Extracts from recent speeches by the Governor of the Bank of England

Paper presented to the International Industrial Conference at San Francisco on 16th September 1969

The future of the international monetary system

. . . Forecasting is a difficult enough business in any field; in the midst of present uncertainties the international monetary system is for forecasters virtually a disaster area. To analyse it and assess its prospects, it is necessary to take a view about political and economic decisions in a host of sovereign countries and to trace complex reactions and responses in many interconnected financial and commercial markets. One would need to be a superman, or perhaps a supercomputer, to analyse all the relevant factors; and one would need to be a superdiplomat to pronounce upon what should be done and emerge unscathed. However, this has not prevented almost every self-respecting economist, politician, central banker and financial journalist from coming forward to tell the world what is wrong with the system, what is going to happen to it and what we must do to be saved. It is with some trepidation that I now add my voice to this mighty chorus, for I am conscious that I have not anything very new or startling to say. But, having been asked, I must say what I think, even though it may disappoint those who are looking for some painless technical solution to the problems which now beset us.

There is one point on which everybody seems agreed: the international monetary system is in trouble. We are all only too conscious of the frequency of exchange crises in recent years and the prolonged uncertainties which have attached to particular currencies. Some would also relate the prevalence throughout the world of inflationary pressures and high interest rates at least partly to defects in the working of international financial mechanisms. I certainly share the general view that all is not well. But before discussing the problems we face, it is important not to exaggerate them. The purpose of any international monetary system is to facilitate and promote the expansion of trade, production and employment. Judged on this test the system has done well, at any rate so far. The decade since the major currencies became convertible in 1958 has been the most prosperous the world has ever known. The annual rates of growth of over 8% and nearly 5% in world trade and world production have probably never been equalled in any previous period. Moreover, far from slackening, the rate of expansion of trade and activity reached record levels in 1968 – a year of three highly publicised exchange crises. All previous international monetary systems suffered periodic crises, and these crises normally plunged the world into severe depressions leading to recurrent outbreaks of economic warfare, restrictionism and deflation. Our present system has been characterised by unprecedented and ever-growing international co-operation and interdependence; and the main casualties of recent crises have been the digestive systems of the world's central bankers. It is not for me to belittle this cost, but it is perhaps one that the world is prepared to pay for a financial mechanism which has hitherto served it better than any other previously devised.

However, we cannot afford to be complacent. There are important things that are wrong and there are serious causes for concern. As I have said, everybody is agreed on this: but agreement stops at that point. There is a wide divergence over what actually is wrong and how it can best be put right.

There is one school of thought which we might represent as believing that the international system is no more than the sum of its parts. This school holds that all our troubles stem from bad national policies, which allow large overseas deficits or surpluses to persist far too long. If every country ran its own affairs properly in this respect the international system would look after itself and there would be no serious problems. I have a lot of sympathy with this view. I am well aware that the external deficits of my own country have long been vulnerable to criticism. The United Kingdom has run such deficits for a number of years. During this period we drew heavily on short and medium-term assistance from other countries and from the I.M.F., were forced to devalue and strained to the utmost the forbearance and trust of our creditors and of all those countries who have traditionally held large quantities of sterling in official and private balances. We have made mistakes in policy, primarily I think from over-optimism. Many hard decisions and unpalatable measures have in fact been taken by the U.K. authorities; it is sad to reflect that had we taken some of them more promptly, we might have avoided others and still have been by now well out of the wood.

But it is profitless to dwell on the past and I believe that our recent performance gives grounds for real, even if cautious, optimism. I am a veteran of false dawns but it does now appear that the U.K. at last moved into external surplus in the second quarter of 1969 and that this surplus should grow from now on. Even if this cautious optimism is justified, however, we still have a long way to go.

