became independent, did this mean we would no longer be beholden to HMT? For her the vital question was whether or not any outsiders would become involved in the development of the Bank's policy. The Governor responded by saying he saw Court as having as full an involvement as the Bank in any mandate that we were given. Any such mandate would be agreed only after consultation had taken place with the Bank, to which Court would be given the opportunity to subscribe. The Bank would be accountable to Court, to government, and to parliament.

Sir Adrian Cadbury said he saw the need for protection; there should be a body between the executive and government. Having said that, he was very keen on a proper unitary board to support any mandate we were given.

Sir Jeremy Morse went on to say there were three side issues; the number of functions the Bank undertook, the secrecy of information, and having a single owner. There must, as a result, be a balance on the board. The Governor said that terms of reference would be prepared. Sir Christopher Hogg added that many Members of Court had difficulty in seeing their role. It would be helped if meetings were held on a monthly basis at the most, and not weekly.

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Sir Chips Keswick drew attention to the paragraphs in the paper dealing with the method of appointment of Governors and Directors. At the moment he thought they were contradictory. He did not feel that all appointments should be made by the politicians. What was wanted was people with knowledge. The Governors would know who these were; it was not something to hand over to the politicians. The Deputy Governor responded by saying that giving politicians mostly the final say was all part of the issue of accountability. He reminded Court of the comments of the Prime Minister, who had indicated that he would be more favourably disposed towards the Bank's independence if the question of accountability could be resolved satisfactorily. The Governor added that it was inconceivable that appointments could be made except by parliament or government. Sir Jeremy Morse thought there should be a middle way and that the Bank should have a veto. The paragraphs in question, said the Governor, had been included to suggest ideas. We had not got the degree of veto right; there needed to be checks and balances. Sir Adrian Cadbury said he agreed with Sir Jeremy Morse's comments. The group had to work together and the Bank should have some degree of choice. He was concerned that politicians were swayed by names. It was very important to have a balanced team, and we needed to give thought to the type of person we were after. Equally, it was very important there should be a dialogue before any appointment was made. If the Bank became independent, Sir David Scholey felt that the initiative for any appointments should come from the Bank; a point which Mr Laird endorsed.

In concluding the discussion, the Governor said he had found both this and previous ones very valuable. The question of governance was one to which Court would return. He added that the Deputy Governor had been helped by the guidance he had received from discussions at Court when he appeared before the Select Committee the previous day. In response to a request from Mrs Heaton, the Governor said he would arrange for Court to receive the minutes of the Select Committee when they were published, subject to any constraint that might be placed on their distribution.

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Under the weekly executive report, the Governor spoke about the outcome of the sale of PRONED. Agreement had been reached in principle to sell PRONED to a combined bid from the management and Egon Zehnder. Consideration was cash in the business of £250,000 and £100,000 goodwill, with a guarantee of the present lease on PRONED's offices, which runs until 2002. The Bank's share was just under one fifth.

The Governor went on to say that PRONED had started in 1982, as a result of recognition by the sponsors that one of the weaknesses in UK companies lay in poor corporate governance. Since its start, it had placed hundreds of Non-Executive Directors on company boards, and had been in the forefront of raising national awareness of the importance of Non-Executive Directors. The publication in 1992 of the Report on the Financial Aspects of Corporate Governance had represented a substantial fulfilment of its missionary role.
Sir Adrian Cadbury had been Chairman since 1984. The Governor suggested, and Court agreed, that appreciation be recorded of all that Sir Adrian Cadbury had contributed to PRONED in particular, and corporate governance as a whole.

G. A. Croughton
Secretary, 11 Jany 1993

Rupert Pennant-Rea

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A COURT OF DIRECTORS AT THE BANK

THURSDAY 11 NOVEMBER 1993

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Anthony Laurie Coleby, Esq
Sir Colin Ross Corness
Mrs Frances Anne Heaton
Sir Christopher Anthony Hogg
Sir Martin Wakefield Jacomb
Sir John Chippendale Lindley Keswick
Mervyn Allister King, Esq
Sir David Bryan Lees
Sir Christopher Jeremy Morse, KCMG
Brian Quinn, Esq
Sir David Gerald Scholey, CBE
Professor Sir Roland Smith

Hugh Christopher Emlyn Harris, Esq
Ian Plenderleith, Esq

The Minutes of the last Court, having been circulated, were approved.

Details of the weekly figures and graphs relating to the state of the foreign exchanges and the domestic markets were laid before Court.

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At the Governor's invitation and with the agreement of Members of Court:-

1 Mr Beverly, the Head of the Financial Markets and Institutions Division and Mr Brierley, a Senior Manager in that Division, attended Court for the discussion on the recommendations made by the Pension Law Review (Goode) Committee, on occupational pension schemes in the UK.

In the absence of Mr Kent and, in introducing the papers which had been sent to Members the previous week, Mr Beverly said that the Report of the Pension Law Review Committee under Professor Roy Goode had been commissioned, to a large extent, in the light of the Maxwell affair, although there had also been concerns in relation to various (smaller) pension schemes. The key recommendations were designed to enhance the security of pension schemes and provide better protection for accrued rights. A new regulator was, therefore, proposed, partly as a back-stop to bolster trust law and partly to fill a gap, given the absence of a statutory authority with responsibility for supervising the solvency of pension schemes and the performance of trustees. Major questions remained to be addressed concerning the relationship of the new regulator with Government departments and existing FSA regulators, the costs of the new regulator, and who should meet them.

Turning to other aspects of the Report, Mr Beverly observed that some form of compensation scheme was probably politically inevitable post-Maxwell. The Goode Report, rightly, envisaged a very limited scheme, covering only fraud, theft and misappropriation, but not poor investment or maladministration. This should help to avoid moral hazard. The 90% limit would encourage vigilance on the part of scheme members, while the absence of a ceiling reflected scheme members' inability

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to spread risks (unlike other areas of financial services).

Mr Beverly said the Report touched on various areas of direct operational interest to the Bank. No opinion had been expressed on whether custody should become a regulated activity, nor on whether there should be strict separation between fund manager and custodian. With the Securities & Investments Board also taking an agnostic line on custody, this outcome was satisfactory for the Bank. The same was true of the Report's recommendations on stock lending, although there were some inaccuracies concerning the extent of the Bank's influence over the stock lending market, which he had highlighted in the Bank's letter to HM Treasury. There were also references in the Report to equity settlement issues, but nothing which should cause any problems for the CREST project. More substantively, however, the Report proposed a new type of index-linked gilt, which would have to be considered carefully in conjunction with interested parties. A preliminary discussion with the NAPF had already taken place.

As for the implications of the Report, if implemented, Mr Beverly noted that the proposal for a minimum solvency standard could induce less well-funded schemes to switch from equities to gilts, with implications for the funding of the PSBR and company finance. More broadly, there was a risk that tightening regulation in this area could encourage a further shift from final salary to money purchase schemes. Demographic and economic factors, which had already induced some shift, were likely to be of more fundamental importance. The proposals would not, of course, eliminate fraud but they held out the promise of detecting fraud earlier and/or minimising its adverse consequences.

In conclusion, Mr Beverly described the Report as thorough, wide-ranging and comprehensive. Many of its

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proposals were in line with the Bank's own submission to Goode. Enhanced regulation would, of course, have a cost - the Occupational Pensions Board, with much more limited functions, currently employed some 130 people - but it was hoped that these would be contained. Several issues remained for further discussion: most controversially, how the proposed new regulator would fit into the existing regulatory structure.

In opening the discussion, Sir Chips Keswick was concerned with the proposed compensation scheme, where he thought Goode's argumentation was weak. He thought a compensation scheme could be justified only in cases where there was financial systemic risk, and this did not appear to apply in the occupational pensions area. Sir Martin Jacomb agreed and added that a compensation scheme was likely to be acceptable to the interested parties only if there were a certain mutuality of financial interest between potential contributors; again, this did not apply to occupational pensions. The Governor observed that this raised the question of whether compensation schemes should be funded by the public sector or the industry. Mr Quinn argued that, in practice, compensation schemes had come to be regarded as necessary for consumer protection purposes, rather than in relation to systemic risk; this had certainly happened in the banking area with the Deposit Protection Fund. Sir David Scholey thought it was unclear why these issues should be of direct concern to the Bank. The Governor replied that the potential impact on financial institutions, and hence markets, was at issue. Mr Brierley suggested that the impact of the compensation scheme would be limited: even if the Maxwell schemes had been covered by the compensation arrangements, and missing assets (after recoveries) amounted to, say, £200mn, the resulting levy would work out at 0.05% of each scheme's assets. Sir David Scholey commented that he regarded this as still rather high.

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Turning to implementation, and picking up Mr Brierly's reference to the absence so far of a definitive Government statement, Sir Martin Jacomb doubted whether it would be possible to introduce detailed legislation for some considerable time. A comprehensive pensions bill was very unlikely in 1994/95. He wondered, therefore, whether some of the key recommendations might be acted upon by the SIB and IMRO more quickly, which might in turn avoid the need for complex legislation. Mr Beverly said that very preliminary discussions had already been held with the SIB, which did not appear to be quarrelling with the gist of Goode's main recommendations. The key point was that the Report drew a clear distinction between (a) prudential supervision of solvency, which would fall to the proposed new regulator, and (b) regulation of the conduct of business of financial services providers, which would continue to be dealt with by the FSA regulators. The SIB was largely content with this distinction, even though several issues concerning the relationship between the proposed new regulator and the FSA bodies remained to be addressed. He thought that there might be some limited scope to assign more responsibilities to the SIB and IMRO, and then use this route to implement certain provisions, as Sir Martin Jacomb had suggested; but this could not apply to the monitoring of solvency and the performance of trustees, which would remain outside the Financial Services Act regime.

Professor Sir Roland Smith wanted to make two points. First, there was, clearly, currently a gap as far as training of trustees was concerned, which he thought needed to be dealt with. Secondly, he noted the muted response to Sir John Cuckney's appeal in connection with the missing assets of the Maxwell pension funds; the failure of voluntary arrangements had undoubtedly increased the pressure for compulsory compensation. Mr Beverly agreed with both points. The Report was undoubtedly weak on training of trustees and had been

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criticised for placing more responsibility on the trustees without addressing the question of their competence to carry out these enhanced functions. On the second point, Mr Beverly thought this was one factor underlying the Report's philosophical approach to compensation (based on a desire to spread the burden as widely as possible).

