

Reflections on the role of the institutions in financing industry

Lecture by the Governor⁽¹⁾

The Governor sees the most important contribution of the Wilson Committee as scotching the impression of a financing gap and questions whether any worthwhile investment would follow from effectively forcefeeding industry with funds from a National Investment Bank funded by the institutions. The major problem in this country is that the rate of return on investment is too low.

The Governor makes the following among many other points:

- *The banks have stepped into the breach left by the debenture market.*
- *Present conditions make it especially desirable for banks to be well and regularly informed about the business of their customers.*
- *The responsibility of the institutions must remain to their shareholders and policy-makers, or pension contributors and pensioners: but the time has passed when the institutions can avoid closer involvement with the companies whose shares they hold.*
- *Discussion of a government-backed loan guarantee scheme for small companies is to be welcomed, though the need is uncertain.*
- *It is hard to believe that the provision of finance by a new institution such as that advocated by the TUC would result in more productive investment or a better allocation of investment as between different industries or different projects.*

Introduction

The Stockton Lectures have already in their short life earned an enviable reputation and it is a privilege to be invited to give the first in the 1981 series. This year's series is devoted to the Wilson Report.⁽²⁾ But that gives little clue to the precise subject matter of any individual lecture—a testimony to the wide ground covered by the report and the catholicity of its approach. The Wilson Committee was appointed four years ago to examine the role and functioning of financial institutions and their value to the economy—terms of reference more specific than those assigned some twenty years earlier to the Radcliffe Committee, which inquired into the workings of the money and credit system. But the deliberations of the Wilson Committee coincided with an exceptionally difficult phase for the development of the UK economy, and a phase of intense debate about economic and financial relationships within it. This was bound to complicate the task of Sir Harold Wilson and his colleagues; and we are indebted to them, and to those who contributed to the impressive array of evidence that was presented, much of it original and of enduring value.

In considering the report and its supporting evidence, one can only be selective. I propose, in the time that has been allotted to me, to address three main areas. I start with the

economic context, which dominates how our financial institutions operate. Then I shall consider the links between our financial institutions and industry, and the scope for increasing their effectiveness. I turn then finally to one of the issues which divided the Wilson Committee, the suggestions by half of its membership for some form of new investment facility.

Economic framework

The Wilson inquiry was set up in part because of the contention some have voiced that our financial institutions and the priorities that they adopt are not as helpful to British industry as they might be. Alongside this, there have been specific strands of criticism: for example, that if our banks devoted less of their energies to the development of their international business and concentrated more of them at home; that if they were more closely influenced by government, as perhaps in France; or controlled industry, as is alleged happens in West Germany; or lent long term, as in Japan; or if they and also our long-term investing institutions were prepared to take more and greater risks, then our economic efficiency and performance would come closer to that in these other countries.

You will hardly be surprised that my general view is that the ability of financial engineering to transform economies

(1) First 1981 Stockton Lecture, delivered at the London Business School on 22 January 1981.

(2) *Report of the Committee to Review the Functioning of Financial Institutions*, Cmnd. 7937, HM Stationery Office: 1980.

is nothing like as great as such criticisms tend to suggest. Comparisons with institutional attitudes and practice elsewhere are frequently over-simplified and misleading. For the total context—social, economic and political—in which both industry and financial institutions operate is what counts. Financial arrangements in other countries, lifted out of their national context, can be made to appear seductively attractive, while good features of our own arrangements are overlooked. The grass commonly looks greener elsewhere. Yet it is in centres whose practices we are invited to emulate that one hears some of the more complimentary remarks about the range and depth of services of the City of London. Nevertheless, we should certainly be ready to learn any worthwhile lessons from the way other countries finance their business and to investigate allegations that there are deficiencies in our own arrangements.

Among the essential services to the community which the financial institutions perform are, it has to be remembered, the transformation of maturities, the pooling of risks and the conversion of present income into claims on the future. These three functions broadly apply respectively to the banks, the insurance companies and the pension funds. All financial intermediaries receive funds, which in turn they invest in assets in order to provide income and capital growth; and such assets include major holdings in productive industry. But the effective use of the capital stock of industry, and the decision to raise funds to add to that stock, depend not on the financial institutions, but on industry; on the borrower not the lender; and on the rate of return which the borrower can secure from the productive use of the assets acquired with the funds he has borrowed. In the modern world, rates of return, though subject to very great risks, remain fundamental both to the willingness to borrow, and to the viability of the enterprise once funds have been borrowed; and whether the enterprise will borrow to invest depends on the rate of return that it expects to be able to generate from the use of capital, and on the effective cost of capital available to it.