But if the U.K. has been an offender, we have not been alone. It is not difficult to point to other major countries where policies have sometimes fallen below the highest standards. I shall not be so ill-mannered – especially since I live in so fragile a glass-house – as to lecture others on their shortcomings. But it would perhaps be generally agreed that in both surplus and deficit countries there has frequently been demonstrated the same tendencies that I have pointed to in the United Kingdom. Delays in implementing appropriate domestic policies have had many ill-effects on the international adjustment process.

I believe, then that we all could have done better; that no international monetary system can work if the policies of individual countries fall below some minimum standard; and that improvement of national policies to reduce both deficits and surpluses will go far towards stabilising the situation and reducing international monetary tensions.

Nevertheless I do not think that this is all that is necessary. The view that there is nothing amiss except bad policy-making does not go to the heart of the matter. This is for two reasons. First, even if everybody behaved virtuously the aims of individual countries might not prove to be mutually compatible. Most countries prefer on average to run surpluses rather than deficits: but only if there is an appropriate

continuous increase in total reserve assets can the aggregate of all surpluses exceed the aggregate of deficits. I shall come back to this point later. The second reason why it is not sufficient to urge an improvement of national policies as a remedy for our difficulties is that we must take the world as it is or is likely to be. Policy-making is an inherently difficult business. We always know so little about what is actually happening until long after the event. There are always powerful political, institutional and administrative constraints on the actions that can be taken. It is therefore necessary to have an international monetary system which can accommodate inevitable mistakes and shortcomings in individual national policies. This leads to what has recently become a rather common form of criticism of our present system: namely that it is too rigid and that we need more flexibility.

Many voices are currently raised to say, despite the success achieved so far, that it is impossible to expect a system of fixed exchange rates to work. Countries' costs and prices are bound to get out of line over the years with the result that adjustment in exchange rates will periodically be necessary. Of course, the Bretton Woods system allows for this in principle, but the critics say that in practice it does not work out as the founding fathers of the I.M.F. envisaged. Exchange rate adjustments are said to be delayed too long for political and prestige reasons. As a result, the adjustment process is frustrated, speculative pressures periodically build up and too much resort is made to short-term borrowing instead of to appropriate corrective action. If and when rate changes are made, they are made under market pressure and so are less likely to be accompanied by the right domestic action. The answer, say these critics, is to introduce more flexibility, making it easier to move exchange rates. Various suggestions are put forward.

The most radical, finding much favour in academic circles, is to abandon the Bretton Woods system entirely and let all exchange rates fluctuate freely in response to market forces. In this way it is claimed that some of our most intractable problems would be conjured out of existence. The balance of payments would always balance, so that would be an end to that headache. There would be no need for reserves – except perhaps for small balances for occasional official intervention – so there would be no international liquidity problem. Some writers even claim as an additional bonus that the power and prestige of central bankers would disappear. It is not surprising that a solution promising so many good things should find ardent advocates. In addition, there is the charm of doctrinal simplicity – leave everything to the market.

Is it not significant, however, that desipte all these apparent attractions, floating rates find very little support among those who have actually to operate the system and be most grateful for its assumed benefits – officials, central bankers, commercial bankers and businessmen? It could be that the older ones remember what floating rates involved before the War: competitive depreciations, rampant economic nationalism, and a degree of uncertainty that proved too great for forward markets to handle. Some may have thought about the

domestic accompaniments to the automatic balancing of external payments by flexible rates: for example, the cumulative upward pressures on prices, wages and costs which could develop in a country which began to float downward and the vicious spirals of inflationary expectations, higher export prices and further depreciations that could be generated. They may at least wonder whether floating rates would not provoke, rather than suppress, unemployment and controls over trade and payments. A little further thought reveals hideous difficulties for international banking and the financing of multi-national companies.