Finally, Sir David Lees asked if there were any figures available to shed light on the scale of pension fund losses. If losses, apart from Maxwell, had been relatively light, the Report, and especially its proposals for a new regulator, could be viewed as an over-reaction. Mr Beverly said figures were not readily available, but it was his understanding that, apart from Maxwell, the scale of losses was not substantial in relation to the aggregate assets of the industry. He reiterated that the proposed regulator would be a back-stop, relying heavily on professionals to do the jobs properly. It could have only a reactive role, given the scale and complexity of the industry and the fact that there were over 100,000 schemes in the private sector alone.

The Governor thanked Mr Beverly and said that Members' comments would be borne in mind when discussions took place with HM Treasury.

2 Mr Foot and Mr Smout, respectively the Head and a Deputy Head of Banking Supervision Division, attended Court for the ensuing discussion of supervisory issues.

In introducing the paper, Mr Quinn drew attention to a change in emphasis recently in the work of the Division, with a little more stress on the macro-economic factors influencing the environment for the banks, and a little less on operational questions. That said, there was still a certain amount of "mopping up" to be done in the small bank sector, while the larger banks were looking

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not only at their cost base and the aftermath of asset deflation, but at more strategic questions posed by a low-inflation environment.

Procedurally, while our techniques and style remained broadly the same, some changes had been made to enhance their effectiveness. For instance, we were now more probing and alert to the possibility that the basis of trust between supervisor and bank may have broken down. In this, the Division was greatly helped by its close relationship with the Special Investigations Unit.

Sir David Scholey asked whether the Bank was now taking more of an interest in the appropriate level of provisions on non-LDC exposures. Mr Foot said that we were indeed asking more questions in this area, not least during the trilaterals at which the accountants were present. In addition, the review teams visiting some of the smaller banks had sometimes made detailed recommendations in this area. Mr Quinn added that it was difficult to be very prescriptive on the absolute level of provisions, although it was rather easier to assess which banks were more or less prudent in relative terms. That said, in this recession banks appeared to have provided more rapidly and fully than previously, with management not using uncertainty as an excuse for inadequate or tardy provisioning. The stock market approved of such action; for the first time for many years, shares in most major UK banks were trading above their book value.

Sir David Scholey was concerned that greater emphasis on short-term performance might lead to less conservative provisioning, compared with a situation in which swings in profitability could be cushioned by movements in inner reserves. Those with more latitude in this area had, in his view, weathered the LDC crisis better than those who had not. The Governor drew attention to the more recent disparity between the experience of the US

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and Japan: US supervision had been overly intensive and had arguably resulted in a credit crunch, whilst the lack of transparency in Japanese accounting had led to suspicions of under-provisioning and had hindered the recovery of the Japanese banks.

Sir Jeremy Morse agreed that it was dangerous to be too prescriptive in this area, but welcomed the fact that the Bank was instead asking questions, a process which should be helpful to all parties. Referring to the Bank's involvement in the LDC debt matrix (raised earlier by Sir David Scholey), he noted the importance of the tax system in influencing provisioning decisions in different countries. Sir Chips Keswick said such factors could also influence lending decisions to small businesses.

In expressing his concern, not just as a Chairman of an insurance company, Sir Roland Smith noted the risks to the banks from a move into insurance, particularly if this were unduly rapid. Mr Foot agreed, adding that we were seeking to learn more on these questions not only from the banks themselves but also from the insurance regulators.

Sir Chips Keswick drew attention to the risks inherent in the trading areas of banks, such as derivatives, an area in which volumes and risks were increasing but spreads were declining. Historically this had been a profitable area, leading to individuals having unrealistic expectations of pay and bonuses. Mr Smout said that the Bank had already carried out some work in this area, both at the level of the individual firm and in relation to the possible systemic issues which arose. The Division was improving its specialist knowledge in this area in view of the anxieties which had been expressed. The Governor added that arrangements were in hand for a presentation on derivatives to be given to

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Members of Court early in the New Year. Those present agreed that this would be a good idea.

Court then turned to consider some of the individual cases which had been considered by the Board of Banking Supervision in recent months.

Sir Roland Smith asked about the implications for the market in the shares of Aitken Hume, given events in the group. Mr Quinn said that it would be difficult for us to pass on any information to other regulators unless we had decided that any of the controllers were not fit and proper, a point which had not yet been reached. The question of the market in the company's shares was, however, a matter which its management was encouraged to keep under review.

Sir David Lees was interested in the proposed review of the future of the small banks. Did we expect another crisis, or a much more gradual deterioration in the position? Mr Smout said that the latter seemed more likely, perhaps in the form of an underlying malaise impeding recovery. Sir Jeremy Morse pointed out that if this were so, it would lessen the dangers often posed by rapid growth. The Governor added that this sector had already shrunk significantly; the balance sheet of the 40 "watch list" banks had fallen by 25% in just over two years.

In considering the future of this sector, Mr Foot noted we had a responsibility to ensure that the benefits provided by enhanced supervision were not outweighed by the costs. Mr Quinn added that the UK had an unusually high number of banks with capital ratios over 15%; on the face of it this was comforting, but enhanced supervision of this type ran the risk of pushing such banks towards high-risk business.

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The Governor then turned to the final section of the paper, on the relationship between the Bank's work and that of the accountants. Mr Foot said that in the past there had been some misunderstandings in this area. In future he hoped that the Bank would receive more background information on the work carried out by the accountants, such as the extent of their samples, and at the same time develop the work of the review teams, which was at present well-regarded within the Division.

The Governor then invited views on the form in which the Bank reported on its supervisory functions to Court, given the existence of the Board of Banking Supervision. Did the present arrangements allow Court to exercise proper oversight of the way in which supervision was carried out? And did it provide directors with sufficient information on supervisory issues without over-burdening them unduly?

Sir Christopher Hogg felt there was a lack of clarity in the arrangements, given the responsibilities of the Board, which, in his view, left only a marginal role for Court. Sir Jeremy Morse noted the untidiness of the arrangements, but said he had found the paper and the discussion that day rather well-judged. Sir David Scholey agreed, adding that the BCCI episode had demonstrated that it was very difficult to argue that Court had no responsibility for supervision, a point with which Sir David Lees concurred.

The Governor suggested that it was natural and desirable that some Members of Court should take more of an interest in supervision, and others less. The Long Court presentations were an acknowledgement that, in the past, supervisory issues had been discussed too rarely at Court. Perhaps there was an analogy with different levels of board responsibility (eg at the operating as opposed to holding company level). Sir Jeremy Morse saw a similarity with the Council at Lloyd's, but

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Sir Christopher Hogg pointed out that a parent board would normally be ultimately responsible for all - or nearly all - of the group's activities, Sir David Scholey adding that it could also fire those on a subsidiary board.

Sir Martin Jacomb felt that Court was now much better informed than in the past, but that he would welcome more feedback on the issues which were currently causing the Board anxiety. Picking up this point, Mrs Heaton wondered whether the Board, as well as Banking Supervision Division, should report to Court, perhaps, as Mr Quinn suggested, in the same way as Audit Committee reported on the work of the rest of the Bank.

The Governor said that we would consider these helpful comments and also whether to let the Board see the Minutes of Court's discussion on supervisory issues.

3 Mr King's Personal Assistant, attended Court for the discussion of the Domestic Economy.

Mr King introduced a broad discussion of the November Inflation Report and the economic situation more generally. He emphasised two messages from the Report. First, the Bank had no reason to change its view that in the medium term - the next two years - inflation was heading towards the centre of the government's target range. This was the appropriate time horizon for the purposes of monetary policy. But, secondly, the most commonly reported measures of inflation were likely to rise over the next six months, by a little more than we had expected at the time of the August Report. Specific factors such as the previously announced VAT changes, the limitation of mortgage tax relief, last year's mortgage interest payment cuts and the switch to the Council Tax were responsible.

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Growth was not yet rapid enough to start closing the output gap, and unemployment remained very high, so there was still downward pressure on inflation in the short term. The danger was that the increase in measured inflation rates in the next six months might lead people to expect higher inflation to continue, and to settle for higher nominal wages than otherwise. This would mean fewer jobs in the medium term.

Mr King noted that it was difficult to interpret current statistics, especially those for manufacturing output, which appeared, surprisingly, to be growing more slowly than the rest of the economy. This was partly because of a problem with the trade statistics, now derived from the new INTRASTAT system; the resulting estimates of European trade indicated an incredible drop. Data revisions may reveal that growth in this quarter was more robust than it now appeared. The Central Statistical Office had been encouraged to look at these problems carefully.

Mrs Heaton argued that it was important to keep on getting the two main messages across, for instance after the Budget, so that people understood the reasons for the temporary increase in measured inflation.

Sir Jeremy Morse was happy that the watchdog had something to talk about. He was pleased that the Inflation Report's conclusion had been amended to make it clear that the Bank's optimism about prices was conditional on a range of assumptions about behaviour.

Sir Martin Jacomb drew attention to the increased importance of imports, the prices of which had been held down by lack of consumer demand. Recovery could quickly put strong upward pressure on them. He emphasised the need for tighter fiscal policy to restrain domestic demand relative to output.

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Sir Colin Corness commented that the Report had been correct to say that the housing market had appeared to be reviving; but this was no longer the case. People may have been holding back until they have seen the next Budget. The September increase in mortgage lending seemed to have been a rogue figure. The construction industry depended heavily on prospects in the housing market, as other sources of demand, such as the road-building programme, were likely to be cut. Mr King acknowledged the uncertainty about the statistics, but stressed the need to have a framework with which to interpret new numbers as they emerged. The public still carried a heavy burden of debt, so consumption was unlikely to increase rapidly. Sir Jeremy Morse thought consumer spending might bounce back up after the Budget. Sir Colin Corness was worried about the restriction of mortgage interest relief; although the merits of restriction were agreed by all, its imposition could be untimely.

Sir Christopher Hogg asked whether HM Treasury had disagreed with any of the Report. The Governor explained that there was now an agreement that the Treasury would not see the Reports before publication, so long as any policy issues raised in the Report had been raised with the Chancellor in advance.

