Speech by the Governor of the Bank of England

Given at the Lord Mayor's dinner to the bankers and merchants of the City of London on 26th October 1967

Last year, my Lord Mayor, I had the privilege of making at this dinner my first speech as Governor of the Bank. Since then an eventful year has passed. In many ways it has been a somewhat disappointing year. At the end of it we are not as close to our goals as we should like or expected to be.

Nevertheless, I should like to say how strongly I support H.M. Government's determination to continue with their chosen policies and thereby to achieve the surpluses in our payments abroad necessary to enable us to repay the external debts accumulated since 1964. I am sure that continuing restraint over the level of internal demand and effective incomes and prices policies are essential parts of H.M. Government's strategy and that the need for these is no temporary matter arising from some purblind obstinacy, as some see it, in putting the pound first. The tendency for money wages to outstrip increases in productivity is a world-wide problem and many countries are following our efforts to solve it in the U.K. with close attention and not a little admiration. Their disappointment will be hardly less than ours if we are unsuccessful.

We are all aware of the special influences outside our own control which have so markedly increased our problems this past year, in particular the closure of the Suez Canal and the slowdown in production and trade throughout the world. In the absence of these factors I have no doubt at all that we should have achieved external surplus in the current year. But some of that surplus would have been achieved at the cost of virtually halting our domestic economic expansion. The main question facing us is how fast we can now go ahead, for it is clear we still have problems to solve if we are to resume economic growth while retaining an external surplus. These problems are of our own making, whether they are destructive labour disputes or a willingness among too many of our industrialists to take refuge in gloomy thoughts when confronted by some idle capacity instead of seeking to use it in export markets. Compared with many other countries there is no doubt that at times we are shamefully short-sighted in our attitudes, and sluggish in our reactions. Fortunately, there are many hopeful signs of change that show us our own problems are capable of solution.

In the past twelve months there have been developments in a number of subjects of particular interest to the City, many of them welcome. Before I refer to these, however, I shall pick up one of my continuing themes, namely government expenditure.

It is a contentious subject, I know, in many other countries besides this. The way in which such expenditure is handled is, I believe, vital to the overall health of the economy. My unhappiness about government expenditure is not caused by its purposes nor simply because it goes on rising every year – which it does – but that it goes on inexorably rising faster than our total output. This year's rise has only proved manageable because of the severe restraints previously imposed on the private sector. But what will happen when the private sector regains its confidence and begins again to expand? When business investment, exports, and stock-building all turn up, consumption will not lag far behind. If together they then come to a head-on clash with rising government expenditure, the economy will be in danger of boiling over again. This, I believe, would inevitably set back all the good work recently done in the field of incomes and productivity and jeopardise our improving balance of payments prospects. I know that the Chancellor is well aware of these dangers to which he himself has referred more than once. I also know how valiantly he has striven to contain government expenditure and how intractable are the problems involved. Nevertheless, I feel bound to point out again that when government expenditure represents so large and ever-increasing a part of total real demand, regulating the economy wholly by changing the climate within the private sector, whether by fiscal or monetary measures or both, becomes an impossible and self-defeating task. I say *self-defeating* because the more inexorably the public sector marches upwards, the more we have to disturb the rhythm of the private sector where most of our prospects of growth lie.

I have little to add about the outline plan for new special drawing rights in the International Monetary Fund unanimously approved at the Annual General Meeting of the Fund in Rio de Janeiro last month. The seed which we have sown may be a small one but I am sure it can and will flourish in the years ahead and produce an increasingly important supplement to the world's supply of reserve assets. Moreover, what is vitally important, it will do this without impairing the acceptability of existing reserve assets. The negotiations which finally produced the plan have been long and sometimes difficult. We are all indebted to the Chancellor for his chairmanship of the committee of ministers and governors of the Group of Ten. Sitting close to him, I was well able to see how greatly his skilful handling of these meetings contributed to their successful result.