On a more philosophical level it seems to me that some form of fixed (but adjustable) exchange rate system accurately reflects the political and economic realities of the modern world. Utterly and immutably fixed rates are suitable only between areas which acknowledge a unified overall sovereignty – the states of America or the countries of the United Kingdom – certainly the countries of the European Economic Community do not seem to be yet ready for them. Individually floating rates might be suitable in terms of national interest, for countries dependent upon a very restricted range of exports or aggressively engaged in breaking their way into competitive markets. But in the world we have and even more in the world that most of us want to see – while individual nations remain sovereign, the degree to which they engage in nationalistic aggressive policies towards one another – military, political or economic – is steadily being reduced and replaced by increasingly sophisticated and far-reaching co-operation. For such a world it is appropriate that exchange rates should in general be regarded as fixed, while the possibility of making changes is retained.

No doubt it is a general recognition of the force of these arguments against complete free floating that explains the current vogue for intermediate proposals for increasing the flexibility of the Bretton Woods system while keeping its essentials. Some have argued for widening the exchange rate margins beyond the present permitted spread of one per cent on either side of parity. My own belief is that any really substantial widening of the spread would be likely to involve us in most of the disagreeable features of freely floating rates while retaining much of what is thought to be unsatisfactory in the present system. Possibly, however, a quite small widening of the spread could provide a little more elbow room and give the authorities a useful degree of flexibility in managing their exchange rates. This is a matter for technicians to thrash out, but there is certainly no need for us to be afraid to contemplate the possibility of such a change if it were generally thought to be helpful.

Another school of thought believes that appropriate exchange rate adjustments under the Bretton Woods system would be facilitated if it were possible to make frequent small changes rather than infrequent larger ones. Many ingenious proposals have been devised to allow parities to 'crawl'. The most radical would take the decision-making out of official hands by making parities depend, according to a formula, on previous movements in the exchange rate. In favour of such a scheme it is claimed that it would 'take the exchange rate out of politics' and enable appropriate

adjustments to be made in good time instead of allowing large disequilibria to build up. But it seems to me Utopian to talk of taking the exchange rate out of politics: one might just as well talk of taking tax rates out of politics. The exchange rate is an extremely important economic magnitude. Movements in it necessarily have far-reaching economic, social and political consequences. It will therefore be impossible in practice and wrong in principle to try to remove it entirely from the political arena.

Other proponents of crawling, rather more realistically, would still leave the authorities free to decide when a change of parity was desirable but would enable them to announce in advance an intention to crawl slowly up or down for a specific period. Perhaps some change in this direction would be helpful but I, for my part, have considerable doubts about this especially when it comes to crawling down.

First, although an exchange rate is indeed, as advocates of flexibility never tire of telling us, only a price, it is, as I have said, an immensely important price. Moreover the effects of a change in this price are highly unpredictable. The textbooks can easily describe situations in which an exchange rate change is not only necessary but sufficient to redress an external imbalance. The difficulty is to identify such situations in real life. In practice, we are all rather bad at forecasting the effects of economic policies. So far as exchange rate alterations are concerned, if one surveys the entire post-war period, the record is poor. Thus even under the present system, when questions arise of possible exchange rate alterations of 10%–20% there can always be a good deal of argument on both sides as to whether it would be an appropriate move. How much more difficult would it be to tell whether a 2% move would make things better or worse. I therefore find it hard to believe that it will in practice be possible to identify situations where the exchange rate is only slightly out of line and can be corrected by a crawling parity.

There are other difficulties. I see grave dangers, particularly in the case of downward movements, that the internal effects both on costs and on expectations would be in the nature of a ratchet so that each year's crawl made necessary a further crawl the following year. Moreover, I do not see how a country in this position could avoid encouraging damaging speculation that it would not be able to stop at crawling down but might resort to jumping. Indeed, it is a defect of all schemes for crawling that they cannot dispense completely with the possibility of the large step changes they are designed to avoid. Finally, interest rate policy provides a further complication in a world of crawling parities. If free gifts were not to be made to arbitrageurs it would be necessary to offset the effects of upward crawling by lower interest rates and downward crawling by higher interest rates. This pre-emption of an important aspect of general domestic policies would in my view seriously complicate the management of the economy. As I have indicated, my reservations are strongest in relation to crawling down. The reverse process, which after all would proceed from strength, may well have more to be said for it.