Sir David Scholey was interested in the Report's readership. He wanted as many people as possible, particularly in the business community, to read it. He had some concern that it had too many 'bells and whistles' and was longer than it needed to be. He asked if there were estimates of the number of its readers (as distinct from the number of copies distributed).
Mr King drew attention to Bank Briefing, which had been redesigned in colour and now covered only the Inflation Report. This was very widely distributed.

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Sir Roland Smith believed that energy prices were the most important influence on costs this year and next. Energy price increases were difficult to avoid, partly because competition in the industry was limited. Margins were under pressure from a variety of sources, including the increased range of consumer imports from the Pacific rim and the big shifts in the defence industry. Nevertheless, managers would put up margins if they could and were encouraged to do so by the personal incentives they faced.

Sir David Lees asked whether research indicated that prospective inflation influenced wage bargaining. He felt that instead it was inflation in the recent past. Mr King replied that wage bargaining in principle concerned the real wage that people wanted to achieve. Thus nominal wages ought to be set to correct for any unexpected inflation since the last pay deal and to obtain the target real wage for the duration of the contract, given the inflation expected over that period. The statistical evidence, however, was inconclusive. Sir David thought that it was very important to sell the message that bargainers should look to the decline in inflation in the medium term.

Mr Harris wondered if moving the Budget from April to November would alter the economic cycle. Mr King explained that having two Budgets within twelve months would lead to a temporarily higher measured inflation rate even if they both simply indexed taxes and duties. This was another illustration of how a price index designed for a different purpose - measuring the typical cost of living - was unsuitable as a guide when setting monetary policy.

Under the weekly executive report:-

1 The Deputy Governor said that Court would be pleased to learn that EBS Investments Ltd, a wholly-owned

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subsidiary of the Bank, acquired as part of the Bank's lifeboat support operations in the mid-1970s, which had been used to acquire assets and liabilities from the former Edward Bates Group, would be finally dissolved later this month. The overall cost to the Bank of support for the Edward Bates Group had totalled £25.4mn.

Slater Walker Ltd, a second lifeboat company, had been placed in voluntary liquidation in November 1989. The company had been purchased by the Bank from Slater Walker Securities, to be wound down. To date, the costs to the Bank had been of the order of some £54.8mn, offset by a dividend of £30mn paid to the Bank in 1989. An orderly insolvency had been delayed pending further litigation but that action had now been withdrawn. Winding up had again been temporarily delayed until possible overpayments of interest, arising from Brazilian bondholdings, have been reconciled. Once this has been achieved the liquidators would conclude the winding up process. This was the last obstacle before the final dissolution process begins.

2 The Governor said that Mr Crockett's appointment as Managing Director of the BIS had been approved in Basle the previous weekend. Mr Crockett's departure, to succeed Mr Lamfalussy who was to become the first President of the EMI, would take place rather earlier than had been anticipated. On behalf of Court, the Governor offered congratulations to Mr Crockett on his appointment.

3 The Governor said that the first events to mark the Bank's tercentenary would be taking place during the coming week. A special exhibition in the Museum marking the centenary of the employment of women in the Bank would open the following day. On Saturday, the Bank had entered a float in the Lord Mayor's Show; some 50 members of the staff were involved in the Bank's contribution. The Governor also drew Members'

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attention to the updated timetable of Tercentenary events, copies of which were in folders. He hoped that he could prevail on Non-Executive Directors to help in receiving guests at the receptions for staff and pensioners at Head Office, which would be held in June and July 1994, and in representing the Bank at some of the out of London events being arranged by the Agents, the Registrar's Department and the Printing Works.

Rupert Pennant-Rea

November 1993

Secretary

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A MEETING OF DIRECTORS AT THE BANK

THURSDAY 18 NOVEMBER 1993

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Anthony Laurie Coleby, Esq
Andrew Duncan Crockett, Esq
Mervyn Allister King, Esq
Brian Quinn, Esq

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The number of Directors assembled being insufficient to form a quorum, those present proceeded to the business, subject to ratification by the next Court.

The Minutes of the last Court, having been circulated, were approved.

There being no comments on the weekly figures, Mr Coleby spoke about the foreign exchanges and the state of the domestic markets.

[signature] Assistant Secretary November 1993 Rupert Pennant-Rea

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12A110/5

A COURT OF DIRECTORS AT THE BANK

THURSDAY 25 NOVEMBER 1993

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Anthony Laurie Coleby, Esq
Andrew Duncan Crockett, Esq
Mrs Frances Anne Heaton
Sir Christopher Anthony Hogg
Sir John Chippendale Lindley Keswick
Gavin Harry Laird, Esq, CBE
Sir David Bryan Lees
Brian Quinn, Esq
Sir Colin Grieve Southgate

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The Minutes of the Court of 11 November were confirmed and those of the Meeting of 18 November, having been circulated, were approved.

There being no comments on the weekly figures, Mr Coleby spoke about the foreign exchanges and the state of the domestic markets.

At the Governor's invitation, and with the agreement of Members of Court, Mr Watt, the Head of the Special Investigations Unit, Mr Peddie, the Head of the Legal Unit, and Mr Choyce, a Manager

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in the Legal Unit, attended Court to present Reports on their Units, together with a brief update on BCCI litigation.

Mr Quinn, in his capacity as the Director responsible for Banking Supervision Division, said there were two points he wished to make before the Reports were given. First, to remind Court that the Units were separate from Banking Supervision Division, although they did come together under his responsibility when budgetary or management matters needed to be considered. Secondly, both Units were new in the life of the Bank. They were functioning very effectively in support of the supervisory aspects of the Bank. Mr Quinn added that, although there was scope for friction between the supervisory areas of the Bank and the Units, there was none. They were all working well together. Having said that, it was, nevertheless, an aspect that needed watching closely as there were risks in both directions, with the supervisors relying too much on the services of the Units and vice-versa. The existing satisfactory state of affairs arose, largely, as a result of the sensitive management being exercised by Messrs Peddie and Watt.

In introducing the Report on the SIU, Mr Watt said he had attempted to give a flavour of the way the Unit worked. The whole emphasis was to assist the regulators and supervisors, at the same time keeping a low profile. It was rare for the Unit to make its presence known to institutions that were being investigated. The Unit had received a good flow of referrals, and alerting staff to its role had proved particularly beneficial in this respect. Mr Watt said they had a good relationship with the supervisors. The SIU formed part of the review team when site visits took place to institutions. Although the Unit was small in numbers, it had a wide catchment area. In view of this, it had organised itself so that it could respond quickly to a situation but it had, as well, the ability to expand or contract as necessary. In the referrals it had received, there had been no case of major systemic fraud. In the main, they had been small cases where advice was being sought. There had been a number of Branch frauds, where

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staff had worked alongside management. The Unit had received, also, a number of anonymous tip-offs of money laundering. A positive response had normally been produced in the cases it had pursued, in that the tip-offs had usually proved to have substance. The new regulations covering money laundering would prove useful - giving one, as they did, an entré to consider other factors, of which money laundering could be a symptom.

In opening the discussion that followed, Sir Christopher Hogg enquired if it was encumbent on an organisation to report fraud. Mr Watt replied that it was and a reminder to that effect was in the process of being sent out. Mr Laird asked if it would be possible in, say, a year's time to see an analytical paper covering the cases the Unit had pursued. It was agreed this would be produced. Sir Chips Keswick was concerned there was scope for confusion between the various regulators as to who was responsible in cases of money laundering. He cited a recent incident at Hambros involving IMRO. He asked if the Bank would have had the final say. Mr Watt responded by saying that there was someone in the Bank who should have been aware of what was happening. There had been a joint guidance note issued recently regarding money laundering enquiries, and we were keeping a close watch on the implications.

Before asking Mr Peddie to present his Report on the Legal Unit, the Governor said that the problems over resources mentioned in the Report would be discussed amongst the Executive, which would report back to Court.

In introducing his Report on the Legal Unit, Mr Peddie said that, essentially, he was presenting a situation report giving a flavour of the work the Unit was undertaking in its advisory role.

In asking Members if they had any comments or questions, the Governor said the Unit was taking on a more pro-active role. Sir David Lees said he was struck by the number of people reporting to Mr Peddie. He hoped as the Unit developed, there

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would be scope, through a subsidiary structure, for reducing the number of those so reporting. Mr Peddie said the reporting lines reflected both the nature of the job and the range of activity of the Unit. Nevertheless, it would be right to consider this point.

The Governor went on to say that in considering the work of the Legal Unit, the opportunity had been taken to update Members of Court on the current position on litigation involving BCCI.

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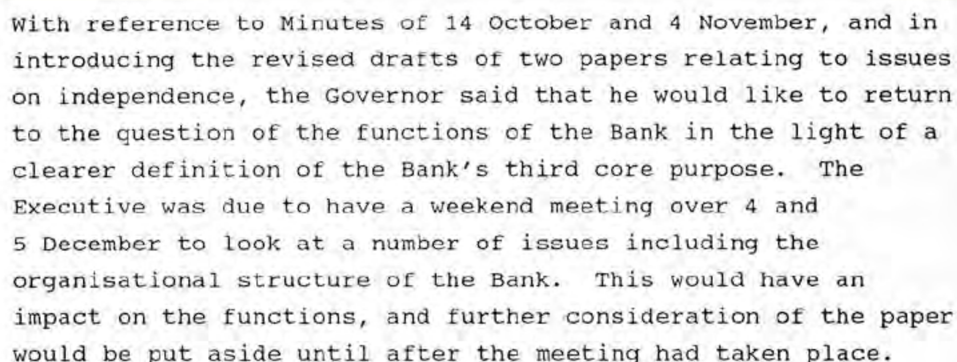
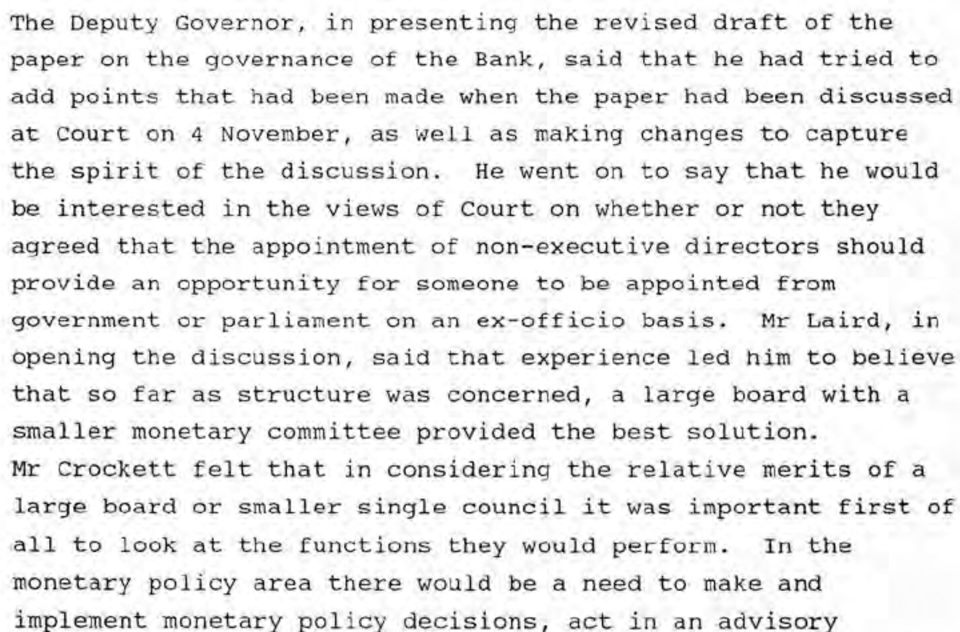


