Speech by the Governor of the Bank of England

Given at the annual banquet of the Overseas Bankers Club, on 6 February 1978.

I am happy to be here tonight and rising next after Mr Roy Jenkins, so that I can say how much we have all admired the eloquent and masterly way he has treated his great theme.

I do not wish to duplicate or dispute his analysis of the shortcomings of the present international monetary system—what I described here two years ago as 'Not so much an international system: more a set of international arrangements'—but I should nevertheless like to complement his remarks on one or two points.

It is clear that for the world economy there is a long struggle ahead. The future prosperity of us all depends on finding and implementing solutions to the severe world-wide problems which face us.

The problems themselves are familiar enough: what is less familiar is their persistence and intractability. Thus inflation, despite its welcome moderation, not least in the United Kingdom, remains stubbornly and dangerously high, and its effects, made more potent by apprehensions of possible resurgence, continue to sap confidence. At the same time—except in the United States—increases in output remain well below potential rates of growth and continue to disappoint earlier expectations; and unemployment in the OECD countries, now at over sixteen million, is more than one million higher than a year ago. In international payments, against the background of the continuing surpluses of the oil-producing countries, the polarisation between the United States on the one hand and Japan and the strong surplus countries in Europe on the other has—as witness the violent movements in exchange rates—added to the world's difficulties.

These are not circumstances in which it is surprising that confidence should be slow to return. They suggest rather a climate in which businessmen and consumers alike remain cautious in committing themselves to spend and in which protectionism can find a friendly soil.

If we are to emerge from this malaise, we must try first to understand its causes. No doubt they are many and complex. I single out two whose impact has been particularly acute: the world-wide inflationary expansion of the early 1970s and the spectacular increase in oil prices in 1973. These developments, themselves linked, necessitated adjustments throughout the world which most countries have found so painful and difficult that the process is still far from complete.

The shift in the terms of trade of all commodities, but particularly oil, experienced in 1973 and 1974 indirectly gave an added impetus to already entrenched inflationary forces.

At the same time, and as has been widely agreed, the existence of the unrequited surpluses of the oil-exporting countries imply, for as long as they persist, a similar aggregate deficit in the rest of the world. It is unfortunately, however, a long step from an abstract acceptance of this general truth to a co-ordinated acceptance of its implications country by country.

What has happened in practice of course is that the aggregate deficit has been distributed between countries in an unsatisfactory way: the claims of individual countries have tended to come into conflict, and the world as a whole has not been able fully to offset the deflationary effect on demand of the oil surpluses.

The caution which individual governments have felt to be imposed on them by balance of payments constraints has been reinforced by a general tendency towards restrictive monetary and fiscal policies to combat inflation. This tendency has, in my view, been right. Had the major countries of the world not tightened policies in the face of the accelerating inflation that occurred in the early 1970s, the world would be in worse case today than it is.

For my part I should not want to belittle the achievement of navigating the stretch of water which the world has been through. But severe economic, and in some cases political, problems persist or are emerging and call for attention.

If we are to meet them successfully, we shall have to rest importantly on co-operation between the three main centres of economic power: the United States, Japan and the European Community. The lesser industrial countries and the developing world, though taking much of the brunt of the present inflationary recession, can themselves do little about it, either individually or in concert.

In the case of the United States recent comment has focused more on the deficit and the dollar and less on the strength of the US economy and its climb out of recession. I imagine we can agree that the deficit is not in itself bad news for the rest of the world. Since the industrial countries as a group are bound to run a large deficit, it is desirable that the stronger ones among them should incur their full share. Less welcome was that much of the deterioration in the US balance of payments last year represented increased payments for oil.

President Carter has shown his awareness of this problem by his commitment to the passage of a major energy bill. We must all wish him speedy success.

Apart from energy, most of the remaining deterioration in the US balance of payments can, I believe, be explained by the timing and strength of the recovery in the United States compared with elsewhere. None of us, I think, would want this gap closed by a slowdown in the rate of expansion in the United States. The Administration's policy of aiming for reasonable non-inflationary domestic growth is a vital element in alleviating the world recession.

