Extracts from recent speeches 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 21st October 1971

On the sixth occasion on which I have had the honour of addressing this distinguished company I look back over past recent years and recall that not one of them has, to put it mildly, been uneventful. I do not complain about this – at least life has not been without interest. But naturally calmer conditions are welcome, for their own sake and because they indicate that the policies adopted have had some success. So far as the balance of payments of the United Kingdom and the position of sterling are concerned the past year has left little to be desired. Internationally the monetary picture, at any rate, has been rather different. This was the year in which the Bretton Woods system finally broke down. It did this, not in dishonour, but because after a quarter of a century the world had greatly changed, and makeshift expedients were no longer acceptable.

It must give great satisfaction to us all that as we come to the end of one era and prepare for the next, the United Kingdom is strong again and has not been backward in giving the world a lead. The Chancellor and I, less than a month ago, were in Washington at the Annual Meeting of the International Monetary Fund and of the World Bank. We and others came fresh from the meeting of the Group of Ten in London a fortnight earlier, assembled largely on the initiative of the Chancellor to consider the situation created by the announcement of the President of the United States on 15th August. We came to Washington in somewhat chastened mood prepared for another disheartening meeting. We left feeling more optimistic than earlier had seemed at all likely.

We must hope that this optimism is justified, for there are very real dangers. In a world without ground rules there must be a serious risk that no individual government will feel any overwhelming compulsion to achieve a new set of rules and that *ad hoc* decisions based on short-sighted self-interest will dominate us all. The longer this goes on, the more difficult will it be to unscramble the network of restrictions that is already growing up and the more difficult it will be to achieve a consensus for reform, until maybe a major international disaster brings us to our senses when much damage has already been done. Many people are attached to the idea of floating currencies on the broad grounds that it is the markets, not the governments and central banks of the world, which should determine the relative level of exchange rates. Even if governments were willing to allow this to occur, I do not myself believe that market forces alone will produce the appropriate structure of exchange rates, particularly in view of the weight of short-term capital movements in the integrated world of today. I further believe that the international co-operation which is essential to peace and prosperity is more easily maintained and fostered under a regime of fixed rates – with appropriate relative parities and of course on the basis that adjustments in parities can be made promptly when necessary.

However, if there are dangers in the present situation there are also opportunities. There is no doubt that the Bretton Woods system, at least in the way it was being operated and interpreted, was becoming increasingly unsatisfactory and unworkable. There could doubtless have been better circumstances in which to set about reforming the international monetary system, but it is at least a virtue of the American action that we are now all forced to take up this task.

As the Chancellor made clear in his recent speech in Washington, which was more warmly received than any I have heard at the Bank/Fund meetings in recent years, it is important not merely to secure an early return to a fixed parity system with a realistic – and I emphasise realistic – realignment of major exchange rates. We must at the same time, and as an equal priority, set about reforming the reserve base of the system. If we could reform and extend the role of the Special Drawing Rights along the lines of the proposals made by the Chancellor we should be able to regain all the advantages the Bretton Woods system offered for liberal and expansionary trade, while at the same time reducing the destabilising role so often played in the past by the traditional reserve assets, and particularly by the reserve currencies.

I believe that these brighter prospects will be enhanced by the United Kingdom joining the Common Market. The long and frustrating history of negotiation was crowned with success in the spring and the House of Commons is to give its verdict next week. I very much hope that that verdict is favourable. Obviously there will be problems and costs for this country associated with membership. Equally, however, it is clear that there will be benefits and, above all, opportunities. Men of good will can legitimately differ over the balance sheet they draw up of the costs and benefits, the opportunities and risks. However difficult such judgements may be they are an essential prelude to making up one's mind on this vitally important issue. Immediate costs are obviously easier to calculate than long-term benefits. But I am sure that the latter are infinitely the more important. We must look ahead not merely five or even ten years but fifty years or more; and we must think of the longer-run consequences for this nation not only of joining the Common Market but also those of staying out. The recent American measures and the events they have set in train surely underline the problems that will increasingly face a middle rank industrial power like the United Kingdom standing outside the world of super powers that is likely to develop in the last quarter of this century.

New changes in direction during the past twelve months have not been confined to the external sphere. For the Bank and for much of the financial community gathered here tonight, 1971 has been the year in which between us we have made new arrangements that enable the banks and the finance houses to compete effectively and the authorities to dispense with direct controls on credit.

The system which these new arrangements constitute has yet to be tested in action in adverse conditions; and there are sceptics who say that we will run back to our old ways as soon as the going gets rough. In the end these people can only be confounded by practical demonstration. This it is our firm intention to provide. Tonight, I should like to say a little about the background to our new system and hence about the strength of its foundation.

The demands that have had to be made upon monetary policy over the past decade and particularly during the very difficult years after the devaluation of 1967 have obliged the Treasury and the Bank, working together, entirely to reappraise their thought and practice in this field. In this task we were greatly assisted by many voices outside. The banking system, and the Committee of London Clearing Bankers in particular, were strongly and rightly critical of many aspects of ceiling controls. There was the vigorous monetary debate in the world of ideas occupied by professional economists, whose messages, for the most part, have been relayed to the rest of the universe by an able corps of financial journalists.