With reference to Minutes of 14 October and 4 November, and in introducing the revised drafts of two papers relating to issues on independence, the Governor said that he would like to return to the question of the functions of the Bank in the light of a clearer definition of the Bank's third core purpose. The Executive was due to have a weekend meeting over 4 and 5 December to look at a number of issues including the organisational structure of the Bank. This would have an impact on the functions, and further consideration of the paper would be put aside until after the meeting had taken place.



The Deputy Governor, in presenting the revised draft of the paper on the governance of the Bank, said that he had tried to add points that had been made when the paper had been discussed at Court on 4 November, as well as making changes to capture the spirit of the discussion. He went on to say that he would be interested in the views of Court on whether or not they agreed that the appointment of non-executive directors should provide an opportunity for someone to be appointed from government or parliament on an ex-officio basis. Mr Laird, in opening the discussion, said that experience led him to believe that so far as structure was concerned, a large board with a smaller monetary committee provided the best solution. Mr Crockett felt that in considering the relative merits of a large board or smaller single council it was important first of all to look at the functions they would perform. In the monetary policy area there would be a need to make and implement monetary policy decisions, act in an advisory

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capacity and, lastly, have a supervisory role, as part of the process of accountability, for actions taken by the executive group. He did not see the logic of a small executive structure. He saw the larger group as one that did not take decisions and did not have representatives of the executive amongst its number. What he suggested would be similar to the way Scandinavian central banks operated. Subsequently, Mr Coleby asked if Mr Crockett would set out in a paper more fully his points on a supervisory body and also the parallels with other countries. This, Mr Crockett agreed to do.

Mrs Heaton voiced concerns about the two tier structure, feeling that such an arrangement would be impractical. The monetary policy function was increasing in importance and a larger board would be in danger of being involved with too much business. She went on to say that she did not consider it would be a good idea to have a monetary policy committee made up solely of Bank executives. She felt it was important that outsiders were included in the monetary policy forum. She wondered if the larger forum should be more of an advisory committee made up by outsiders with no commercial interests including, perhaps, HM Treasury representatives. The Deputy Governor responded by saying that the notion of non-full time employees on a monetary committee was a difficult one, especially if they were required to have no outside commercial involvement. Such people did not exist. Mrs Heaton saw people being involved through an executive role but not on a full-time basis, although the Deputy Governor found it hard to see an executive role not being a full time one. Mrs Heaton expressed concern at the thought of full time career executives without outsiders being able to exert an influence. The Governor accepted the point and said such a situation was not excluded. Sir Adrian Cadbury commented that much turned on the balance of power between the two bodies and their having the right relationship. It could require some difficult decisions to carry out the mandate and it would be necessary to have people on the larger board who were knowledgeable and objective. In the final analysis, it would come back to choosing the right people.

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Sir Chips Keswick moved onto the aspect of the involvement of non-executive directors and the frequency of meetings. He felt there was benefit in not having too few meetings. The Governor said that we had tried to move away from having too short term a focus. Sir Christopher Hogg favoured a move away from the present frequency of meetings. Mr Laird, for his part, felt that if meetings were infrequent there was a danger of having to hold too many emergency meetings. The Governor did not see there would be any need for emergency meetings of a monetary policy committee. Sir Colin Southgate said that if meetings became more infrequent the success or otherwise of these meetings would depend very much on how much effort non-executive directors were willing to put in. A point with which Sir David Lees agreed, adding that they could not be effective if meetings were less than monthly. He went on to say that if the functions of the Bank remained as wide as they were at the moment, there was need for a board that took ultimate responsibility. Such a board should make appointments, and not an advisory group. He was in favour of a large board with a smaller monetary committee, and felt comfortable with the proposals for monetary policy with the board taking an overview. The Governor questioned whether or not such a board would have a supervisory/advisory role. Would it be much different from Court's present role with regard to monetary policy? The suggested relationship between Court and the executive would not be different fundamentally from the present. Sir Adrian Cadbury felt, depending on the interpretation of the mandate they were given, that the board would have a more precise focus. The board would have a different kind of discussion and answer different questions. The Governor saw a more intense discussion where the mandate was being agreed, with Court having a bigger role in that discussion.

Returning to Sir David Lees's comments, Mrs Heaton said she agreed that if the Bank retained its present scope of functions then the structure of Court should not change. However, if they were reduced then the existing organisation of Court would not be appropriate.

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The Governor concluded the discussion by saying that there were three layers to consider: government, supervisory board and parliament.

Under the weekly executive report:-

1 The Governor drew Court's attention to the finance for small firms seminar that was to be held in the Bank on the following Monday. Representatives from all the bodies we had been talking to would be joining us to review a paper that had been sent to the Chancellor of the Exchequer.

2 Mr Quinn spoke about the alterations that had been made to the new Series E £10 note that was in circulation. In order to improve identification, the crown on the top right hand corner of the front of the note had been replaced by an additional black denominational symbol. A further such symbol had been placed on the same corner on the back of the note.

Rupert Pennant-Rea

G. A. Croughton.
Secretary.
2 December 1993

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A COURT OF DIRECTORS AT THE BANK

THURSDAY 2 DECEMBER 1993

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Anthony Laurie Coleby, Esq
Sir Colin Ross Corness
Mrs Frances Anne Heaton
Sir John Chippendale Lindley Keswick
Mervyn Allister King, Esq
Gavin Harry Laird, Esq, CBE
Sir David Bryan Lees
Sir Christopher Jeremy Morse, KCMG
Sir David Gerald Scholey, CBE
Professor Sir Roland Smith

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The Minutes of the last Court, having been circulated, were approved.

At the Governor's invitation, Mr Townend, the Head of Gilt-Edged and Money Markets Division, spoke to Court about the work of his Division. Gilt-Edged and Money Markets was a small Division of just 22 people plus support staff; and was part of the core of the Bank. In addition to contributing to the formulation of the Bank's advice on monetary policy, the Division executed all of the Bank's daily operations in both the money and gilt-edged markets. It therefore had a close interest in the nature and structure of those markets.

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The past year had been extraordinarily busy as a result of a combination of influences coming together. The scale of the daily operations had increased considerably: in the money markets because of an acute liquidity shortage in the banking system which had to be made good day by day; and in the gilt market because of the need to fund the swollen PSBR.

In addition, the Division had been engaged on major exercises in both markets: in the money market, analysing the structural problems created by the liquidity shortage and advancing solutions to them; in the gilt market, considering the pros and cons of moving to a generalised repo market. The first of these exercises was reactive, responding to identifiable pressures. The second was pro-active, designed to keep the Bank ahead of the game.

Part of the pressures on the Division stemmed from initiatives it had itself mounted. It had deliberately stepped up its communications effort: it had tried to establish a more open image for the area, using all the direct means of communication - speeches, meetings, lunches/dinners and the like - but also through the preparation of two free booklets on gilts, one for professionals and one for the man-in-the-street, which had been distributed widely. He said he was also determined to improve the management information available to the Bank on gilt operations, so that we could better measure our performance: a major exercise was underway to this end.

Finally, Mr Townend said that the Division was devoting an increasing effort to training and technical assistance.

So far as the staff were concerned, he said that he was fortunate in having working for him a number of the most able Bank staff, all of whom are highly motivated and committed, so that there were few problems of morale. To that extent his management task was eased. But the Division had suffered from a relatively rapid turnover amongst the more junior staff and a deterioration in the quality of some of them. This put additional pressure on the senior managers.

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In commenting on Mr Townend's presentation, Sir Jeremy Morse said that he was encouraged to hear that morale was high, but enquired how the staff had reacted to the events of 16 September 1992. In response, Mr Townend said it had been a very hectic experience, but the staff had found it interesting and fascinating living through it at first hand. Mr Plenderleith commented that during that time the pressures had really been on the foreign exchange dealers rather than on Mr Townend's staff. He had been particularly impressed with the professionalism displayed by those foreign exchange dealers at that time.

Sir David Scholey asked if any of the staff had gained experience in other banks, both commercial and central. He also commented that the strains in the money market had been building up for some while, and enquired whether there would be radical and significant changes to ease the situation in the coming two or three years, or whether changes would take place gradually.

In commenting on the strains in the market, Mr Townend said that these had caused the Bank to think seriously about their nature and to consider possible changes to ease them. But the strains were not constant, and some of the immediate pressure arising from problems in one discount house had gone away. Moreover, the Chancellor's announcement in Tuesday's Budget, to fund by £7 bn less than implied by the full fund rule over the period to end 1994/95, would ease the situation in that the liquidity shortage would be commensurately reduced. Pressure would also be eased by systematizing the current temporary facility so that more of the shortage was handled through off-market transactions. These measures would assist, without causing a major upheaval. However, European issues will need to be considered as we moved towards stage 3 of EMU. Other European countries had different systems, and it was not clear, at this stage, how much convergence would be necessary.

