Speeches by the Governor of the Bank of England

Given at the annual dinner of the Cardiff Chamber of Commerce and Industry on 10 March 1978.

The toast you have entrusted to me to propose is *industry, trade and commerce,* with which I shall associate the continued success of the Cardiff Chamber of Commerce. It is a privilege to propose the toast — not least because the prosperity of industry, trade and commerce is a close concern of the Bank of England and myself. The Bank's primary responsibilities lie of course in the financial and monetary fields, but the policies we have advocated and the action we have taken in these areas have pre-eminently as their object the establishment of a sound and stable framework within which industry, trade and commerce can have the chance to prosper. The planned monetary expansion, fiscal moderation and stability for which we argue are not, as is sometimes suggested, an obstacle to growth. On the contrary they provide the indispensable basis for that steady and sustained growth on which our plans and hopes for a more prosperous society must rest.

Recent months and weeks have seen striking alterations of mood about our economic condition. These sudden swings of opinion do not strike me as sensible, or indeed as flattering to our intelligence or judgment. For underlying conditions do not change with this bewildering speed. What is surely clear is that the world — after economic disturbances over the last few years unprecedented in recent history — is finding it hard to shake off the recessionary influences which have been released. We have a new condition in which inflation and the underemployment of men and resources — once thought irreconcilable — now co-exist: the condition which a distinguished American economist has characterised as the 'great stagflation swamp'.

The underlying causes of this condition are no doubt numerous — for instance, worsening inflation in the early 1970s sharply exacerbated by the oil price rises, the breakdown of the formal structure of the international monetary system, the size and maldistribution of international payments disequilibria and so on. And as the causes are numerous, so are the immediate prescriptions for amendment of our ills. I do not propose tonight to tackle these multiple problems. I want rather to look at one particular factor which I believe is necessary to the vitality of our mixed economy. I refer to the factor of profitability.

Now talking about increasing profitability — and that is what I shall be doing — at a time when all of us are being urged or constrained to accept limitations on earnings may seem pretty hard tack. I do so because it is essential for industry, trade and commerce, which alone can provide the economic growth and increased employment which all of us, of whatever persuasion, want.

In relation to profits, appearances can easily be deceptive to the unwary or unwarned observer. The profit figures that you read about in the newspapers have— at least until very recently — shown substantial improvement. 'Company X's profits up 20%', the headlines read. The aggregate of gross trading profits in the United Kingdom — that is the sum total of the profits you see reported in the newspapers — is running at three times the average level achieved in the 1960s. Over that time the book value of the capital stock — that is to say of the plant and machinery needed to produce the ultimate goods and services that are sold — has increased by about the same amount. Profitability thus appears still as good as in the 1960s.

But that would be a misunderstanding. The profits I have just referred to — the profits reported in companies' basic accounts — do not yet make allowance for the effects of inflation. What we need to measure is real profits and real profitability, or the real rate of return on the capital stock.

The equivalence of profitability now and in the 1960s is true only on the basis of the traditional accounting conventions. In inflationary conditions, such accounting methods understate the true level of costs, and thus overstate the true level of corporate profits. Additionally, inflation means that the replacement cost of the capital stock generating the profits is higher than its book value. The measure of profitability — the percentage rate of return — is thus doubly distorted.

This view is hardly novel. It is two and a half years since the Sandilands Committee reported on the shortcomings of our conventional methods of looking at profits. There are, of course, difficulties in making appropriate allowance for inflation. But whatever the uncertainties, the adjusted figures show a trend which is, I think, beyond dispute.

In 1960, the real rate of return for industrial and commercial companies, before deducting tax, was about 13½%. In 1976, excluding profit attributable to North Sea oil, it was no more than 3½%. Last year it is likely to have been only about one percentage point higher than in 1976. In after-tax terms, the drop has been from about 10% in 1960 to probably about 3% in 1977.

An alternative way of looking at this is to think in terms of the shares of the national income going to profits on the one hand and to those in employment on the other. This again shows that profits have been taking a smaller and smaller share. Whereas twenty years ago industrial and commercial companies' profits accounted for nearly 14% of national income in real terms, they had slimmed to 8½% by 1973 and in the wake of the oil price rise dropped to only about 3½% during 1975 and 1976. Over the same period the incomes of those in employment have taken an increasing share, from about 75% twenty years ago to over 80% now.

