Speech by
THE GOVERNOR OF THE BANK OF ENGLAND
at a Dinner given by the Lord Mayor to the Bankers and Merchants of the City of London on the 16th October 1963

Last year when we met on a similar occasion I recall that I suggested that the task before us was to steer the economic expansion, which was already then the aim, in such a manner as would provide for continuing expansion but without re-creating the conditions which, in 1961, had provoked the need for exceptional restraint. The policies which have been pursued during the past year and the measures used seem to me consonant with this aim.

That same night the Chancellor told us of the proposed increases in public sector investment and of the release of further post-war credits which would be likely to increase consumer demand. Not long afterwards he made significant changes in investment and depreciation allowances; the purchase tax on motor-cars also was brought down and gave, as it was designed to do, much help to both their export and home sales. In the course of the year further fiscal changes were made to increase consumer demand by other reductions in purchase tax. In the Budget in April additional stimulus was given to consumer spending by reductions in income tax in the lower personal income brackets, and substantial additional expenditure was budgeted for in the public sector. Significant tax incentives were also introduced to encourage investment in the development areas.

In the monetary field the trend of policy has been in the same direction, with Special Deposits repaid and Bank Rate lowered at the turn of the year. When this change took place the Bank of England announced the intention to vary rates charged to the money market; a practice which had fallen into disuse, although previously it had formed part of the technique of money market management. It was a measure which endowed the authorities with rather greater flexibility, although limited in the degree of freedom of action it secured. In the spring which eventually followed a memorably disagreeable winter, it appeared that the banks, who had been called upon to meet some somewhat unusual demands for credit partly associated with the severe winter, might find themselves having to limit the increase in their advances in order to comply with maintaining the 30% liquidity ratio. To avoid this situation arising, which clearly was not in keeping with public policy, the banks were informed that the authorities would not take exception to their liquidity ratio falling to a minimum of 29%; this movement was naturally noted at the time by financial journalists and others who follow the banking figures. More recently, and in line with the earlier decision, the clearing banks have been informed that they should aim to achieve a liquidity ratio of not less than 28% between now and the make-up date in April 1964. A minimum level of 30% for the liquidity ratio is historical; it was the agreed minimum level of liquidity which prudent bankers in their wisdom and experience had found appropriate to the circumstance of their business. This convention was taken up by the authorities as a useful fulcrum of official monetary policy. With improving communications bringing more accurate control over the use of their funds, and for other reasons, the clearing banks would, I understand, be content, from the point of view of banking prudence, to adopt a lower figure as the conventional minimum liquidity ratio appropriate to modern circumstances. The Bank of England would see no objection to a gradual move towards such a lower figure which could provide the fulcrum against which Special Deposits, amongst other things, could be applied should the need for them arise. It is clearly in the interests of the authorities to co-operate in ensuring that the banks are in a position to assist, within terms appropriate to banks, in sustaining the economic expansion that we wish to see at the present time. Timing of such changes or indeed of any others is important so that they may, whenever possible, complement the Government's economic policy.

In short, this has been a year of *Go.* I believe we have acted rightly in giving the stimulus to the economy that has been given but, although it may seem premature to some, I think we should now be giving thought to the next phase—the phase which will arise as the stimulants achieve their purpose and growing export and consumer demands lead to increasing activity and extensive further capital investment in the private sector.

I am well aware of the dislike of what is called the *Stop-Go* policy. I can see the appeal of the phrase which I believe was coined at Cape Canaveral—*All Systems Go*. But even at Cape Canaveral it was found that without complete balance of the whole system *All Systems Go* could lead to over-heating, explosions and a very complete *Stop*. I am not in favour of *Stop*; growth without inflation as propounded by the Chancellor is of course what we need.

However, on this question of controlled balance I would like to say a few words here this evening. When we found in the summer of 1961 that the over-heating was such that drastic checks were necessary, all the conventional controls in the monetary machine were applied. There is little doubt that, in the conjuncture of events at that time, they achieved the objectives that were being sought—at a price. We are still feeling the after-effects today—and let us be quite clear—some at least of the after-effects are what we needed, for example, more stable costs with the very welcome increase in exports which we have recently seen.

The problem that arises in these days is that the traditional monetary regulators do not apply over the economy as a whole to the same extent as was the case, say, fifty years ago. Today roughly a third of the gross national product—what is technically known as the public sector—is not subject to the direct or psychological impact of monetary measures. Public sector expenditure, be it on capital or current account, is only marginally influenced by monetary measures. In the face of crisis, efforts are of course made at least to slow down the rate of increase of public sector demand on resources, and indeed at such times it may well sound as if it is the public sector which is being most curtailed. I do not think that in practice this is what happens for a number of reasons, of which one is the devolution of responsibility for spending public moneys. To take one case, it has to be realised that the great bulk of public sector investment is undertaken by the local authorities and the nationalised industries rather than by the Central Government itself so that the Central Government's power of control over timing in this important field of demand is indirect and slow to take effect and this is only one example. This of course applies equally in an expansionary period as it does at times of restraint.