In the gilts market, any move to introduce repos could have significant implications for market structure. Overall, it

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was his view that we should not resist change; the markets should be left to evolve. Sir David Scholey agreed, but questioned whether the Bank had been sufficiently adaptable in allowing this to happen. Mr Townend suggested that the changes in the gilt market introduced in 1986 had proved very effective: the fact that the Bank had managed without difficulty to fund a £50 bn PSBR in the current year spoke for itself. In contemplating further change, it seemed to him right not to rush into it, but to consider very carefully indeed all the angles.

Mr Plenderleith commented that if the Bank could achieve what it required within the existing structure, it was not really for us to challenge or dictate how it should work or who should participate. However, if the structure itself was under strain then it might be appropriate for the Bank to intervene.

Mr Coleby agreed that the origin of the problems was the severe strain on the liquidity of the system as a whole. That would have been a source of disturbance, whatever the structure of the market or of our arrangements for operating in it. The point was not sufficiently understood by critics of the present structure. He particularly welcomed the Budget announcement on funding, which would enable system liquidity to come into much better balance. Looking ahead, there were developments that would require continuing review of our structure - for example, any moves towards EMU - but they did not as yet give any clear indication of the nature of changes that would become desirable.

Responding to Sir David Scholey's question on secondments, Mr Townend said that although the Bank had a general policy of giving staff experience elsewhere through secondments etc, which he fully supported, it was difficult to do so for staff in the dealing area. He was concerned that the rewards available to dealers outside the Bank would be too great a temptation and staff might not return to the Bank.

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The Governor, in introducing a letter from Mr Crockett dated 23 November, giving notice of his resignation from Court in the Office of Director on 31 December 1993, which was laid before Court, said that he was sure he was speaking on behalf of Members of Court in expressing appreciation of Mr Crockett's contribution to the Bank both during his recent period of office on Court and in his previous period of service.
It was RESOLVED that the Secretary be directed to communicate to the Chancellor of the Exchequer the notice of resignation of Mr Crockett from the Office of Director of the Bank pursuant to Clause 8 (e) of the Charter of 1 March 1946.

There being no comments on the weekly figures, Mr Plenderleith spoke about the foreign exchanges, including the Official Reserves figures for November, and the state of the domestic markets.

At the Governor's invitation and with the agreement of Members of Court, [redacted] Mr King's Personal Assistant, attended Court for the ensuing discussion on the Budget.

Mr King introduced a discussion of the Budget, noting that it was indeed a challenging test of the new unified Budget and public expenditure arrangements to have to confront a public sector borrowing requirement of £50 billion. The Budget had not been about tax reform or how to structure public expenditure. The Budget speech, which was perhaps the fastest ever in terms of words and announcements per minute, concentrated on reducing this deficit. Mr King drew attention to the decline in the PSBR, projected in table 1.1 of the Financial Statement and Budget Report (Red Book) to fall to £2 billion in 1998-99. Had the unified Budget arrangements helped? It was possible that Ministers had appreciated better the tax consequences of their decisions in the spending round as a result.

The share of taxation in GDP would increase. Combining the effects of both the 1993 Budgets, taxes in 1994-95 would go up by £8 1/2 billion (compared with an indexed base), by

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£15 billion in 1995-96, and £18 billion in 1996-97; these figures were equivalent to 4p on the basic rate of income tax in 1994-95, 7p the next year, and 8p or 9p in the final year. The impact would be felt in pay packets next year, when personal disposable income would be around 1 1/2% lower as a result; in the year after, it would be 3 1/2% lower. On the spending side, there had been an unexpected reduction in the New Control Total (which excluded unemployment benefits and income support paid to people of working age). HM Treasury had managed to persuade spending departments to stick to the cash limits for 1994-95 announced twelve months ago. Usually, some of the unallocated reserves would have been used to deal with contingencies in 1994-95 which had been identified in the last year; this time, the usual reduction in the reserves was not offset in this way. The overall effect of this Budget on the PSBR was to reduce it (compared with March's projections) by £5 1/2 billion in 1994/95, £7 billion in 1995/96, and £10 1/2 billion in 1996/97.

Mr King then turned to the impact of the Budget on market expectations of future interest rates and inflation. Referring to charts presented at Court, he noted that both had declined significantly since the day before the Budget. In the Bank's Inflation Reports, the importance of reducing future fiscal deficits to strengthen the credibility of our anti-inflationary policy had been emphasised. Now that measures have been taken, we have seen that credibility enhanced.

Mr King then mentioned some of the detailed Budget measures. The married couple's allowance and mortgage interest relief would be restricted to a rate of 15% from 1995/96. Excise duties on petrol and tobacco would be increased substantially now and in future years. New taxes on insurance and air travel had been introduced. There were some measures to assist small businesses, but these were not very extravagant. Mr King thought that the new arrangements for assessing the incomes of the self-employed would clarify the tax system for all concerned. On the benefits side, it was not clear that the Job-Seekers' Allowance was really new. The Child Care

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Allowance, however, was new, and probably took the form it did because of the unified Budget arrangement.

Sir Chips Keswick was concerned that his customers were just waiting to put up their prices at the first opportunity. They were constrained by competition, particularly retail competition at the moment, but pressure to increase prices would grow as people began to realise that economic growth was now under way at 2 1/2% per year. He felt that the Bank needed an early warning mechanism, or else price rises would run away. Sir David Lees agreed with this view. There had been severe pressure for price increases building up for a long time now. The economic situation on the Continent was holding them back at the moment, but firms will increase prices when they can. He feared that, as the Budget measures were assimilated, pressures would build up for wage increases in future pay rounds. The last Budget and some corporate measures (for instance, the increase in contributions to pension funds) would exacerbate the problem, particularly if we see a real economic recovery. Mr Laird shared Sir David's opinions. There was no immediate pressure on wages because we were still in a recession; but if the economy was really picking up, there might be a problem soon.

Sir Colin Corness drew attention to the significance of the low profits of UK operations of multinational enterprises. He was disappointed that the serious problems of British multinationals and ACT had not been recognised. As far as his own industry was concerned, the price of bricks had halved in the last three years, and business was unprofitable. He could not see increased volumes being possible, and the industry would instead try to increase prices.

Sir Roland Smith also thought that managers would try to restore margins as soon as there was any strength in UK markets. Costs had been taken out of businesses over the last few years. The only thing left to do was to restore margins. Profit related pay gave managers an incentive to do this, too. The tax implications of the Budget would not be received

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favourably in families. The implied constraint on consumption in 1994 would worry retailers. One needed to distinguish opportunities for profits in the UK and overseas; profits would not be found in the UK.

Sir Jeremy Morse asked about the Chancellor's references to the Bank in his Budget speech. Had they simply repeated what had been said last week about decisions on the timing of interest rate announcements? The Governor confirmed that the references had gone no further, and clarified the new procedure. The Chancellor takes the decision on interest rate movements at the monthly meeting with the Governor, and asks the Bank to implement it before the next regular meeting. This would remove interest rate announcements from the Chancellor's speeches and dispel the suspicion that they had been taken for reasons of political expediency. In the Governor's experience, they had never been taken on this basis anyway. The new procedure was useful to the Bank, but was not significantly related to the independence issue. Mr Laird nevertheless thought it would help. The Governor felt the change had been blown out of proportion by the press.

Sir David Lees was puzzled that HM Treasury's forecast of cyclical spending did not appear to be very cyclical. Mr Bowen pointed out that the Treasury projections for output growth did not envisage a rapid closing of the output gap, so little cyclical variation was to be expected.

Mr King wondered why several comments had suggested that, to raise profits, prices could be increased in the future, but not volumes. Was there no spare capacity to allow volume increases? If this were the case, it was very worrying.

The Governor said he was somewhat surprised that the discussion suggested both that the Budget had been tough and that there would be room to put up prices and margins. Mr Laird thought the response reflected relief that some measures had not been taken. Sir Roland Smith argued that companies hoped that the economy's strength would allow the recovery of margins, and

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believed that firms would take out capacity if necessary to allow this to happen. The Budget was likely to affect wage negotiations because it would reduce real incomes. The Governor agreed that the question of margins was important. His talk to the 100 Group on this subject had aroused as much interest as any speech he had made before. First, the Bank and Members of Court should understand the issues. Second, the topic needed to be further investigated. Firms are different from workers, in the sense that the former could increase their income by increasing the volume of their output, whereas the latter could not. There were deficiencies in the data which needed to be sorted out. The Governor proposed that Court return to the subject early in the New Year.

Under the weekly executive report:-

(i) the Governor drew attention to his exchange of letters with Mr John Watts, MP, the Chairman of the Treasury and Civil Service Select Committee concerning, comments which had been made on the composition of the Court of Directors of the Bank during evidence given to the Select Committee. He said that he had agreed with Mr Watts that no purpose would be served by publishing their exchange of letters. Members were content.

(ii) the Governor mentioned that arrangements had been made for a seminar on Derivatives to be held in the Bank on the afternoon of Thursday, 27 January 1994, and he hoped that those who were interested would be able to attend.

(iii) in reminding Court that the members of the Executive Committee were meeting at Ashridge over the coming weekend, the Governor said that he hoped to be able to report on the outcome of their discussions at Court on 16 December.

Adrian Cadbury
9/12/93

G. A. Croughton
Secretary.

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A COURT OF DIRECTORS AT THE BANK

THURSDAY 9 DECEMBER 1993

Present

Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Andrew Duncan Crockett, Esq
Mrs Frances Anne Heaton
Sir John Chippendale Lindley Keswick
Mervyn Allister King, Esq
Sir David Bryan Lees
Sir Christopher Jeremy Morse, KCMG
Brian Quinn, Esq
Sir David Gerald Scholey, CBE
Professor Sir Roland Smith
Sir Colin Grieve Southgate

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The Minutes of the last Court, having been circulated, were approved.

Details of the weekly figures and graphs relating to the state of the foreign exchanges and the domestic markets were laid before Court.

Court gave their approval for Sir David Scholey to allow his name to go forward for appointment as a Governor of the British Broadcasting Corporation, which would entail him becoming a Non-Executive Director of the Corporation.