Now it is of vital importance to analyse and agree on why real profitability matters. The discipline of seeking, and the satisfaction of achieving, adequate rates of return on investment are an essential to any efficient economic system, whether it be purely capitalist, a mixed economy like our own or, indeed, a much more planned economy. A society like ours may well have preferences about the areas of activity in which profits are earned; but if society wants an efficient economy, it has to accept profits.

Profits, if adequate, provide the incentive to invest — a businessman considering investment must compare the expected rate of return on the money invested with the cost of that money to him. Profits equally provide a test of efficiency

in the use of resources. Faced with a choice of different investments, a businessman should, other things being equal, choose that which has the highest expected rate of return. I am not arguing that this is a perfect test of efficiency; but it is a test which should not be despised, not least because it provides important guidance as to what type of product industry or commerce should be aiming to sell.

This being so, it is not hard to divine the consequences of a mere 3% rate of return after tax. If sustained for any length of time, it will weaken the will to invest. In those cases where that will persists, it will tend to starve industry of the funds for investment.

To some this line of argument may seem biased, but as I have said before and repeat in this context: 'Companies are not the enemy of the people, entrenched on the other side of some no-man's-land. Companies are bodies who organise employment and output and turn savings into productive investment. For this, companies — including those in the public sector — need profits.' [1] Higher employment and higher wages on any sustainable basis can only come with higher profitability. I need hardly remind those living in South Wales, where important parts of both the coal and steel industries are situated, that this is true not only in the private sector but also for that substantial part of our nationalised industries which produces goods in competitive conditions.

It is easier to describe the importance of higher profitability than it is to analyse why profitability has fallen so low. Quite apart from the effects of the present recession, there are other complex and hotly-debated factors at work. They relate, among other things, to our low level of productivity and to the difficulties we seem to have in many areas in producing goods, for sale both at home and abroad, which satisfy the tastes and requirements of consumers as well as those produced elsewhere. To attempt to discuss these causal factors now, or to prescribe specific remedies, would test your patience and divert me from the main message I want to leave with you tonight.

That message is simply this — that we will not find any lasting improvement in the performance of British industry until we have a much wider understanding of the importance of profits throughout our economy and society, and of rewarding adequately those who help to produce profits, whether in factory, office or boardroom.

This is a matter of national psychology not of economics. The values of a society ultimately determine what sort of society it becomes, and a society in which the search for and achievement of profits attracts approbation rather than criticism is more likely to be one which can create the wealth to satisfy both its material and non-material aspirations.

The importance of profitability needs to be appreciated by government, in business and in society at large.

Government can of course help, not least by making the effect of their actions on profitability a yardstick of policy. The concern for small businesses and the emphasis in the industrial strategy, productivity are encouraging the spread of understanding.

Business itself needs to be more alert to making the adjustments made necessary by inflation, the onset of which in the last four years has been so rapid that many firms have been misled into thinking that they were doing better than they were. And labour needs to welcome increased profitability even though this involves an increased share for profits in the national income as it grows.

What I have been trying to say this evening was well put by the Member of Parliament for Cardiff, South-East, the Prime Minister, in a speech some eighteen months ago. 'The willingness of industry to invest in new plant and machinery,' he said, 'requires not only that we overcome inflation, but that industry is left with sufficient funds and sufficient confidence to make the new investment. When I say they must have sufficient funds, I mean they must be able to earn a surplus, which is a euphemism for saying that they must make a profit. And whether you call it surplus or profit it is necessary whether we live in a socialist economy, a mixed economy or a capitalist economy.' If all of you share that belief and it is, or can become, the belief of all who work with you, then I believe the clouds will begin to lift for British business. In that spirit I ask you to rise and drink with conviction the toast I now have the pleasure to propose: 'Industry, trade and commerce, coupled with the continued success of the Cardiff Chamber of Commerce'.

Given at the annual conference of the Building Societies Association on 18 May 1978 and entitled The Building Societies in a changing financial environment.