Investment therefore depends first on the extent to which our economic and social environment enables industry to get an adequate real rate of return, and secondly on there being no shortage of funds for ventures which satisfy that test, due allowance having been made for risk. It is in this first area, the rate of return, that the major problem in this country seems to lie. The Wilson Committee cites a study undertaken for the OECD by Professor Hill,⁽¹⁾ which suggests that real pre-tax rates of return on manufacturing are lower in the United Kingdom than elsewhere, and shows that they have fallen faster here. More recent figures from the same project suggest that manufacturing profitability in the United States declined only modestly—by some five percentage points between the late 1950s and the period 1976–78; but in the United Kingdom over the same period, it declined by some twelve percentage points—to a pre-tax real rate of return in manufacturing of

only 5%. The erosion of profitability in German manufacturing industry appears to have been sharper than in the United States, though the decline was by no means as steep as in the United Kingdom—nor to so low a level.

These disparities in rates of return are of course indicative of deeper causes, and comprise only one element, albeit important, in the different economic performance in different countries. We cannot fail to observe that the United States also comes out low in the international league table of economic growth rates. May not this more persuasively be related to the fact, not that we have similar financial systems, but that we have similar shares of employee compensation in domestic income? Thus OECD figures for the 1970s reveal that the share of labour in domestic income in the United Kingdom and the United States was close to 80%, as against a share not much above 70% in West Germany and around 65% in Japan.

Longer-term improvement in the economic performance of the United Kingdom requires, among other things, an increase in the proportion of resources devoted to investment. I do not minimise the difficulties of bringing this about, given the extent of world recession. But a task which lies to hand is the need to improve the efficiency with which our existing capital stock is used; and much in fact is now being done under the pressure of events. There can be no doubt that, over a longer period, the expectation of continuing low rates of return has had a discouraging effect on new investment in manufacturing industry. Its effect on the demand for capital to invest is at least as important as the supply and cost of capital. The Wilson Committee recognised in their conclusions that real investment in the United Kingdom has not generally been constrained by shortages in the supply of external finance.

Nevertheless, one may still ask whether there are ways in which closer relationships between financial institutions and industrial managements would help. Does our experience with the financing of North Sea oil—a subject to which the Wilson Committee turned its attention at an early stage—contain a lesson from which we can learn?

Experience suggests that where there is confidence that an enterprise will be profitable, shortage of finance is not a difficulty. But may there not be situations, perhaps those involving high risk or substantial sums, in which a close association between those who invest financially and those who make the physical investment could be of particular value and importance? This would not require new institutions. What it would require is mutual confidence and understanding, and readiness on the part of financial institutions to become positively involved with engineers and managers at an early stage in the gestation of projects and to develop long-term arrangements for association with, and continuing support of, such projects when they are under way. Might this not be of particular value in areas

(1) T P Hill. *Profits and rates of return* (Paris: OECD, 1979).

of new technology, especially where the translation of ideas into competitive production requires large capital sums, sometimes with a low early yield but with a rich promise if the enterprise is successful?

This type of approach was outstandingly successful in the financing of North Sea oil development, which saw the creation of new companies and associations combining the entrepreneurial activity of both financial institutions and industry. North Sea development was a risky business; those who invested hoped for a high rate of return—a hope which might have been disappointed if oil prices had not risen as much as they have.

I turn now to a separate line of criticism of our financial arrangements, namely that even where rates of return in the United Kingdom are as high as rates of return elsewhere, the maximum gearing ratios acceptable to the financial community are so much lower in the United Kingdom. It is not in dispute that gearing ratios are different; but the proposition that lower gearing ratios here starve British business of funds, and act as a material constraint on expansion, is hard to square with the fact that industrial customers do not make full use of facilities available to them. The utilisation of bank facilities to industrial customers is on average rarely much more than half. Bank facilities are of course intended to leave a margin for contingencies and would not normally be fully drawn; but the extent of unused facilities available to British business borrowers hardly suggests that a serious overall gearing constraint is imposed on them. Small firms probably make greater use of their bank facilities than the average; but, equally, smaller firms are typically more highly geared. Thus while debt to equity ratios above one to one are unusual in normal conditions among firms listed on the Stock Exchange, they are common enough among the banks' smaller business customers.

Since 1974 the capital gearing of our industrial and commercial companies has tended to fall. But this does not indicate that financial institutions have been deliberately tightening up, reducing the maximum debt to equity ratios that are acceptable to them. The reason, I suggest, lies entirely elsewhere—above all in the rise in the burden of companies' debt interest and the sharp decline in their profitability. In the second half of 1980, the income gearing of industrial and commercial companies probably exceeded the 1974 peak of 40%, and since then company borrowing from the banks has increased and operating margins have remained depressed. The recent fall in short-term interest rates may therefore have done no more than prevent a further rise in income gearing. Because cash pressures rather than weakened profitability are frequently the proximate cause of corporate insolvency, it is scarcely surprising that company boards, their financial management and their bankers are paying particularly close attention to income gearing in present circumstances.