None of this is, of course, to say that it may not sometimes

be necessary or helpful to change an exchange rate. I simply wish to emphasise that it is a more complicated question than some appear to think. It is right, I believe, that it should be, if not of last resort, at least a measure well down the list of possible policies. It is also obvious, it seems to me, that it is overwhelmingly a matter for the country concerned, on whom the main effects will fall, to decide if and when a move is appropriate.

If I may then sum up this part of my talk, I believe the current eagerness for more flexibility and more alterations in exchange rates is somewhat facile. It reflects a confidence in the effects of exchange rate changes and an ignorance of the forces inclining governments towards stability which is rather remarkable in the light of recent history.

I turn now to a different view of what is wrong with the international monetary system: this is that it is not so much defects in the so-called adjustment process which are at the root of the trouble, but a shortage of acceptable international liquidity. This is a view with which I have much sympathy. One can look at this question in two ways, either in terms of the adequacy of a particular stock of reserves to sustain an appropriate volume of trade and payments or in terms of the increase in total reserves which will enable total surpluses throughout the world to exceed total deficits by an appropriate amount.

A number of factors will influence the volume of reserves a country wishes to hold – the volume of its trade, the extent to which it is subject to fluctuations of trade, the size of its liabilities and so on. Obviously the relationships will never be very precise. Countries, like firms or individuals, will find ways of adjusting their aspirations to their circumstances, making do with smaller reserves than they would ideally like without making corresponding adjustments in their overall payments. But there is a limit to this flexibility. If a country's reserves fall below a certain minimum it will find life increasingly uncomfortable; will become increasingly vulnerable to speculative attacks and will have by one means or another to attempt to cut back on its current payments. What is true for an individual country will be true, in similar circumstances, for all countries taken together. The figures in fact show a very striking and disturbing trend. Over the past ten years the overall ratio of total reserves to total world imports has been steadily declining from about 57% in 1958 to 40% in 1965 and 34% in 1968. If there were no further increase in reserves while world trade continued to grow as it has in the past, the ratio would reach 19% by 1975. The significance of this is brought out if we look at individual countries when we find that they are almost invariably in difficulties when their ratio of reserves to imports falls below 20%.

Another approach to the problem is to look at the implications for the rest of the world if the United States and United Kingdom were to move permanently out of deficit. Simple arithmetic then demonstrates that, unless there is quite a substantial annual increase in total reserves, either a drastic curtailment of international capital flows or a quite unacceptable continuing fall in the reserves of the present major creditor countries would be necessary.

Of course, calculations like these cannot provide precise answers to our problems. They can do no more than suggest broad orders of magnitude, but to me at least they do provide a wholly convincing case for the desirability of a significant rate of increase in total reserves from now on. The Special Drawing Rights scheme provides a mechanism for just such a steady controlled increase in liquidity. I believe we should welcome it warmly and that it will prove wise to proceed to an early activation of Special Drawing Rights.

It is not merely in providing an increase in total liquidity, however, that S.D.R.s are likely to prove helpful. Total liquidity is not, I think, a very useful concept. The composition of the world's total reserves is just as important as the total itself and lumping together different kinds of reserve assets obscures as much as it reveals. This leads me to a fourth line of criticism of the present international monetary system: that the present composition of international reserves is unsatisfactory and unstable.

Hitherto reserves have consisted primarily of gold, reserve currencies and positions in the I.M.F. The relative proportions of these assets have been changing. There was no lasting increase in official sterling balances between the end of the War and 1962. Such increase as there has been since then is of a most unsatisfactory and temporary kind, consisting of the counterpart of short-term assistance granted to the United Kingdom to finance her continuing deficit. There has been no increase in monetary gold stocks for ten years – the level in 1968 was identical with that in 1958. All the increase in owned reserves over the past decade has come in the form of dollars. Even this source has dried up recently. Moreover, much of what increase in dollar holdings has occurred in the past few years has been generated either by an increasingly unwelcome U.S. deficit or to finance an equally unwelcome U.K. deficit. There have of course been two substantial and very welcome general increases in I.M.F. quotas (by 50% in 1959 and by 25% in 1966), together with several individual special increases. But the liquidity thus provided, though performing an important function, is essentially conditional and not fully comparable with owned reserves.