One of the most widely publicised events for the clearing banks this year has been, I suppose, the report of the Prices and Incomes Board on bank charges. As you know, this report concluded that there was little to criticise in the existing levels of bank charges. Before coming to this conclusion, however, the Board felt it necessary to review the banking system generally, many related financial activities in the City and elsewhere, and even some aspects of monetary policy. Opinions will differ as to how far this broad sweep was either necessary or useful. I myself would not wish to take up the position that the professional always knows best and I am sure the outside critic will equally not assume that he has the monopoly of insight into these complicated matters. The banks and the authorities are giving careful study to a thought-provoking report. For my part, I entirely accept the dictum that the technical implementation of monetary policy must accommodate itself to the commercial banking system as it evolves.

If it were to evolve so as to bring more of the many diverse banking and credit facilities now available into the clearing bank system, the task of the monetary authorities might perhaps be made easier. There would, so to speak, be fewer taps for us to turn off and on. However, we are making good progress in our discussions about the extension of continuing control to the rest of the banking system. We already know that we shall find there the same goodwill and co-operation which we get from the main deposit banks. But let me add that I, as Governor, bear in mind that the authorities should not lean too heavily upon this goodwill, whether by seeking to impede normal developments in banking or by imposing over-strict controls upon existing business.

Quite apart from relations between the monetary authorities and the banks, there is a question whether a concentration of banking into the clearing bank system would better serve the manifold needs of business and the public generally, both as lenders and borrowers. What I might call 'off the peg' banking might well become more diverse and all-embracing but my guess would be that the made-to-measure variety, which tends to be especially important for the economy, might become less good. In short, I am not at all convinced that the advantages of specialisation in the City are a myth. Specialisation may have been overdone in the past but that has been changing for some considerable time. Our banking system is, in its own chosen ways, evolving at an accelerating rate and I am sure this will continue, spurred on, maybe, by the Prices and Incomes report. We have this year, for example, seen increasing participation by British banks in international banking ventures, the launching of new unit trust schemes by clearing banks, and various new credit arrangements. I shall continue to keep a watchful eye on such changes for the sake of the general health of the banking system. The system is not perfect, of course, but taken as a whole it would be hard to match it in the world, even in these days when our commercial supremacy, which used to provide it with such an unparalleled springboard, has disappeared. Would that more of our activities nowadays were still held in such high esteem abroad.

You, my Lord Mayor, have made the subject of our invisible earnings and particularly those of the City, your very own this year. As you approach the close of an outstanding year of office, I certainly have no wish to steal your thunder. On the contrary, I would like to take this very appropriate opportunity to congratulate you, sir, on choosing a theme so central to the well-being of the country as a whole, as well as to the City, and for following it through in such a lucid and well thought out way. We are all indebted to you.

I would, however, like to add a few personal thoughts on the questions of overseas investments and invisible earnings arising from my reading of the Reddaway and Atlas Committee reports.

The Reddaway report, as one would expect, was a scholarly and thorough exercise. It was, of course, only an interim report and one necessarily based on only a small sample. Even so, it shows very diverse experience and illustrates the great difficulty of trying to be precise about quantifying the complex variety of gains that can accrue. Its failure to produce emphatic support for overseas investment disappointed some, while critics of such investment too readily hailed the report as proving their case. I believe that, studied carefully, it does no such thing. It offers no evidence that the resources available for home investment are impaired by overseas investment or that more domestic investment will take place when overseas investment is curtailed, as it is at present.

In dire balance of payments difficulties we have no option but to restrict capital remittances. But the message that emerges from the report seems to me clear enough. The longer this restriction goes on the more we shall eventually lose in permanent support for our balance of payments through invisible earnings, and the more we shall add to the difficulty of retaining our access to markets. "On the whole", and I am now quoting the report, "direct investment overseas should strengthen our fundamental position". That has always been my view. Indeed it seems to me a trifle obvious. Nevertheless even the obvious is the better for being buttressed by learned argument and complex statistics, and we should be grateful to the authors of the report for doing this.