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At the Deputy Governor's invitation, and with the agreement of Members of Court, Mr Rumins, the Head of Finance and Resource Planning Division, attended Court to present the statement outlining the Banking Department's profit outturn for the six months ended 31 August 1993 and comparing the latest forecast of the Department's profit for the year ended 28 February 1994 with the original forecast, and with the outturn for the previous year.

Mr Rumins pointed out that there had been a sharp reduction in variable income, down from £121.7 mn to £78.9 mn, resulting mainly from lower interest rates of 5.2% this year compared with 8.3% in the previous year, on balances of a similar order of magnitude. Fixed income showed a modest reduction from £174.7 mn to £169.9 mn, and total income had fallen from £306.7 mn to £248.7 mn.

Current expenditure was fairly close to forecast, at £186.8 mn against the outturn for the previous year of £181.5 mn. The reduction of expenditure in the Personnel area reflected a shortage of staff. The increase shown under Other Expenditure was attributable to higher professional fees in connection with BCCI and Section 41 investigations, and increased expenditure on advertisements for British Government Securities.

Profit before provisions was currently forecast at £112.9 mn, compared with an actual of £174.4 mn for the year ended 28 February 1993. Mr Rumins explained that the change in the Pension Cost Adjustment arose from the Actuary's draft Report. In the previous year this item had been a credit to the Profit and Loss Account because of the large surplus previously reported in the Pension Fund. The latest Report identified a much reduced surplus and thus an increased charge to the Profit and Loss Account. No adjustment of the provision in respect of support operations had been made and, on current information, it did not seem that a large change would be necessary.

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Accordingly, the operating profit was estimated at £109 mn, compared with £88.3 mn the previous year. The formula to determine the dividend was due to be renegotiated with HM Treasury this year, but Mr Rumins said that, assuming a continuation of the existing 50:50 apportionment of post-tax profit, dividend and retained profit would each amount to £44 mn compared with £38 mn the previous year.

In response to Sir Colin Southgate's comment about the SSAP adjustment, Mr Rumins confirmed that the Personnel costs included a 10% contribution paid to the Pension Fund. The SSAP adjustment of £3.9 mn was effectively a transfer from the pre-payment account - currently standing at some £30 mn. Now that the calculated pension cost given by the Actuary was in excess of the pension contribution paid, the repayment account would run off over a period of years.

Sir Chips Keswick said that it would be helpful to have a copy of the balance sheet in order to make critical comment on the accounts. He suggested that there would be close press and public interest in the Bank's accounts when published, particularly in the total income of £248 mn and the reduced profit before provision. He said that presentation of the accounts should be considered very carefully. He also suggested that the Bank should use the derivatives market to smooth out changes in income flow caused by fluctuations in interest rates.

The Deputy Governor explained that he and the Governor had met the Auditors, Messrs Coopers & Lybrand, to discuss the presentation of provisions for support operations in the accounts. The Auditors were currently considering an appropriate method of presentation which would be submitted to Sir David Scholey and his colleagues on the Audit Committee, and then to Court. Sir David said that the Audit Committee had considered the question of presentation of the Bank's accounts, and a further discussion would be held prior to the year end. Much would depend on the outcome of the re-negotiation of the dividend formula and what we did to

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preserve our capital. The Deputy Governor said that much depended on what one thought our capital and reserves should be, and whether we should be building them up. Sir Adrian Cadbury said that our capital and reserves should be sufficient to mount support operations when needed. He also supported the renegotiation of the dividend formula on a term of years basis rather than an annual negotiation, as previously.

In commenting on the discussion on the realisation or otherwise of the excess of market value over book value of the BGS portfolio, Mr Rumins pointed out that tax and dividend would be paid on any realised profit. Thus, realising profit and switching the portfolio reduced the ongoing stream of future income. In commenting on Sir Chips Keswick's remarks, Mr King said that in his opinion there would be interest shown in the Bank's accounts this year because of the independence issue. He also endorsed Sir Chips's point about investing in the derivatives market to smooth out fluctuations in interest rates.

With the agreement of Members of Court and at the Deputy Governor's invitation, the following Bank Officials attended Court for the discussion of the three papers on International Issues:-
Mr Collins, the Head of Industrial World Division, and Mr Wright, a Senior Adviser in that Division responsible for macro-economics, for the discussion of the World Economic Forecast; Mr Collins and Mr Webster, the Senior Adviser on Japanese matters, for the discussion of the paper entitled "Longer term trends in Japan's financial system"; and Mr Clark, the Head of the European Division, and Mr Arrowsmith, a Senior Adviser responsible for European Monetary Union matters, for the discussion of the paper on the preparation for Stage 2 of EMU.

In introducing the World Economic Forecast, Mr Wright said that it was a twice yearly exercise which was valuable in that it gave a considered view of the major economies and where they

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were going. This coherent overview was as important as the detailed figures. The overall picture was one of very moderate growth and very moderate inflation. But looking at individual regions, the picture was more differentiated, with areas being at different stages of the cycle. So far as the USA was concerned, the recovery was still firmly based, the downturn having been shallow and short. Corporate debt and employment were still seen as a damper on the pace of recovery, which was unspectacular. One of the main issues in the US was the prospect for a pick-up in inflation. The US was the only major industrial country in which output was very close to, or at, potential. The prospect was for moderate growth of some 2 1/2% - only a little above estimates of potential growth. The Bank shared the view of financial markets that some pick up in inflation was likely and that this would precipitate some tightening of policy. But the timing was uncertain.

Turning to Japan, Mr Wright said that the economy was still very much in the doldrums, with some contraction in GNP this year and modest expansion forecast for next. He identified a number of weaknesses in the corporate sector: the debt overhang was still significant and the yen had appreciated some 20% since January, with implications for competitiveness. Producer prices continued to fall and, from the perspective of companies, monetary policy was still tight. A further fiscal easing was still expected, but recovery was likely to be slow.

Moving on to Europe, Mr Wright suggested that it looked as though Germany had reached the trough of the recession in Q2. But there were signs of only very moderate recovery, even with the further expected monetary easing involving a cut of 150 basis points in interest rates, made possible by a fall in inflation. Employment prospects were poor, with falls in real incomes. The issue for continental Europe was whether the pace of monetary easing was sufficient to allow other former narrow band countries to continue to link their interest rate policies to those in Germany, and whether a faster pace of monetary relaxation than was currently envisaged would be possible.

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Mr Wright then focused on two other issues, world trade and unemployment. The growth in world trade had been sustained by the developing countries and the US. It was forecast to grow by some 5 1/2%. But UK export markets would grow by only a little over 2%, reflecting the relative importance of depressed European markets.

On unemployment, Mr Wright said that this was a growing problem, particularly in Europe where unemployment stood at 11%. It was a topical problem, and a variety of proposals had been put forward to deal with it: off budget spending financed by EC bonds; increased incentives, particularly to encourage mobility and job search; and a greater match of real earnings to productivity. In commenting on these issues, Mr Wright said that the US was doing conspicuously better than other countries. As far as productivity trends were concerned, although Europe was catching up the US, it would be a very slow process. Initiatives based solely on productivity improvements could not be relied on to improve employment prospects in the short-term.

Sir David Scholey wondered whether the views expressed in the World Economic Forecast by Mr Wright on unemployment didn't understate the problem in the major economies somewhat. New techniques and competition from newly industrialising economies meant that there was little prospect of any improvement in the foreseeable future. He wondered whether it was still appropriate to focus on the G7, given the growing importance of newly industrialising countries. It was also difficult to generalise about inflation, given that prices were behaving differently in different sectors. Finally, he wondered whether we had been able to take account of 'informal' economic activity in our estimates and whether this was significant.

In response, Mr Wright said that new technology and competition from NIEs were clearly important influences on employment. It was important to remember that activity and employment were dynamic concepts: there is not a fixed total of global employment which is moving elsewhere. There was a question

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about how far it was possible for the G7 to move into higher value added production or services. It was also possible to examine the relationship between real wages and productivity. On country groupings, we were looking increasingly closely at developments in the NIEs. At the moment, these were more important in their share of world trade than in their share of global GDP. It was indeed the case that inflation was behaving differently in different sectors. Mr Wright had referred to falling manufacturing prices in Japan; this was also happening in France and Germany. We did not attempt to estimate the size of informal economies since this would be impossibly complicated - though the issue was clearly an important one, and could alter our view about activity and the scope for tightening fiscal policy. Sir Chips Keswick commented that it had been suggested that the black economy in the UK might amount to 8% of GDP.

The Deputy Governor asked what had been assumed about the Uruguay Round. Mr Wright said that the assumption in the forecast had been neutral. Essentially, we had assumed a positive outcome in which the Round was concluded, though the positive benefits would be slow to appear and would have little impact on our (short term) projections. We had no grounds on which to dissent from the OECD's estimate that a successful outcome would increase world GDP by 1% by the end of the decade. The adverse consequences of a failure to agree could come through much more quickly, but this was not our central case.

Mr Quinn remarked that there was a sense in the US and Japan that policy was in a corner; activity was perceived to be weak but it was unclear what the policy response should be.

Mr Wright said that there was no universal policy prescription for the G7. There was probably scope for fiscal easing in Japan and for monetary easing in continental Europe. In the US (where the recovery was well advanced), the issue was when it would be appropriate to tighten monetary policy to forestall a pick up in inflation.

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Sir Jeremy Morse pointed out that the recessions in Japan, the US and the UK had had an element of the 1930s about them, involving debt deflation and falling prices in some sectors. This was less true of continental Europe, where the downturn had more the characteristic of the familiar stop-go cycle.

Mr Crockett said that the objective of monetary policy continued to be the achievement and maintenance of stability. It was difficult to identify any macro economic measures which would have a palliative effect. But policy makers needed to ensure that in future recessions policy making would not find itself in the same corner as in the recent downturn.

Introducing the paper on longer term trends in Japan's financial system, Mr Webster noted that there were a number of areas where change was taking place, or might do over the next few years. The strongly established Keiretsu (business groupings) links and the main bank system and relationship banking might not change in anything but the very long term, but the cross shareholding links which were a part of these arrangements were reported to be weakening at the margin. This was a system which had delivered Japanese economic growth in the post-war period. From the UK point of view, British firms might benefit from weakening of the Keiretsu-type relationships and from deregulation more generally: for example, an end to some of the price cartels might lead to greater imports.