Meanwhile, certain time-honoured practices of the banking system were being critically examined elsewhere. Neither the Prices and Incomes Board nor the Monopolies Commission, in the course of enquiries into bank charges and mergers respectively, found much merit in the so-called interest rate cartel. On the contrary, they argued that however justified it might have been in the past and however convenient it might be to authority, the cartel was now no less inimical to improvement and innovation than many comparable restrictive practices in other industries. These arguments found much cogent support from individual critics and commentators. For our part, we came to accept their force and their merit – and to recognise that, sooner or later, we would have to modify our own techniques so as to prevent a move towards greater competition in banking from being frustrated by the mechanism of credit control.

On looking back, I consider that this public and official debate about monetary policy and banking practice, in which everyone concerned played a part, served much the same purpose as a full-dress public enquiry, and perhaps the better so for being less formal. Certainly it was a great help to us in our attempts to devise a new approach to credit control. It also meant that when our proposals came along this year, designed to give technical effect to the general objectives of permitting greater competition in banking while preserving effective official control over credit conditions, they were based upon something like a developed consensus. Of course we have not pleased everyone. For many of the theorists we have not gone far enough. There are probably a number of individual practical bankers here tonight who feel that from their point of view, on particular aspects, we have gone too far. In so complex a matter this would not be surprising. However, and this is the important point, I believe that a very wide range of opinion accepts that our moves have been in the right direction and, broadly, along the right lines.

Our task now must be to learn rapidly from experience with the new arrangements and, to this end, cast totally aside modes of thought rooted in the old and discarded methods. Naturally, no new system is perfect from the start and no system can remain free from obsolescence. Practical problems will assuredly arise, perhaps severe ones, but their solution must be found in the evolution of the new rather than in harking back to the old. So we must all now set to work in the new environment that we have provided for ourselves; and I do not doubt that the services provided to industry and commerce by the world of finance will be much improved as a result.

Looking more widely at developments in the economy, as I said earlier, the past year has been very different from most of its recent predecessors. We have been running a massive and unprecedented balance of payments surplus. This surplus as well as some very large inflows of short-term funds has enabled us to repay most of our outstanding external debt and add greatly to our reserves. However, I am afraid we cannot give this surplus an unreserved welcome, or take it at its face value. It reflects in large part a level of unemployment at home which is by any standards much too high, and which all of us must wish to see reduced.

The difficulty is, of course, that the unacceptable level of unemployment has been combined with an unacceptable rate of inflation. Indeed, through the mood of uncertainty and retrenchment it has induced in so many of our industrial firms over the past year, the rate of wages increases itself has done much to swell the numbers of the unemployed. The two social and economic evils are now so closely interlinked that I continue to doubt whether it will prove possible to tackle one of them satisfactorily without at the same time tackling the other.

In this context, developments in the United States may have great significance for the rest of the world. The domestic elements in the new policy President Nixon launched on 15th August constitute a simultaneous attack on unemployment and inflation, combining expansionary fiscal measures with a direct approach to incomes and prices. The first step was a purely temporary freeze on wages and prices; but this will soon be succeeded by longer-term measures whose nature and success we shall study with the closest interest.

Here in the United Kingdom, we may also be at the beginning of a new and more hopeful development. The Confederation of British Industry's initiative resulting in a pledge by nearly 200 major firms – and by a great many more smaller organisations – of moderation in price increases was an imaginative gesture and, for many individual firms in a difficult position with respect to profits and cash flow, a courageous one. This initiative undoubtedly made it possible for the Chancellor to give more stimulus to the economy in July than he might otherwise have felt was prudent, so that it has already borne some valuable fruit. But the main purpose of the initiative on prices was, of course, to secure some moderation in the rate of wage settlements. At this moment it is still too early to pronounce on whether it will have that effect. We must all hope that it does. A substantial deceleration in wage and price increases is the most important need confronting us. If we can secure it, we should be able quite soon to reach appropriately high levels of activity and growth, and at the same time maintain a satisfactory balance of payments. If, on the other hand, wage settlements do not significantly moderate, it will be impossible to maintain price restraint for very long. A combination of a continued rapid rate of inflation at home and an uncertain and restrictive climate abroad could then produce very severe consequences for employment, investment, and prosperity in this country.

Given at the British-Portuguese Chamber of Commerce in Lisbon on 22nd November 1971

. . . As a central banker, I cannot but regret the problems for trade and commerce arising from the present international monetary situation. No one looks forward more anxiously than I do to the more settled state of affairs which we all hope it will in due course be possible to achieve.