Thus not merely has the growth in the quantity of reserves slowed right down, but their quality, the willingness with which they are held and the degree to which they are regarded as liquid has seriously declined. The relative supplies of reserve assets have got out of line with relative preferences for them. This is an inherently unstable situation and has led to increasing difficulties being placed in the way of conversions of one asset into another and a steady rise in the prices paid in the form of interest rates (and in the case of official sterling balances, guarantees of value) to holders of reserve currency balances.

There is no doubt in my mind that this instability of preferences among reserve assets is an important element in our troubles, quite separate from any deficiencies in the adjustment process or any shortage in total reserves. How can it best be tackled?

The best and most immediate approach will be a move

out of deficit by the United States and the United Kingdom. This will increase the desirability of the remaining dollar and sterling balances and although it will involve the destruction of some of the least wanted liquidity, I am confident that this will be made up by a sufficient creation of S.D.R.s. If we look beyond a move into surplus by the United Kingdom and abolition of the deficit of the United States, the outlook for the reserve currencies is obviously hard to forecast, but their futures are likely to be different. I should expect that there would be a world demand for a certain amount of extra official dollar balances year in year out along with S.D.R.s, and I see no reason why this desire should not be satisfied.

On the other hand, I should not expect, nor would the U.K. authorities wish to see, a secular growth in official sterling reserves. Indeed, we may well see some run-down in these balances over time. But I cannot agree with those who feel that some particular scale of run-down, or some change in the nature of official sterling balances, would be a desirable end in itself. We have, alas, many liabilities of many kinds and to many countries. The holders of these claims on the U.K., whether private or official, sterling area or non-sterling area, hold their claims for many different reasons and with different degrees of willingness. In this situation the right course is surely to concentrate on the achievement of a substantial and sustained external surplus which will enable us steadily to repay those of our liabilities – including if necessary some official sterling balances – which are least willingly held. This process will at the same time inevitably increase the willingness and stability with which the remainder of our liabilities are held. I believe that provided we play our part it will prove less difficult to achieve a stable position than many people fear. On the other hand, unless and until we play our part, there are no devices available for brushing our debts under the carpet, freezing them or making them disappear by mirrors.

I know that a number of people have devised schemes for internationalising and funding reserve currency balances either through some use of Special Drawing Rights or in other ways. Such a development may come one day. But I confess it does not strike me as particularly relevant to our present problems. Nor do the more grandiose schemes sometimes proposed in which all reserve assets, including gold, would be turned over to an international account in exchange for some new international asset. All these schemes presuppose a willingness among all the nations of the world to accept a radical change in the nature of their reserves and their liabilities without any corresponding change in the pattern of their trade and payments, their surpluses and deficits and the overall working of the adjustment process. All these approaches in short seem to me attempts not so much to solve the present instability of preferences as to ignore it and the reasons why it has developed.

The obverse of the lessened willingness in recent years to increase holdings of reserve currencies is the widespread relative preference for gold. Again it is no help to ignore this fact, or to pretend it does not exist by simply saying it is irrational, primitive, sentimental or what you will, for an

individual or a central bank to want to hold gold. The problem exists and must be squarely faced.

When the demand for something exceeds the supply, one way of restoring equilibrium is to raise its price. Some people believe this is the way to tackle the gold problem and maybe if it had been so tackled some years ago many subsequent crises would not have occurred – but that is past history. Certainly such a course has the attraction of simplicity – at least in principle, if not in practice. But most complex problems are not amenable to simple solutions and this one is no exception. A rise in the gold price would have to be completely arbitrary in amount; if it were to be big enough to prevent early speculation on a further rise it could produce more reserves than the world needs today, with perhaps far-reaching effects on inflationary pressures and the adjustment process. The distribution of benefits would be arbitrary and unfair. Perhaps most serious of all, the possibility of developing a steady, efficient, controlled source of increasing international liquidity could be set back several decades.