It begins to look as though a tradition is being created that your Association should afford the Governor of the Bank of England the privilege of addressing its annual conference roughly once a decade. This gives a special opportunity to look at the way events have developed in a rather longer perspective than can normally be possible from annual conference to annual conference, and to discuss more easily the pattern of change in the financial environment.

I do not know how my predecessor Lord O'Brien felt in 1969, but I am bound to say that looking back from my seat over the past ten years it seems to have been quite a decade. To name just a few of the events which have had major effects in the banking field, we have had the move away from quantitative credit restrictions and the introduction of competition and credit control, the adoption of monetary targets, the breakdown of the Bretton Woods international monetary system and the move toward floating exchange rates, the rapid expansion of the euro-currency markets in London, fuelled in particular since 1973 by the deposits of the oil producers, not to mention the secondary banking crisis and the lifeboat: a kaleidoscope of varied fortunes, conducive to short nights and interrupted weekends.

[1] See the December 1974 issue, page 436.

In a somewhat different, and maybe less uncomfortable, way it has been quite an adventurous decade for the building society movement too. You have had your fair share of anxious moments, no doubt, but generally the most striking feature since 1969 has been your rate of growth, which has been impressive, whatever the yardstick by which it is reckoned. Shares and deposits, which represent in the main the savings of individuals, have risen from £9 billion in 1969 to £33 billion — so that they now account for about half the total identified liquid assets of the personal sector. In 1975, the total shares and deposits of the societies for the first time exceeded the sterling deposits of the London clearing banks and the gap has now grown to some £5½ billion. To grow in this way, the societies have been attracting annually new funds equivalent to almost 40% of total personal savings.

The growth in your liabilities has reflected both the growing propensity to save through a period of rapid inflation and the persistently strong demand for owner-occupation. For a long time the proportion of the housing stock that is owner-occupied has been rising; even since 1969 it has risen from 49% to some 55%. The relative size of the societies' share of this market (some 80% of all loans to housebuyers over the past decade, but over 90% in the last two years) is a feature peculiar to the United Kingdom. In the United States, where the proportion of the housing stock that is owner-occupied is some 10% higher than in this country, the main specialist lenders of housing finance provide little over half the total loans made. In Germany, where owner-occupation is relatively less important than in the United Kingdom, the institutions corresponding to building societies finance only about 40% of house purchases.

There are a variety of reasons for this trend towards owner-occupation. In part, no doubt, it results from the rapid decline — due to rent control and other legislation — of the private rented sector in our major cities. It also obviously reflects a desire for independence and, I believe, for mobility. Other powerful contributory factors must also be the tax relief available on mortgage interest payments and the absence of any charge to tax in respect of the imputed income of owner-occupiers. A further factor, which has become particularly significant during the 1970s, has been the attraction to individuals of house ownership as probably the best hedge against inflation. This attraction has been reinforced by another fiscal advantage, in the shape of exemption from capital gains tax of gains on the sale of a principal residence.

In the process of growth on such a scale, the building societies have come a further distance from their origins as local mutual societies, engaged primarily in recycling the savings of their members in order to bridge the gap between the time when a man's circumstances permitted him to save and the time when the demands on his financial resources were greatest. Something of this ethos remains in the preference which societies give to potential borrowers who already hold funds with the society. And something remains in the strong local ties of many of your societies, although these have long been transcended by the larger societies which account for the bulk of your movement's business and which have become national institutions. This achievement is one which is widely applauded, and of which you can rightly feel proud. But it has changed your movement into a significant economic force both in the scale of its operations and in the consequences of fluctuations in their level. This very success has in itself brought to the forefront an array of questions, some of which have obviously been carefully considered by you at this conference. Given your importance in the financial scene, many of these questions have a wide relevance; and it is from the point of view of the Bank of England, with their general financial responsibilities, that I wish to reflect on what seem to me some of the most significant: these are the implications of the size of your operations for monetary policy, the question of new sources of finance, competition both with the banks and among yourselves, questions relating to supervision and finally a brief word on your relations with government. I have no ready answers to the problems they raise, but I hope it may be a small contribution to the debate if I touch on some of the ways in which certain of your central preoccupations interconnect with and affect other parts of the financial system, of which your movement has become so important an element.