Although an appreciably higher capital gearing would appear feasible for many companies, and indeed reasonable

on balance sheet grounds, this would risk placing undue strain on cash resources, unless the assets purchased with the additional borrowed funds generated a particularly rapid cash flow. This underlines an important, if obvious, conclusion—that the braking effect of low real rates of return is increased the higher the nominal cost of debt service.

This seems a convenient point to refer to the cost of capital. The real cost of capital to industrial and commercial companies in the United Kingdom appears not to have changed materially over the last two decades. For the cost of raising capital depends not only on interest rates, which have fluctuated considerably in both nominal and real terms, but on the market valuation of the equity interest, which has tended to be high in relation to companies' current earnings. To the extent, therefore, that financial factors affecting the pace of investment have become more of a problem over this period, it would seem more appropriate to focus on those contributing to the fall in profitability than on those bearing on the cost of capital.

It is relevant to recognise here the extent to which the effective cost of capital to British industry is reduced by the Exchequer. Total Exchequer support to British industry in the widest sense, including capital allowances, interest relief and regional grants, is considerable and probably no smaller proportionately than that provided by the state in many other countries. In this country it goes along with subvention of the housing market on a scale broadly comparable with the support given to industry, in particular through public sector housing subsidies and the combination of mortgage interest relief with the exemption from tax of the benefits of owner occupation. This is described as a 'privilege' in the Wilson Committee report, and it undoubtedly increases competition for the available supply of savings, both through the building societies and through additional public borrowing. The greater Exchequer support for housing in this country compared with most other advanced countries no doubt reflects political and social priorities. My purpose is not to question whether the ranking of priorities implied by our fiscal arrangements is appropriate; but rather to suggest that the argument that inadequate savings are channelled into industrial investment needs to be addressed first and foremost to policy priorities such as these, rather than to the way in which financial institutions respond to them.

A particular criticism of our financial institutions that has been given prominence recently is that British industry has in practice felt unable to borrow on a medium or long-term basis on the capital market. It has further been suggested that the gap here should be filled by the banks. The Wilson Committee gave us a very thorough review of the host of issues that arise in this area. Let me offer some brief observations that appear particularly pertinent now, in the light of most recent experience.

First, the capital market has, in the past, been a more important source of funds for industry in this country than

in many other countries. In the last few years it has become a more volatile source of equity finance, and has dried up virtually completely as a source of long-term debt finance. This reflects general economic conditions—above all, high rates of inflation, and the high nominal interest rates associated with this, coupled with the decline in real rates of return. The drying up of the long-term corporate debt market has been one of the major costs of inflation in the 1970s and I share the concern of the Wilson Committee about this impairment of the effectiveness of our financial system. But I have no doubt that the market could soon revive if the cost of long-term borrowing were to come down far enough; to achieve this requires continued progress in bringing inflation down.

Second, we should not overlook the extent to which the banks have stepped into the breach left by the debenture market. You will not suppose that I have not been keenly conscious of the impulse to monetary growth that dependence on bank finance has involved. But the positive aspect of this is that it shows the flexibility and capability of the banking system to cope with the exceptional demands put upon it. In the 1960s, debenture issues typically financed about 25%–30% of the net borrowing requirement of industrial and commercial companies, and bank borrowing about 50%–60%. In 1979, by contrast, the proportion of the corporate net borrowing requirement that was financed by bank borrowing was over 90%, with net debenture issues effectively zero.

Third, although the average term of bank loans is much shorter than those typical of debenture issues, banks have over the past decade increased the proportion of term loans which they grant and lengthened the average maturities. In their evidence to the Wilson Committee, the London clearing banks indicated that their term lending in 1976 was some 47% of their total lending other than to persons. The comparable figure for term lending, again including foreign currency finance, by all banks to industrial and commercial customers was probably close to 60% in 1980. Moreover, a good deal of overdraft lending is in practice, though not in form, term lending, with limits regularly revised. The banks have also provided substantial medium-term support to industry through the development of their leasing business, which has been particularly attractive to those companies which have had insufficient taxable capacity to enable them to benefit directly from first-year capital allowances.

This first part of my lecture has been concerned with the economic framework within which our financial institutions operate. I am left with the view that major influences such as the rate of return and factors bearing on the cost of capital, including fiscal arrangements, have been more important than the financial structures and relationships with which the Wilson Committee was, properly, principally concerned.

To conclude that the general economic and policy environment is of critical importance to the funding needs

of industry and how they are met is not of course to argue that financial structures and relationships are unimportant. We need to be satisfied that financial mechanisms are flexible and sensitive to the needs of industry. It is to this subject that I now turn.