For there is another well-known way of restoring equilibrium when the supply of something cannot be expanded to meet the demand for it: develop a substitute. This is just what the world's governments and central banks have done in creating S.D.R.s. S.D.R.s are not simply a means of increasing total international liquidity: they are as close a substitute to one particular reserve asset – gold – as could be devised out of paper. They carry a full gold guarantee; and unlike all previous paper assets, but like gold, they have no backing, no counterpart liability. They will derive their acceptability, as gold does, simply from the fact that all countries do accept them. Of course this will not be achieved overnight. To begin with, no doubt, they will not be universally regarded as fully equivalent to gold. But time will be on their side. Over the years, given the will among all the countries of the world, full acceptance will gradually come; and provided that at the same time extra dollar balances are created in only moderate amounts, the existing relative preferences between reserve assets will gradually be met by a change in relative supply.

Advocates of a rise in the gold price and opponents of S.D.R.s are accustomed to refer to S.D.R.s contemptuously as 'paper gold'. It is true that no paper asset can as yet compete with the deeply-engrained belief, often vindicated in history, that in times of war, chaos and insurrection, gold will retain its value. Were such conditions to recur, S.D.R.s would, I am sure, lose their appeal and gold be re-enthroned. But, largely as a result of the growth of international co-operation – of which S.D.R.s themselves are an important outcome – the recurrence of those calamities under which the gold holder has traditionally triumphed is becoming steadily less likely.

Another, and major, misgiving felt by those who distrust paper gold comes from the knowledge that printed paper is only too easy to make. Each of us in our own country has seen a printing press at work. Will excesses of printing be any better avoided by an international body than they have been by national governments? I think they will be. The

checks and balances are different within the international body from those within a national political scene. Pressure groups there will be in both. But in the international body it is far less likely that the predominant pressures will be just in one direction.

It is for us all to be reasonable, that is, to be tolerably long-sighted, in our international councils. Co-operation is just one part of such reasonable conduct. We must all work to take the world further and further along this path. Patience, time, and effort by all of us will in due course turn paper gold from a term of opprobrium to one of honour.

Given at the Lord Mayor's dinner to the bankers and merchants of the City of London on 16th October 1969

. . . Our years of travail may not be over but at least there is at present much less to lament in our own performance. Indeed, we – and in particular the Chancellor – can take credit for a not inconsiderable improvement in our affairs. In the first six months of this year we have achieved a balance of payments surplus, in marked contrast to the previous year and several before it.

A big share in this improved performance came from booming invisible earnings. The City has no monopoly of invisible earnings. Indeed, such earnings from activities outside the City have risen most markedly. Furthermore, some of the significant improvement in net overseas earnings from interest, profits and dividends is, effectively, a direct result of devaluation. Even so, after all allowances have been made, a very substantial contribution has come from the earnings of City markets, banking, insurance, and other financial services. These are fields in which our competitive strength seems greater than average. These export industries need little nourishment from expensive imports and their performance so far has in no way been diminished by industrial strife. In giving publicity to the results of their work, the invisible earners are not seeking special treatment. They are seeking full recognition of their work and every proper encouragement to continue and expand it. They deserve more consideration and understanding and, as realisation grows of how much we rely on them, I hope they will get it. I am equally in favour of all possible encouragement being given to our other export industries. None of these is more important than the motor car industry which does wonders despite having to cope with many troubles both within the industry and outside it. . . .