As a central banker my prime concern is with monetary policy, and it is natural therefore for me to focus first on the interaction of building society operations and monetary policy. There is an immediate connexion, for it is partly through the impact of changes in the cost and availability of credit on commercial construction and housing that changes in monetary conditions have their effect on the real economy. But political and social priorities in this area have led to continuing concern about the implications of any severe change in monetary conditions both for the position of owner-occupiers and for the state of the housing market. These two concerns, commonly lumped together, are substantially different and may in fact point in opposite directions — for example the interest of existing owner-occupiers is against higher mortgage rates, whereas the housing market and housing construction might on occasion be better served by higher rates if this were the alternative to mortgage famine. With the flexibility of mortgage rates constrained by such concerns, various attempts have been made to even out the flow of new mortgages, to prevent a cycle of glut and famine resulting from the stickiness of mortgage rates. Such means have included official acceptance and indeed encouragement of considerable variations in the liquidity ratios of the building societies, the 9½% interest-rate ceiling on small deposits with the banks introduced temporarily in 1973, government lending to the building societies in 1974 and lending guidelines introduced in 1975. But these are, of course, devices for meeting transitory though recurrent problems, and I would like to turn now to what I see as a longer-term development in monetary management which has implications for the building societies and for the housing market.

The conduct of monetary policy has moved a long way from the Radcliffe days of the late 1950s and indeed from our approach of less than a decade ago when my predecessor addressed this Association. Whereas the main emphasis in the late 1950s and much of the 1960s was on the rate of interest, the combination of developments in academic analysis and in influential opinion with the harsh reality of persistently high rates of inflation caused us to switch our focus to monetary aggregates as the better guide to the thrust of policy, and we now of course have a declared policy objective in terms of the growth of monetary aggregates. This implies a more adaptive rôle for interest rates than was appropriate when they were themselves regarded as the proximate objective of monetary policy. I would certainly not want to suggest that the range of

interest-rate fluctuations we have seen since the second half of 1976 will prove typical of what is needed to secure reasonable stability in the growth of monetary aggregates. But we have to accept the likelihood that achievement of these declared monetary objectives may well continue to require greater interest-rate flexibility than was the pattern in the 1950s and 1960s. This may call for some reconsideration of conventional attitudes to the adjustment of building society rates.

Perhaps I may turn now from interest rates to the choice of the aggregate in terms of which the objective of monetary policy is declared. The view that monetary aggregates matter does not in itself imply the choice of any particular aggregate. On balance, at the present time and given the present state of our financial technology, I judge that sterling M_3 is the right one to choose, but this certainly should not and indeed does not exclude our keeping a close eye on the development of other monetary aggregates such as M_1, narrow money, or a wider monetary aggregate, which might amount to M_3 plus other liquid holdings including building society deposits. Just as there is argument for focus on M_1, largely on the ground that the relationship between narrow money and short-term interest rates has tended to be relatively stable, so there is argument for broadening the focus to a wider monetary aggregate on the basis that money deposited with the building societies is similar to deposits with the banking system. No doubt there is some tendency to exaggerate the extent to which deposits with building societies have become more akin to deposits with banks, but they are more alike than they were: and in assessing the prospective development of money, we need to keep in mind the possibility that a change in interest-rate relationships can quite quickly cause a sizable shift of deposits from the building societies to the banks, or vice versa, which can frequently boost or depress the money supply defined as sterling M_3.

But monetary policy requires us at times to look at the type of lending undertaken as well as the aggregate of deposits. The building societies lend predominantly to a specialised market in which the banks are hardly engaged save as providers of bridging finance. And this traditional demarcation has justified a difference of treatment by the authorities in respect of guidance or other official influence on lending. However, the greater the breaking down of this demarcation as a result of ventures into house lending by the banks or increased use of loans from building societies to finance purchases other than of houses, the stronger the case would be for treating building societies and banks similarly for monetary policy purposes.