However, the fact is that drastic use of monetary measures has a sharp and abrupt effect on business sentiment and confidence with consequences which take a considerable time to get over. Public sector activities, on the other hand, particularly in investment, being often the outcome of protracted planning and parley, once having obtained approval are not inhibited automatically by the economic climate from demanding the resources needed to embark upon whatever the project may be. To this extent, private enterprise and private consumption have, under such circumstances, either to be restrained to a greater degree or for a longer period.

This seems to me to create an unfortunate distortion in our affairs. For it has to be remembered that, however great is the social desirability of expenditure in the public sector, and that, however dependent industry may be on the services provided by the public sector in roads, railways, electricity and other things, the country is primarily reliant on the success of the private sector to earn the foreign exchange we need to avoid a balance of payments crisis. The direct connections between our production and our export markets lie in the hands of a multitude of private manufacturers and merchants. The very measures of a monetary character which are invoked make it more difficult in the short term for the private sector to achieve success in the vital role it plays in our economy.

I have heard it argued that attempts to bring about short-term reduction or even deferment of expenditure in the public sector create intolerable dislocation of long-term plans or programmes. I can only say that monetary measures can, and do, cause considerable dislocation to industry in fulfilling industry's capital investment programmes or in the full utilisation of new plant. Such dislocation in the private sector is likely directly in the short term to impair our exports, and hence our earning power in foreign exchange—an effect above all we would wish to minimise.

Let me not be misunderstood. I am not advocating restraint at this time—indeed further expansion of activity, especially in the private sector, is the order of the day. But I do suggest that it is prudent to be looking ahead as to how we maintain a balance between the competing sectors of the economy—a balance appropriate to our international economic situation and appropriate to our domestic economic aspirations.

There is food for thought for the future in the knowledge that a significant amount of the stimulation which has been applied to the economy over the past eighteen months or so has been applied in the public sector. This does not in itself cause me concern at this time, but I suggest that we should be applying our thoughts to what we should do when demand picks up as well in the private sector, which is what we want to see happen. We should, I suggest, be giving thought as to whether, when overall demand appears to be reaching a height which, as a nation, is as much as we can meet, we should be able, at the least, to withdraw that element of demand from the public sector which has been brought in to take up the running while private expenditures lagged, and which by then will have served its express purpose. Or, will we once again find industrial activity and growth having to bear the brunt of any restraint which may become necessary?

The Chancellor, I feel sure, will see much truth in all this as an abstract observation on economic policy and its relevance to monetary policy. He can fairly claim too that it is much easier to talk about these matters in an after-dinner speech than it is to act on them. But whether it is easy to act or not, we must remember that *All Systems Go* without necessary balance will lead to *Stop*. I do suggest that it is only by the exercise of foresight now that we will avoid in the future the past rigours of *Stop-Go*. Monetary measures have their part to play but excessive reliance on them may not achieve the aim we are seeking.

In conclusion a few brief words on our overseas earnings—brief not because the subject is not of paramount importance but brief because the hour is late. I have said before and I make no apology for saying it again, that I have no doubt that the question of our overseas earnings must remain of the highest priority in the nation's policies if we are to fulfil our economic aspirations at home and if we are to retain our authority in world affairs. Industry in this country has done a magnificent job in building up exports, actively supported by the Bankers and Merchants, but we cannot afford not to employ to the full every opportunity to increase our invisible earnings—to use all available resources and all available skilled knowledge to this end. We are not, as yet, doing so. The Federation of British Industries, in a report which generally endorses prevailing trade policies, has recently drawn attention to a competitive disadvantage of British industry in setting up overseas operations and I am aware too of other impediments to financial business which could otherwise contribute to a further strengthening of our economic standing. I was particularly glad therefore to hear you, Mr. Chancellor, assure us this evening that the Government does not underrate the importance of reaffirming London's unique position as a financial centre. Indeed this has been evidenced this year by the removal or mitigation of some of the obstructions to a higher level of international business. The business community appreciate these steps : they look forward to more to come.

My Lord Mayor, I am proud to reply on behalf of the Bankers and Merchants of the City of London to this toast—they serve this country well. I know I speak in their name in assuring you that they are ready and willing to contribute even more actively towards the financial strength of the country during the ensuing year.