You may recall that, when here last October, I referred to the question of the money supply, saying that ". . . when it continues to rise rather fast . . . and, above all, when it does this at a time of deficit in overseas payments . . . then I am sure we must pay attention." I do not, of course, claim that our attention to this subject originated from that remark, far from it, but certainly since then it has become a matter of increasing concern to the authorities and I believe rightly so. The concept of domestic credit expansion, or D.C.E., which concentrates on what is happening to the money supply in the context of what is happening to the balance of payments is a useful one. I would not go so far as to describe it as some wonderful new, or rediscovered instrument of policy

but I am sure we have benefited, and will continue to benefit, from paying close attention to it. So far, our performance this year has been the reverse of last; which is very satisfactory, considering our present needs. The money supply has been falling and the balance of payments has moved into surplus.

We have been greatly helped by the extraordinary situation so far as the financing of the public sector is concerned. A substantial surplus in this sector taken as a whole, and a dramatically large one in the narrower context of central government expenditure, is unprecedented. Good though this is, one cannot but regret the heavy additional taxation that has been necessary to produce such a result. As you know, year after year, I have called attention to the urgent need to do something about the other side of the account – government expenditure. I continue to be concerned on this score, but I also acclaim the courage and determination which the Chancellor and his colleagues have shown in tackling the problem and I congratulate him on the success he has achieved in keeping to the programme he set and in ensuring that the whole future of government expenditure is kept under continuous and detailed study in Whitehall. It is difficult enough to keep expenditure within its planned boundaries even for one year. To keep it within properly planned boundaries year in and year out is even harder, but no less urgent.

These developments, together with the sharp fall in the equity market in the past year and the exemption of government stocks from long-term capital gains tax, have helped to revive the gilt-edged market so that, on balance, since the beginning of June last the Bank have been able to sell very substantial quantities of government stock.

Increased yields on gilt-edged, brought about by earlier weakness of the market and accepted by the authorities as a matter of policy, have, of course, played an important part in this recovery, which might have come earlier, but for fears about possible policy changes in market management arising from D.C.E. requirements. These fears were accentuated for a time by commentators bent on getting the Government Brokersacked from his job in the belief that this would provide a better foundation for the recovery of the gilt-edged market. Indeed, it would seem that there are those who still suppose that something of the sort has happened. I think it is important to dispel any such misunderstanding. It implies that our earlier practice put market management above everything else and that more recently we have paid more attention to wider policy needs by abruptly abandoning the market to its own devices. In fact, our basic technique has been unchanged throughout, as have our basic aims. These must be to foster the long-term strength and capacity of the market so that it continues to be capable of meeting the demands that have to be placed on it by H.M. Government. This requires not only that the yields available shall be attractive, but also that large purchases and sales at something near current prices should continue to be possible without difficulty. Consequently it is not feasible for the Bank to play only an intermittent rôle in the market. Our response must be continuous, but flexible. What has been exceptional over the past year has been the scale of the

adjustments necessary in the market and thus in our tactics.

For the banks and finance houses this has been another year of oppressive ceilings imposed on their lending. The requirements of the authorities have been necessarily severe and, so far as the clearing banks are concerned, have not been entirely met. I do not underrate the difficulties nor do I suggest that the efforts made by the clearing banks have been appreciably less valiant than those made by the others. Nevertheless, I am sure the Chancellor is right in saying that the time has not yet come to ease the pressure on them.

Circumstances have changed greatly since the clearing and Scottish banks originally accepted the arrangements under which they provide medium-term credit for exports and shipbuilding at a fixed rate of interest of 5½%. This is now a markedly concessionary rate which it was not intended to be when the scheme began. I am, therefore, grateful to the banks concerned, as I know the Chancellor is also, for recently agreeing to continue these arrangements in full for a further period despite the changed circumstances.

Meanwhile, as you are aware, the Bank have approved the proposal of the clearing banks to increase their ordinary lending rates, thus altering the long-standing relationship between them and Bank rate. Undoubtedly clearing bank advances have, for some time, been unduly cheap in relation to the general pattern of interest rates prevailing and this has increased the banks' difficulties in restraining the growth of their advances. The increase in Bank rate to 8% last February did not have the hoped-for effect of reducing the disparity in rates. There seemed no good reason therefore to repeat this move, particularly when our internal situation was developing more satisfactorily and when sterling was doing well apart from intermittent and short-lived speculative pressures. There have been more than enough increases in discount rates around the world this past year to make one pause before adding to this unwelcome upward spiral.