Before leaving monetary considerations, I think it relevant to flag the question whether the weight of finance directed toward the housing market has increased the cost of industrial borrowing. The question is a very difficult one. I do not propose to try to answer it now, nor would I wish to suggest that if such crowding out were to occur, responsibility would lie with the building societies. But while I have no doubt that the preferential treatment of housing is justified as a matter of social priority, we must also in the period ahead have regard to the claims of industry, services and the Government themselves on the same overall pool of funds, especially as the switch to owner-occupation envisaged in the Housing Green Paper proceeds.

The execution of monetary policy relies importantly on the control and movement of short-term rates of interest. This is the area where societies are sensitive to competing interest rates. For it is a striking fact that in this country nearly all lending for house purchases, while itself medium or long-term, is financed by what are technically short-term deposits. This comes about, of course, because your movement accounts for such a high proportion of all the house purchase finance provided, and because the societies' assets are financed as to almost 90% by shares and deposits, representing personal savings withdrawable at short notice. Such financing is unusual in comparison with practice in many other countries. In Germany, for example, mortgage banks can and do obtain finance by long-term borrowing; and in both Germany and in the United States liquidity is provided to the system by the well-developed secondary markets for mortgage debt.

Your movement is based on what your President described in a recent debate in the House of Lords as 'the delicate premise that you borrow short and lend long.' In my judgment you have some very effective protection against the apparent risks. As with the banks, experience justifies you in treating a substantial proportion of your notionally short-term deposits as hardcore and, in practice, long-term. The diversity and fragmentation of both the sources of your funds, in the shape of deposits from myriads of small savers, and the uses to which they are put, in the form of a multiplicity of small mortgages, is a powerful bastion against a bad debt leading to a loss of confidence on the part of depositors. Furthermore, despite the nominally long maturity of your assets, there is a constant flow of repayments through amortisation and the fact that mortgages are on average repaid after only about one third of their full term. More importantly you have substantial holdings of liquid assets which act as a buffer against sudden withdrawals of deposits because of unfavourable interest-rate changes, and those have over the past few years been consciously allowed to grow as 'stabilisation funds'. Finally, you have the power to vary mortgage rates.

Nevertheless, you need no reminding that there have been famines in the supply of your funds from time to time, and since for the reasons I have already discussed it is deemed undesirable that the volume of funds available for use in the housing markets should fluctuate sharply, it has been suggested that you should seek to diversify your sources of finance. The Housing Green Paper made two specific suggestions which I am sure you have under consideration. As regards the proposition that you should tap long-term money from institutions, the problem for you, as for others who would like long-term money, is its availability in a period of inflation at a price it seems prudent to pay. I know also that you have a concern that if economic circumstances dictate that your cost of funds must increase then it is your traditional investors who should reap the benefit, and your inclination might therefore be to increase the rates you pay them rather than to seek expensive long-term money. Nevertheless, I believe that there may be a case for looking at the introduction into your balance sheets of some small portion of longer-term money at some future date.

The second suggestion was that you should look to the wholesale money markets to cover any marginal outflow of funds induced by changes in interest rates. The logic of this would be that you would simply be recapturing the deposits you had lost, since it is to the wholesale money markets that they apparently go. On the other hand when such deposits do go, the wholesale markets are likely to be expensive. So the circumstances in which you might follow one route or the other would be rather different. For my part, I think it might well be

prudent to keep in mind the possibilities of diversifying your sources of funds by both routes as possible ways of coping with temporary outflows of funds at times when it is considered undesirable to move all your rates, even if there is no pressing need to do so as long as the propensity to save remains as high as it is.

These questions of possible alternative sources of funds bring us to the heart of the question of competition. In competing for personal savings you have had considerable success, thanks I am sure to the fact that you offer an attractive package of service, not least in respect of your opening hours, an often favourable return on funds, combined with a well-justified reputation for security. Success often brings attendant problems, not least criticism from competitors. Since recently the attention not only of Fleet Street but also of the television cameras has been focused on you, there can be few who are unaware either of the clearing banks' view that the building societies enjoy certain tax and other privileges which give them an unfair advantage, or of your vigorous riposte to the charge. Now it is not my present purpose to set myself up as arbitrator in this matter. It is more appropriate, in my judgment, for the clearing banks and the building societies to establish, so far as they can in mutual discussion, agreement on what is — or would be — fair competition. I think I am revealing no secrets if I say that this process has already begun. A meeting took place last week at the Bank which I understand was felt by all parties to be useful and which is likely to be repeated from time to time. This must be right. I would simply make one or two general points.