Some influential academics and journalists in the United Kingdom have persistently advocated the floating of currencies and they hope that this state of affairs will long continue with the minimum of interference by central monetary authorities. I do not share their point of view, but I can understand some of the reasons why they hold it. No one is better placed than a central banker to savour the worry and frustration caused by an international monetary system lurching from one crisis to another such as ours has done so many times over the past decade. He can see as well as anyone the constraints which such crises place on internal economic policies. He more than most would welcome being withdrawn from the front line where he feverishly watches the exchange rate and the level of external reserves day by day and wonders where he may have to try to borrow next. I have had more than my fair share of carrying the begging-bowl. It was not an experience which I yearn to repeat.

Despite these worries, which all Finance Ministers and central bank governors share at one time or another, and despite the alluring attractions which a regime of floating rates is supposed to offer, virtually everyone in official circles in all countries outside the United States, which is in rather a special position for the moment, has stressed the urgent need to return to a system of fixed parities as soon as possible. Can we all be simply blind and stupid? I doubt it. We know that a system of fixed parities can only operate satisfactorily if nations do not shrink from adjusting their exchange rates adequately and without undue delay. We know how often political considerations get in the way of these necessary adjustments and will doubtless continue to do so. But we still think it best to try again, hoping that a reform of the system and the chastening experiences of the past decade will help us to do better in the future. The floating alternative we fear because we believe that it would inevitably be associated with mounting exchange control and trade restrictions to the detriment of international commerce and to the prosperity of all countries, particularly those like Britain and Portugal whose external trade is so important to them.

Though we seek to return to a system of exchange rate parities, we do not suppose that all was well with the structure of the international monetary system as it existed until last August. Reform must go beyond the simple willingness to change parities when it is appropriate to do so. It must include a reshaping and strengthening of the powers of the international community to control the size and the composition of the world's monetary reserves. It must seek to provide uniform pressures for external adjustment on all countries, whether in surplus or in deficit, and whether or not their currency has customarily been accepted as a reserve asset.

Some of you may have wondered why in the present international monetary negotiation the other countries of the Group of Ten are insisting that the United States should contribute a small devaluation of the dollar to any agreed realignment of exchange rates. In part this is a major matter of political burden-sharing; but it should not be ignored that such a devaluation would not only be against gold but also – perhaps more important – against the S.D.R.[1] Given that all of us, including the United States, want to work towards a system in which there is less asymmetry between the position of the United States and that of other countries, it is highly desirable that the United States should demonstrate its willingness when it has the opportunity to move its rate against the numeraire of the system.

The general direction in which we would wish the system to develop was set out by the Chancellor of the Exchequer in his speech to the I.M.F. Annual Meeting in September. It envisages an increasingly central role for a neutral reserve asset – something akin to, and very probably developed from, the existing Special Drawing Rights. It would be in terms of this asset that the par values of individual currencies would be expressed. The principal source of additions to world reserves would come from internationally decided allocations of the asset. The consequence would be a decline in the part played in international reserves by national currencies – certainly a relative decline, very probably an absolute one – and also a continuing decline in the part played by gold.

An important subsidiary question in this field will be the future of sterling as a reserve currency. As you know H.M. Government said in the context of the negotiations for British entry into the Common Market that they would be prepared to envisage a gradual run-down in official sterling balances provided this was acceptable to the holders of them. This cannot be expected to happen overnight. Furthermore, irrespective of its reserve role, sterling will continue to play an important role as a trading currency, in those areas of trade which have traditionally been carried out to a large extent in sterling. Sterling bills and acceptances will, I believe, continue to be part of your daily life for many years to come.

1 Because the value of the S.D.R. is itself expressed in terms of gold.

Finally, I would like to say something about Europe. I am sure this is a subject very much in your minds and I know you must be especially concerned about Portugal's prospects. I hope you welcomed the historic decision of the House of Commons last month which means that in just over a year's time the United Kingdom together, we confidently expect, with Denmark, Norway and Eire, will be joining the European Economic Community. We shall be joining it rather late in the day and when most of the countries already in it are beset with problems, like we ourselves, which threaten their future prosperity. Such uncertainties face much of the world today. In fact, I would say that we have reached the point in our post-war history at which the easy assumption that full employment and rising prosperity are here for ever is being put to the test. I believe we can maintain them and that a more united Europe will help us to do so. Those in the United Kingdom who, like myself, favour our entry into the E.E.C. expect that this will provide us with much wider opportunities for our trade and commerce and yield increased prosperity for ourselves and Europe as a whole, thus helping it to become a strong and united force for world peace.

But why, you may say, should Portugal in particular welcome our entry? To that my answer is that, even though Portugal in common with some of our partners in E.F.T.A. may not, for very good reasons, yet be ready to join the Community herself, her future is very much bound up with the future of Europe and with its strength. I think I have already said enough to indicate my conviction that the enlargement of the Community has an essential contribution to make to the strength of Europe in the world as it will be in the closing years of this century. But even if one looks at the question from the narrower viewpoint of its effects on our two countries I think you will agree that the economic prosperity of Portugal's largest trading partner is of no little importance to Portugal herself. I therefore welcome the opportunity you have given me to reaffirm my belief that in the new era on which we are about to embark the close ties that exist between our two countries will continue and indeed be enhanced.