There have been a number of other events in the banking world. The main shape of the system was pretty well established, I would judge for a good many years to come, by the great mergers of last year. These have been followed by smaller regroupings among the home and overseas banks and in the discount market, all of which I have welcomed as further contributions to strength and efficiency.

The advent of five-day banking was not so welcome, but was, I fear, inevitable. In this we have followed an example set us long ago by many countries abroad and here as there bank customers seem to have accepted the change with good grace. The banks have tried, and I hope will continue to try, to offset the loss by improvements in other aspects of their service to customers.

The clearing and Scottish banks have also decided that the time has come to be more forthcoming to their shareholders, by no longer availing themselves of the exemptions in the Companies Act from the obligation to disclose full profits and reserves. I am sure that this is a change for the better and that in practice it will show how very strong our banking system is.

Take-over bids, and the controversies associated with some of them, have again hit the headlines after a quiet

period, and the revised Code and reconstituted Panel have had their baptism of fire which they are generally regarded as having come through with honour. Sir Humphrey Mynors published his report on the first year's work of the Panel Mark I in March last. It set that work in proper perspective and showed how valuable it had been. I shall never cease to be indebted to Sir Humphrey for taking on that new and ungrateful job and for carrying the burden of it, which was far greater than could have been foreseen, almost single-handed for twelve months. With the benefit of his experience, and with his continued help, a more powerful organisation has now been created. The City, no less than I, should be exceedingly grateful that Lord Shawcross accepted my invitation to him to become non-executive – though, as it turned out, a far from inactive – chairman and that Mr. Ian Fraser agreed to become the full-time director general. The start they have made confirms my belief that a voluntary system can be run in a way that is generally acceptable.

I am not only happier with our own performance but also now with the international monetary scene. Before very long the major uncertainty which has dogged our path throughout the past year of internal progress now looks like being resolved. Admittedly, others remain, in particular the inflationary situation in the U.S.A., which some say is being brought under control, while others doubt it. An undoubted benefit will come from the activation of the S.D.R. system which will ensure a steady growth in world reserves as from the 1st January next.

The conditions of crisis or near-crisis in international monetary affairs amidst which we have lived so long have not surprisingly called into question the adequacy of the Bretton Woods system. There are those who now condemn that system root and branch and others who feel that, at least, it requires some radical modification. Those who have seen the paper, or reports of it, which I read in San Francisco last month will know that I do not belong to either of these schools. I do not believe that the Bretton Woods system is generally deficient. But this – or indeed any other system – cannot hope to run smoothly unless the two reserve currencies maintain reasonable equilibrium. In both cases this performance has been lacking in recent years and there lies the root of our troubles, which might not otherwise have been more than marginal. By all means let us reappraise the system. Some improvements may indeed be possible. I suggest, however, that we should give more time and thought to diagnosis before we too enthusiastically adopt imagined cures.

Finally, I must return to our own internal affairs. I think we would all agree that we have more than ever to gain from firmly establishing good sense in industrial relations in the U.K. One can only welcome the commitments into which the T.U.C. have entered and hope that the unions and their members will enable them to be carried out.

Better prospects abroad offer this country a real opportunity. Recent trade figures suggest that we are rising to this challenge but it is still early days and we have a long way to go. Home demand must continue to be restrained. I know that some complain that this means discouraging the

forward-looking investment upon which our future depends, but investment based on an unsustainable growth in the home market will not preserve our future. Our real need is for investment stimulated by demand from markets abroad. This investment will grow rapidly as our manufacturers grow more confident of their competitive strength, and I suggest that such confidence would not now be misplaced. Having struggled so long and being at last in sight of real success we must hold on to it resolutely in the years ahead.