From the Atlas Committee also we have a valuable report giving us better information on important features of our balance of payments not yet as well known as they ought to be. We thank the Committee and Mr. Clarke very warmly for illuminating one of our biggest success stories. For centuries our invisible exports have earned a massive income from abroad; and it deserves to be noticed that over the past decade, when we have badly needed every addition to our income that we could achieve, we have increased our earnings from invisibles by 50% or more.

But the report does not merely turn on more lights; the Committee's aim has been to find ways of reinforcing the success. I fully share this aim. The Committee have suggested many ways, some familiar, some novel, in which the authorities could stimulate and help these exports. Their suggestions deserve sympathetic attention; and the administrative difficulties that have so far been thought to prevent the more obvious kinds of help being provided should now, I am sure, be critically re-examined.

In the longer run, the most important of the Committee's recommendations could be their proposal for a permanent organisation to carry forward the work that they have begun. There are many forms that such an organisation might take; and we should need to be sure that we were setting up a body capable of doing its job. But I find the proposal an attractive one and shall not lose sight of it.

There has been intense activity in amalgamations and mergers during the past year. The Chairman of the Stock Exchange spoke to me about the embarrassments which this can bring for the Stock Exchange Council, who from time to time have been urged to take action, by withdrawal of quotations, which they have sometimes felt was neither justified nor useful. I readily agreed to Mr. Wilkinson's proposal that the Working Group of the Issuing Houses Committee should be reconvened to re-examine the Code of Conduct issued with the then Governor's approval in October 1963. This work is now going on and, I am sure, will be completed with all possible speed. I did not feel, however, that simply improving the Code was the complete answer to the criticisms of some take-over operations which had been made. The best of codes can be variously interpreted. Complete information concerning the considerations involved in contested bids can hardly ever be divulged. It seemed to me what was wanted was a body of unquestioned impartiality and standing to hold the ring. Such a body should offer reassurance and protection to shareholders and to the public. I was most grateful to Sir Humphrey Mynors for undertaking the chairmanship of this panel. The Bank of England are providing a secretariat but the panel will work out its own procedures and methods. I need hardly say that it will have my full support. I have made these arrangements because I believe that such matters are better handled by the City itself than by the introduction of legal sanctions.

Finally, I want to give you some thoughts of a central banker on interest rates. As I see it, no central banker worth his salt ever wants interest rates to be higher than is clearly necessary. Unnecessarily high rates are bad in themselves and they reduce the room for manoeuvre in the application of monetary policy. It was a great relief therefore to get down from 7% to 5½% in stages early this year, and the Chancellor's efforts at Chequers certainly helped the process. We might otherwise, in part at least, have missed what proved to be a short-lived opportunity. But I must repeat my warning against the view that the level of interest rates is something that can be readily lowered all round if only there is the will internationally to do it. General interest rate disarmament of an enduring kind is only possible if it is fully backed up by appropriate internal policies. High rates are a symptom of various related diseases which have been prevalent throughout the world since the war and which stem very largely from the actions or inaction of governments. Where government spending and heavy deficit financing play too large a part in generally expansionist economic policies they become the prime cause of inflation and of the balance of payments pressures which make it impossible to ignore high rates in other countries. At the present time many countries are looking anxiously at developments in the U.S.A., where it is hoped that, in an admittedly very difficult situation, the authorities will contrive to achieve a balance between fiscal and monetary action which will not have harmful consequences for other countries. Albeit unwillingly, we in the U.K. have already responded in a marginal way to the upward trend of U.S. rates.

My Lord Mayor, as I said to begin with, we have had a somewhat disappointing year, but I am sure the Government are right to have continued faith in their present policies and in their determination to pursue them. To weaken now would bring immense risks and dubious opportunities. The light at the end of the tunnel may yet be small but I think it can be discerned. We must work to bring it nearer with all possible speed.