There were signs of changes in corporate behaviour, on profit distribution, the role of the shareholder, and disclosure. Moreover, Japanese banks were now concentrating less on growth and more on profitability. Whereas British firms had learnt much from Japanese manufacturing, it seemed they had little to learn from Japanese financial institutions.

The economic downturn and other changes had led to increased questioning within Japan of the concept of lifetime employment, although there was no real evidence of any change in practice so far. Firms were, however, cutting back on overtime,

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recruitment, bonuses etc. If the recession was prolonged we could see more fundamental changes, but there were also longer term demographic changes involved.

Mr Webster also wondered whether the role of the Ministry of Finance in closely co-ordinating the financial system might change over the longer term. He noted that in many respects British firms felt reasonably comfortable with the present arrangements, and at least felt that nowadays they were listened to.

The Ministry of Finance was pushing forward with deregulation, a process which had implications for the City of London. Repatriation of business to Tokyo could mean some loss of market share in London, but the overall cake might be larger. It was important that there was no discrimination against British firms in this process.

Finally, on the subject of bail-outs and rescues, the Japanese authorities' policy of not allowing any bank to fail, or depositor to lose his money, seemed likely to continue in the present circumstances.

Mr Quinn said that he had recently returned from supervisory bilateral talks in Tokyo. On financial stability, the banks had told him that the worst would be over in terms of increases in non-performing loans by March next year; but he felt that this was rather optimistic, and it assumed a pick-up in the economy which might well not be there. He also thought that the property market was capable of falling further. The level of reported non-performing loans was understated, given the narrow definition of loans used (ie those six months overdue). Some regional banks and non-banks, such as small insurance companies, were said to be in difficulties. But he found that the authorities (Ministry of Finance and the Bank of Japan) were calmer than he expected, considering the falls in the Nikkei (but not to a level which would wipeout hidden reserves). He was encouraged by the fact that the banks and the authorities were talking a great deal behind the scenes,

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putting their minds to the problems and thinking about appropriate techniques for rescues, including how public sector support might be injected (eg through tax relief). On deregulation, he noted that there was already considerable progress and Japan was moving from a corporate to a capitalist culture. One aspect of deregulation was deposit interest rates, where next year the removal of ceilings on demand deposits could cause small banks to pay more for funds.

Sir Jeremy Morse agreed that real change was taking place in the Japanese system, but only slowly. It was important, for example, that progress was made towards improving dividends for shareholders, but this could take generations. He would like to have seen some discussions in the paper of Japanese participation in developments towards integration of the Far East region. On this last point, Mr Crockett noted that the topic was talked about a great deal, but unlike other areas such as North America and Europe, there had been no "internal" trade integration so far, though this was now beginning to change. He noted that the Japanese tended to address this topic in terms of a reaction to disadvantages to Japan posed by movement towards economic groupings in other areas.

Sir David Lees wondered whether the level of 14,000 for the Nikkei was crucial. Mr Quinn noted that people in Tokyo seemed to think it was. If the index fell below 14,000, there would be some pressure for official intervention, which appeared to have been lacking in recent weeks. What recently seemed to have moved the stock market (in both directions) was statements about fiscal action by Prime Minister Hosakawa and other ministers. On the Japanese economy, he noted that employment had been a big worry amongst those he had talked to in Tokyo. Partly this was connected with possible loss of jobs to lower-cost Asian economies. He had been struck by a newspaper report talking about a "surge" in employment from 2.6% to 2.7%!

Sir David Scholey observed that the unemployment numbers were oversimplified. He had heard suggestions that true unemployment was nearer 6% and heading towards double figures.

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Moreover, the level of bonuses was sharply down. He noted that even a year or two ago there were certain "mavericks", for example Morita (Sony), Aida and Tabuchi (Nomura), who had been quite outspoken about the economic situation and the risk of downturn. They had thought, however, that the bureaucracy would be very slow to change. But some firms were changing, for example with regard to use of derivatives and greater attention to dividends. Nippon Life, he understood, had run down its core cash holdings to 50% of former levels, and had focused increasingly on derivatives.

Sir David did not think we had very much to learn from the Japanese financial system, but the process of change would provide tremendous opportunities. (Japanese firms were now giving more opportunities to overseas firms.) Within the firms themselves, traditional hierarchy principles were now being questioned and the younger people were much more critical of their seniors. Sir Colin Southgate noted that young people were not going into big firms in the old way. For example, the Thorn EMI operation in Tokyo had about 3,500 applications for (certain) jobs, whereas its joint venture partner Toshiba had only 500. Moreover, whereas other firms in Japan had experienced problems of recession, his firm's experience was steady 20-25% growth throughout the period.

Sir Chips Keswick felt that UK firms did not understand Japanese book keeping and cash flow accounting. Until we did, we could not draw any firm conclusions about Japanese firms. This led him to be very cautious about Japan. Sir Colin Southgate commented that it was not so much Japanese strength in manufacturing which gave them the edge, but their product development capacity.

Sir Roland Smith asked about the behaviour of Japanese firms in the UK and the extent to which they use British rather than Japanese banks. Sir Jeremy Morse thought that the tendency for mainstream business would be to use the Japanese banks, but they would also use British banks, for example for the retail end of their business. Sir David Scholey commented that

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Japanese corporates appeared to use a wide nationality range of banks for their requirements.

Mr Clark, introducing a paper on Stage 2 of Economic and Monetary Union, identified the three main functions of the European Monetary Institute, which would come into being on 1 January 1994: monetary policy co-operation in the interests of economic convergence, which was already conducted within the framework of the Committee of Governors but would now be assisted by the rather larger staff at the EMI's disposal and encouraged by the need in Stage 2 to prepare the ground for Stage 3; technical preparation of the framework for the conduct of a single monetary policy in Stage 3; and overseeing the development, and facilitating the use, of the ECU. Various pieces of secondary legislation with implications for the conduct of UK economic and monetary policy would also come into effect on 1 January next year. On the policy environment generally, there had been significant changes since the Treaty was signed, with the loosening of the exchange rate mechanism and the shift towards employment and growth as a policy priority.

Mr Arrowsmith then described the three documents which would set the tone for economic and monetary policies in the Community at the start of Stage 2: the Commission's White paper, the "Broad Guidelines" which the Council would need to adopt, and the Commission's report on the extent to which convergence had been achieved during Stage 1.

Sir Jeremy Morse asked whether the idea of a Schengen-type sub-set of Community countries, which might move to EMU ahead of the Maastricht timetable, was still alive. Sir David Scholey wondered whether, as an alternative, countries might informally lock their exchange rates. Mr Crockett said he thought that while some countries might consider pegging de facto more closely to the Deutsche Mark, a formal, de jure, move of this kind was not realistic. He also felt that a

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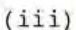
return to narrower bands of exchange rates might not prove to be a practicable route to eventual fixing.

Sir Roland Smith said he had been struck by the way President Delors, in his recent speech which was delivered on his behalf in Harrogate, seemed to overlook the difficult questions concerning the next three years and focused only on the sunny uplands beyond 1996. The fact that Europe was a high cost area would have to be addressed; as an example, both technical and structural factors made air travel in Europe very costly. Sir Colin Southgate felt that this particular example was not intrinsic to the European Community.

Under the weekly executive report:-

(i) the Deputy Governor mentioned that the agenda for Court the following week, 16 December, would be devoted to a discussion of the issues that arose out of the EXCO strategic weekend at Ashridge.

(ii) the Deputy Governor also mentioned that the TCSC Report was expected to be published on 16 December. He hoped that copies would be available to Members of Court on that day.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Insert Permanent. Rec

G. A. Croughton.
Secretary.
16 December 1993

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A COURT OF DIRECTORS AT THE BANK

THURSDAY 16 DECEMBER 1993

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Anthony Laurie Coleby, Esq
Sir Colin Ross Corness
Mrs Frances Anne Heaton
Sir Christopher Anthony Hogg
Sir Martin Wakefield Jacomb
Sir John Chippendale Lindley Keswick
Mervyn Allister King, Esq
Gavin Harry Laird, Esq, CBE
Sir David Bryan Lees
Sir Christopher Jeremy Morse, KCMG
Brian Quinn, Esq
Professor Sir Roland Smith

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The Minutes of the last Court, having been circulated, were approved.

Mr Quinn commented on the weekly figures and Mr Coleby spoke about the foreign exchanges and the state of the domestic markets.

6

Under the weekly executive report, the Governor mentioned that the TCSC Report was being published that day and copies were in

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Members' folders. The Report would be discussed at Court on 6 January.

At the Governor's invitation, and with the agreement of Members of Court, Mr Trundle, the Governor's Private Secretary, attended Court for the discussion on the issues raised during the meetings involving members of the Executive Committee over the weekend of 3-5 December, at the Ashridge Management College.

The Governor drew Members' attention to the note of the briefing which he had given Senior Officials about the Executive's discussions at Ashridge. The Governor said a further paper on the definition of the third core purpose would be presented to Court in the New Year. He suggested Court concentrate, during the present discussion, on structure and on the management of Officials, which were the main items covered at Ashridge. The conclusions on structure were summarised in the diagram which had been circulated with the note.

The Governor said that the changes had been motivated not by a sense that the current structure did not work, but by the belief that the structure envisaged would be better. He hoped it would avoid many of the tensions between existing Divisions, which were encouraged by the current structure. Individual areas tended to believe that they owned certain topics. For example, any question which had a European label might be seen as a topic for the International area, but a subject such as preparation for the single currency could equally be owned by the relevant functional area. Such tensions were currently resolved by cross-Bank committees. Another example was tensions which arose between the analytical and operational Divisions from time to time. There was also a concern that staff in Banking Department, in the back office, had a sense that they did not quite belong. The Governor said that the Executive believed that the new structure could resolve many of these tensions, but it was itself not without risks. Tensions could be recreated within or between the wings, but he believed such tensions would be more manageable.