There remains, however, the recent weakness of the dollar which has been a cause of widespread concern. As the major international reserve asset for both official and private holders, this is inimical to stability in the widest possible sense.

I welcome therefore the recent expressions of official US concern and in particular the announced readiness to intervene in the exchange markets as appropriate. The longer-run strategy outlined in President Carter's recent public statements is also important—a strategy aimed not only at conserving energy but at combating inflation, stimulating business investment and maintaining growth. But I agree with Mr Jenkins that, if greater stability is to be achieved, we cannot expect the United States to carry the whole burden on its own.

I turn then to Japan, on which much has been written and said. I shall add little. It is of course plain that the problems raised both for the world and for themselves by the huge Japanese payments surplus and by a domestic rate of growth below their enviably high potential are formidable. But the Japanese authorities have now, I suspect, come to realise their scale, and the need to take action to solve them. In the United Kingdom we have long struggled with the mirror image of their problem and we can therefore well understand the magnitude of the restructuring changes involved. While such changes are being effected it will be helpful if Japan can continue to step up capital exports, both public and private, to the weaker countries where they are needed.

Finally, I come home to the European Community, of whose rôle and potential Mr Jenkins has spoken so eloquently tonight. What contribution can we make towards solving the world's economic problems—and our own? For the Community has two responsibilities, one to itself, the other to the rest of the world.

In respect of the first, it would be unreasonable not to recognise the improvements we have seen, both in inflation and in better external balance. But it remains the case that the economic health of the Community is not good. Inflation is still much too high in most member countries, overall growth too slow and there remain six million people unemployed. There is much to be done here, but great difficulties for each of our countries, however strong, acting in isolation. Those of us who are structurally dependent on exports will, in the present state of the world's markets for their exports, find it difficult (as Japan does) to produce the necessary stimulus to non-inflationary growth in the short run. Those of us in a weaker position, either because of a still excessive inflation rate or because of a balance of payments constraint, must necessarily be cautious in providing stimulus to demand.

Taking the countries of the European Community together, however, a different picture emerges. Over half of all the member countries' exports go to their partners; and the Community as a whole is in net balance of payments surplus with the outside world.

It is, of course, the perception of the vastly greater strength of the European Community as a whole as against the strength of its individual parts which underlies the case which Mr Jenkins has, tonight and elsewhere, so powerfully argued for European economic and monetary union. For my part, I welcome his desire to reopen the debate at the strategic level and see no reason why it should be thought inconsistent with the smaller pragmatic steps which can continue to be taken as occasion offers.

Meanwhile we must operate in the existing environment, in which, as I have said, member states are already highly interdependent. Can we not, in this situation, concert policies for non-inflationary expansion so that the result can be greater than the sum of isolated moves?

Great care would, of course, be necessary to ensure that concerted growth was not inflationary. But in the present conjuncture, the risks of exacerbating inflation may not all lie in one direction. The spiral of protectionism that continued stagnation might bring would include the danger of an acceleration of inflation among its other untoward effects.

Such self-interested action aimed at sustainable non-inflationary growth would help the Community meet its wider responsibilities to the rest of the world, most importantly perhaps by helping to stabilise the dollar and exchange rates generally. The balance of payments problems of the smaller countries too would be somewhat alleviated, though while the OPEC surpluses last, one can hardly look for their removal. This points to the need for a continuation of—and indeed growth in—long-term exports of capital, where the record of EEC members is already not negligible.

What I have argued tonight—and what Mr Jenkins and his fellow Commissioners are in my view rightly stressing—is that the problems facing both the world as a whole and the economies of the Nine will not be resolved until concerted efforts—and I have to add more determined ones than have hitherto been the case—are made to tackle them.

The essential question is how best to achieve these concerted efforts. I myself do not believe that there is any single (or multiple) procedure or any set of rules which is likely of itself to lead to the desired results. What is required is a commonly-perceived sense of the economic problems we face and for this to be translated into co-ordinated action. The President and the Commission are seeking to act as the catalyst for encouraging this common perception. I wish them well.