First, as I indicated at the beginning, one of the strengths of the building societies is that they are lending in a market which is uniquely favoured because interest on house purchase loans is allowable against tax, while it is generally not allowable in respect of other personal borrowing. By reducing the post-tax cost of mortgages, this increases the demand for them, and in consequence it also increases the volume of the building societies' business and the amount they can pay for money deposited with them. But the concession is, of course, available to housebuyers generally, regardless of who lends to them and cannot be cited as a privilege exclusive to building societies.

It is also argued that the societies receive an unfair advantage in the operation of the composite tax rate system. That this arrangement enables building societies to quote a rate which can be grossed up at the basic rate of tax to look perhaps ½% to ¾% higher than their money actually costs them, and that there is a benefit in this for the basic rate taxpayer at the expense of those paying no tax at all, is of course true. But I do not think that the banks seek to argue that the composite rate system is a decisive advantage in itself. Moreover, as you have pointed out, the Inland Revenue collects the same tax as it would have received much more laboriously if each of your shareholders had been assessed individually, and in my judgment it would be foolish to do away with so sensible an administrative simplification without very good reason indeed.

The burden of the banks' case is that there are a number of inequalities in the manner in which they are treated fiscally, prudentially and in terms of monetary control compared not only with building societies but with other financial institutions. And I think that they might attach more significance to the inequalities in terms of monetary and prudential control than to the effects of fiscal advantages.

The controls to which you are subject are dictated by the specialised nature of your business and the overall social and political considerations of housing policy. The controls to which the banks are subject are a combination of monetary and prudential controls. To suggest that building societies should be subject to similar controls as banks and finance houses is therefore to revert to the central issue to which I have already alluded, namely the extent to which the housing sector is by reason of its social priority treated differently from others.

The other main aspect of competition is internal competition amongst societies themselves. As I see it, this is determined by the recommended rate agreement, in combination now with the guideline system. In most industrial or service sectors we might wonder whether such a system would not discourage efficiency and innovation and perhaps encourage competition of the wrong sort, for example in an unnecessary expenditure on outlets or branches.

It is, I think, difficult to judge whether this has happened in your case. It is a matter of record that the number of building society branches has doubled since 1969, but there have, of course, been more mortgages to service and more money to gather in. The number of share and deposit accounts has more than doubled, and the number of mortgage advances increased by about one third. Your very success in these spheres must be an important part of the defence against doubts about efficiency. No doubt those branches earn their keep but it is not altogether surprising that outsiders sometimes wonder about the extent to which some of them do so only because the margin between borrowing and lending rates is fixed under present arrangements to ensure such an outcome.

Such scepticism is bound to arise in situations where the traditional objective test of efficiency — profit — is absent or in some way trammelled. It is therefore, I believe, important that careful consideration be given to the question whether alternative arrangements might not have beneficial effects. It has been argued, for example, that if the fixing of borrowing and lending rates according to their own best judgment were to rest more firmly with the directors of each building society there would be found some scope for cutting costs and margins, with resulting benefits to the successful society and to both its investors and its borrowers.

In considering such a substantial change, however, it would be essential to think through the consequences thoroughly. Some would argue that the cost of mortgages would rise. This might be so, although whether temporarily while adjustments were taking place, or permanently might very much depend on the extent to which competition was genuinely unfettered.

Also, it is likely that keener competition would lead to amalgamations among societies, and these might well be desirable in some cases in any event — even though they may be difficult to achieve. The difficulties seem to stem not so much from the statutory procedure whereby a merger has to be approved, since the most onerous provisions can be waived by the Chief Registrar of Friendly Societies, but rather to the inhibitions societies themselves have against mergers because of the resulting loss of identity by one of the parties. What this points to is the need particularly to encourage mergers which would improve efficiency without losing the very valuable ingredients of flexibility and grass-roots contact that local societies are able to provide.

Increased competition within the movement, and indeed other possible changes adumbrated earlier, might well lead to fears of imprudent practices creeping in. Imprudence tends to be an unwelcome risk of freedom and innovation. The answer is not, in my judgment, to stifle freedom and innovation, but to ensure that supervisory arrangements are constantly examined for their adequacy and relevance.