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Sir Jeremy Morse had read the paper with a great deal of assent. He was delighted to see the Executive addressing these questions of structure and management. Although he had never worked in an organisation with such a clear bipartite structure, he thought it would be effective in drawing everyone into a core purpose. There was always a risk that staff working in what were perceived to be outlying areas would feel threatened, even when they were quite secure. Sir Jeremy said that the division between geographical and functional responsibilities was not as strong in the Bank as in many other organisations - the Bank had very few staff working overseas. Sir Jeremy thought the creation of the separate Supervision Division had carried a greater risk of confrontation, although it seemed to have worked reasonably well. The new structure made clear that any tensions between the monetary and financial stability wings - eg if the whole banking system were threatened by another LDC debt crisis - would have to be resolved at the top.

Sir Jeremy thought the proposed changes would profoundly change the top of the Bank. They would be likely to result in a supremo in each wing; and the two Governors and the two senior Directors would effectively be the powerful four in the Bank. Sir Jeremy added that there were a number of obvious advantages in merging the European work with the domestic work. The danger was that of introversion. It would be important that the analytical wings made sure that they were well informed, and that they maintained the right degree of internationalism in their outlook. He also encouraged the Executive to ensure that the Bank maintained the many valuable elements of its country coverage. It was important that the Bank remained well informed here too. Finally, Sir Jeremy said it was important that the Bank should have a senior "Mr International" figure. Although many different people would attend overseas meetings, there was a clear role for one individual, below the Governor, to be seen as the senior contact with overseas institutions.

Mr Laird said his point was rather narrower, and related to the Printing Works. There, as in commercial companies, the

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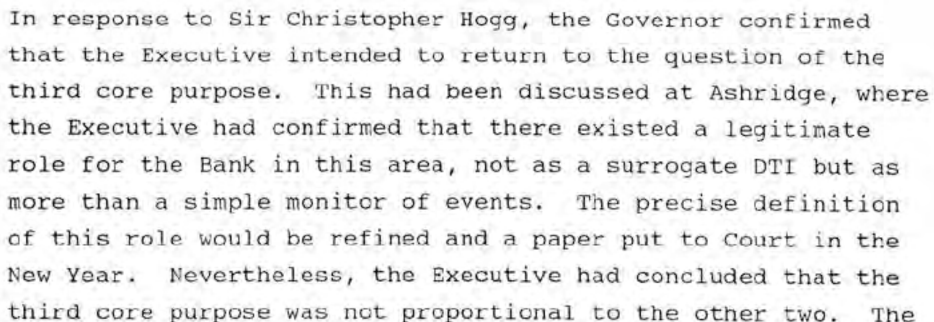
objective had been to motivate each individual area to view itself as a sort of profit centre which added value for the organisation, and to relate its work to other printing activities. The ethos was rather competitive. It was sensible to try to ensure that the management was not isolated from the rest of the Bank, but there was a contradiction between tackling this and ensuring that the local management had sufficient autonomy to carry through such changes. He therefore asked that the working party liaise with the non-executive Directors who were members of the Debden Committee. The Governors agreed that this was a good idea.

Sir Chips Keswick said that he believed that good management dominated structure. He said that, in the process of change, the Bank needed to avoid surreptitious shedding of living expertise. The Bank had great quality in depth, and should be cautious in making changes.

Sir David Lees said he found it difficult to distinguish from the note how the tensions which had been identified would be improved by the change in structure. He very much agreed with Sir Jeremy Morse that the new structure would create two principal Directors. The success of the reorganisation would depend very much on the quality and ability of the individuals leading these parts of the Bank. As a general rule, he said it was better to bend an organisation to the people, rather than vice-versa. It was more important to have the right people than to have the theoretically best structure.

In response to Sir Christopher Hogg, the Governor confirmed that the Executive intended to return to the question of the third core purpose. This had been discussed at Ashridge, where the Executive had confirmed that there existed a legitimate role for the Bank in this area, not as a surrogate DTI but as more than a simple monitor of events. The precise definition of this role would be refined and a paper put to Court in the New Year. Nevertheless, the Executive had concluded that the third core purpose was not proportional to the other two. The



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substance of much of the work in this area could, in practice, be done in the two main wings of the Bank.

Sir Christopher Hogg asked that the paper on this subject set out what different parts of Government did in relation to the City. He also asked for an explanation of the way that the change of style in the Bank would affect key individuals. The Governor explained that the Officials group in the Bank was essentially the management cadre, which largely comprised graduate staff. This was distinct from the clerical function. The proposal was that graduates should be recruited as potential Officials from the outset, and that their later promotion to the management rank of Official 1b should be subject to confirmation by a board. The Governor said that it was in the Official structure that the need to improve motivation was greatest. The Officer arrangements may not be perfect, but any concerns were less pressing.

Sir Christopher expressed nervousness about introducing greater spikiness in pay for officials. He said he had a similar concern in respect of the Civil Service. For it to work, there needed to be wide-spread agreement about how performance was measured. That was not easy in such functions. The Governor said that he did not think that the proposed changes were revolutionary. Performance had always been assessed subjectively in the Bank. The difficulty was that all the staff were so nice that they were reluctant to draw sharp distinctions between individuals. But the failure to discriminate properly was demotivating to the brightest staff. The system needed to be made to work by changing the behaviour of individuals. The Deputy Governor said it would be necessary to persuade assessors that they would be judged by how they judged others. Sir Christopher asked how irremediably poor performance would be dealt with. The Deputy Governor said the Executive had concluded that the existing arrangements provided a mechanism for dealing with such staff, but that it should be used more often. The procedures provided for warnings for sub-standard staff which, in some cases, might motivate them to perform better. Others would be encouraged to leave. But such

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matters were clearly sensitive in an organisation such as the Bank.

Sir Adrian Cadbury believed it was important to start with structure, even if this might have to be trimmed to reflect the top people available. He urged the Executive to consider how far the Bank needed to undertake analysis in-house, and to consider carefully the judgment of how much to buy in. He thought it right to put the operational and analytical functions together. In addition, the Bank needed to consider the division of functions between Bank and Government. It was rather strange that in some areas the Bank may have been better informed that the FCO. In part, the Bank had acquired functions because of its status and influence, which may be greater than that of the UK as a whole. That was an accident of history, and Sir Adrian believed that the Bank should draw back from that degree of involvement. Finally, Sir Adrian thought it important that staff should move between the analytical and operational branches, and between the financial stability and monetary stability wings of the Bank, and that this would reinforce the concept of one Bank. The Governor confirmed that this was very much the intention.

Sir Colin Corness questioned whether it might be better to keep the two analytical branches of the wings together. The Governor agreed that this was a possibility, but suggested that the nature of the analysis in these two wings was quite different. The monetary wing would concentrate on conjunctural matters, whereas the financial wing would concentrate on institutional developments and policy for the regulatory framework. It was already the case that the supervisors had developed their own information on supervisory structures internationally, and this pattern was likely to become more widespread. But this was a matter for discussion. Sir Colin suggested that there were common skills between the two areas even though the work was different. Keeping the two analytical sides together would encourage the development of skills for both branches. He added that such an extensive restructuring was likely to give rise to considerable anxiety about

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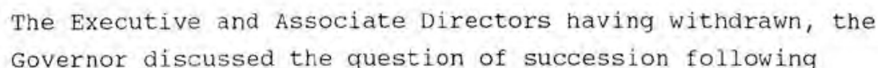
individual career prospects, and the staff would have to consider which side of the fence they wanted to jump. The Governor said Officials would be encouraged to move between the four branches of the restructured Bank. That would include moving between analysis branches of the monetary stability and financial stability wings. He feared that combining these two branches would re-open some of the tensions he had described.

Professor Sir Roland Smith asked Members to consider why organisations took the initiative to make such changes. He suggested organisations wanted to increase accountability because their work had changed. Structure should be a function of the work that was to be undertaken, and work was flexible. The change in culture should be to make individuals accountable for their performance rather than to make them conform. He commented that his visits to parts of the Bank had given him the impression that career prospects were very much better in some parts of the Bank than others. The Bank needed to be able to justify such distinctions. Sir Roland said that the strength of the Bank was in its people. The nature of the work meant that the Bank's staff had to be creative people - rather like in a University. The Bank did not produce anything, and it was difficult to manage staff of that calibre. As a result, the personnel function was critical. For this reason, Sir Roland still believed that the role of Staff Committee had been very important, and that the Court of the Bank should be directly involved in staff questions. The Bank's staff was its greatest resource.

Mr Kent commented that the Printing Works also held a strategy weekend when the Executive was meeting at Ashridge. Managers at the Printing Works were hoping to make changes very much along the lines that Sir Roland had been suggesting. The emphasis would be on accountability for raising productivity. Further details would be provided for a later discussion at Court.



The Executive and Associate Directors having withdrawn, the Governor discussed the question of succession following

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Mr Crockett's resignation with effect from 31 December and also invited comment on his nominations for the appointment of a Non-Executive Director to succeed Sir Adrian Cadbury who would be retiring from Court on 28 February.

The Deputy Governor asked Members if they were able to suggest the names of any consultants with experience in organisational change, who might be able to assist with the restructuring exercise.

Rupert Pennant-Rea

G. A. Croughton.
Secretary. 6 Jany 1994.

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A MEETING OF DIRECTORS AT THE BANK

THURSDAY 23 DECEMBER 1993

Present

Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Mervyn Allister King, Esq
Brian Quinn, Esq

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The number of Directors assembled being insufficient to form a quorum, those present proceeded to the business, subject to ratification by the next Court.

The Minutes of the last Court, having been circulated, were approved.

There being no comments on the weekly figures, Mr Plenderleith spoke about the foreign exchanges and the state of the domestic markets.

Rupert Pennant-Rea

G. A. Croughton
Secretary 6 January 1994

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A MEETING OF DIRECTORS AT THE BANK

THURSDAY 30 DECEMBER 1993

Present

Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Anthony Laurie Coleby, Esq

Hugh Christopher Emlyn Harris, Esq

The number of Directors assembled being insufficient to form a quorum, those present proceeded to the business, subject to ratification by the next Court.

The Minutes of the Meeting the previous week, having been circulated, were approved.

Mr Coleby commented on the weekly figures and also spoke about the foreign exchanges and the state of the domestic markets.

Rupert Pennant-Rea

G. A. Croughton.
Secretary 6 Jan 1994

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