In this connexion I noted with interest that your movement was recently urged by the Chief Registrar of Friendly Societies to set up a compensation fund in order to enhance and reinforce the reassurance the public has long come to expect from the movement, in the wake of an isolated instance of malfeasance in one of your member societies. I have no doubt that this is right, and as you will be aware a deposit protection scheme is an essential part of the proposed legislation relating to banks and deposit-taking institutions. I would suggest, however, that deposit protection schemes or compensation funds serve only as a valuable reassurance to depositors: they do not of themselves help to detect or, more importantly, to avoid situations which would call them into operation.

For the prevention of trouble arising through either malfeasance or imprudence there are really three major lines of defence. The main one rests with directors and management themselves, for they it is who bear the prime responsibility in a building society as in any other business. This I must stress. The second is that of the independent audit, for which there is already statutory provision. Very considerable responsibility is thereby placed on the shoulders of the accountants who undertake these audits. I need hardly underline in present circumstances how much may turn on the conscientiousness and effectiveness of their efforts, and I welcome the training courses on the auditing of building society accounts which have been arranged by the Institute of Chartered Accountants in England and Wales. But the potential effectiveness of the safeguard of the independent audit depends not only on the auditor himself, but on the internal accounting system which he has to audit, which brings us straight back to the conscientious and effective discharge of their duties by directors, on whom the Building Societies Act places responsibility for the accounting system. I am glad to hear that this Association runs training courses covering this and other aspects of directors' responsibilities. If I may echo the recent words of the Chief Registrar, any director of a building society who has any doubts as to the accounting standards that are being maintained has a clear duty either to see that a better system is instituted forthwith or to seek out an appropriate merger with another society where proper standards are maintained.

The final defence is the supervisory system itself. This means that adequate and appropriate resources must be available not only for the task in hand, but also to anticipate future tasks that may arise. Any future extension of your movement into Europe, a prospect to which Lord Selkirk alluded in the House of Lords recently, would only serve to reinforce this need.

I come finally to the relations of your movement with government. The prophecy of Lord O'Brien in 1969 that developments then apparent might 'have the effect of drawing you increasingly into the ambit of the official machine' has been fully justified, for there can be no doubt that over the years since then your relationship with the Government has become much closer than it was.

Now there is nothing wrong or surprising about the development of regular consultation between yourselves and government departments. Given the size and importance of the building society movement it would indeed be surprising if you were not in frequent contact with government officials. I might add in passing that your relationship with the Bank has also become closer over recent years and I very much welcome that. But your relations with what are known as 'the authorities' have, perhaps naturally enough, been built upon and reinforced the institutional structure and practices which were already in existence, because at times government or the societies have felt the need rather for urgent consultations than for a considered examination of the most sensible basis on which the developing relationship should be founded. It would no doubt be necessary to reconsider how your relationships with government should develop alongside any possible developments in your own structure. If, for example, there were to be moves towards greater competition between building societies, alternative arrangements would probably be necessary to achieve the objective of the Joint Advisory Committee, which I am sure that we all consider desirable, namely that the volume of building society lending should be a stabilising, rather than a destabilising, influence in the housing market.

My Lord President, I have finished my tour of your domain, which has not been made in the spirit of a trespasser. Your movement's very success has inevitably brought it close to the centre of a far larger stage than that envisaged by its founders, where your actions cannot fail to affect significantly others playing upon it. In these circumstances the questions I have raised are bound to be posed, the more so perhaps because your arrival at the centre of the stage has been to some extent rather sudden and until recently not widely noticed — either by yourselves or by those already there. Since you manifestly are not going to retire to the wings, the task becomes one of seeing how best to integrate you with the other players in a play which must proceed largely by improvisation. Since building societies are now major financial institutions, I am bound to concern myself with the outcome.

I have not attempted to suggest solutions, but rather to point to a few possibilities and to a few interconnexions. These interconnexions are important, for they show where interests may conflict and have to be reconciled. What seems to me important is to work through all the interconnexions so that the problems are not answered singly and without consideration for the consequences of the solutions proposed.