Specific institutional problems and initiatives

It is one of the Bank's tasks to contribute in any way it sensibly can to enable and indeed encourage the institutions and markets which make up the financial system to adapt to change. Industry, faced with great changes in the economic environment in which it is to operate, rightly looks to the financial system for helpful innovation in the facilities it offers and in the structure of markets. The Bank has the second and separate task of ensuring that that part of financial business which comes within its purview is prudently conducted. Supervision of banking business now rests on a statutory base, by virtue of the Banking Act 1979; while supervision of financial markets, on the other hand, and notably the securities market, is partly statutory and partly non-statutory. But whatever the basis of our supervision there is a balance to be struck between our two aims, as the Wilson Committee recognised. On the one hand, as I have said, we welcome innovation and adaptation; on the other hand, prudence requires that some rules or guidelines should be observed. The more restrictive and inflexible these are, the less scope there is likely to be for change. Our basic approach is therefore to welcome innovation, resisting it only if we can identify substantial reasons for doing so. In relation to the supervision of markets, the Wilson Committee considered that the balance in the present mixture of statutory and non-statutory forms was, by and large, about right. I welcome this conclusion and for the non-statutory part which falls specifically to the Bank we shall, I hope, continue from time to time to make the adaptations which changing market forces point to, or indeed as are required to ensure effective supervision.

Perhaps the most important contribution of the Wilson Committee, and of those who gave evidence to it, has been to scotch the impression of any general financing gap. Their thorough examination also focussed attention on a number of important specific issues—notably the difficulties facing small firms; the longer-term relationship between financial institutions and industrial companies after a financing commitment, of whatever kind, has been made; and the role of government with respect to industrial finance.

I look first at the position of small firms. They may represent only the minor part of the economy; but, on what I think would be a generally accepted definition of a small firm, they probably account for nearly a quarter of the output of private sector industry and commerce. Moreover, their fortunes and those of larger companies are closely interrelated. Large firms buy from them and they in turn depend for survival in one way or another on larger companies; and our economy, like others, benefits from the enterprise of small firms in innovation and development of new products and services. It is largely true that, in the

popular phrase, small firms represent the seed-bed of our future. It is proper to ask whether our financial system is doing enough to help them.

Considerable progress has been made in the past year or two, in part stimulated by the Wilson Committee's own work—in particular their interim report on small firms—and by the recognition by both the present Government and its predecessor that it is important that the small firms sector should thrive. The clearing banks have moved rapidly to improve and extend their arrangements for meeting the financial needs of small firms, supplementing, and indeed in competition with, the services provided by the Industrial and Commercial Finance Corporation, in which they are shareholders. The facilities offered to small firms by the clearers and other banks now include venture capital and equity finance as well as advice on financial management and control. This growth in the range of services and facilities provided by banks has been paralleled by an increase in the role of institutional investors in relation to small firms as sources of equity and other forms of finance. I hope too that the recent introduction of the unlisted securities market will eventually prove of material help to many smaller companies which, while growing and with good prospects, are not yet big enough or ready to meet the more stringent conditions for a full listing.

On the face of it, the financial facilities now available to small firms are impressive. But concern is still expressed that specific gaps remain in the lending market. It is suggested that banks are unduly conservative in their credit assessment, especially in respect of gearing ratios, and that they commonly require personal security and guarantees to a degree that may unreasonably deter a businessman in developing his enterprise.

A number of schemes have been suggested in recent years to address such problems and to assist the flow of funds to small firms. These have recently centred on the possible introduction of some form of loan guarantee scheme, under which the banks would make loans involving a degree of risk somewhat beyond their normal lending parameters or which they would normally provide only against extra personal security, for some proportion of which they might in future be covered by guarantees from government. For myself, I am unclear how far bank managers are now unduly conservative or restrictive and how far their requests for personal security are unduly burdensome; and, in any event, it has to be remembered that the number of high-risk propositions and bad debts now being encountered is probably greater than before. The extent to which present lending practices leave existing or potential small firms with inadequate financial provision should, ideally, be a matter of ascertainable fact; but in practice the debate is often little more than an exchange of anecdotes. At the end of the day, it may not be possible to resolve the issue without experimenting with some form of loan guarantee scheme and I welcome the Government's decision to embark on exploratory discussions to this end.

I turn now to larger firms, and to another aspect of our financial system—namely the nature of the continuing relationship between the providers of funds and industry. I want to focus first on the growth in the proportion of equity capital in British companies that is owned by financial institutions, a feature which figured prominently in the Wilson Report; I turn, secondly, to the greater reliance of companies on the banks, especially given the drying up of the market for industrial debentures. Do these developments change the relationship of finance to industry?

The equity capital of the larger British companies, accounting for perhaps three quarters of the output of our private sector industry and commerce, is increasingly owned by the main institutional investors, above all the life assurance companies and pension funds. Indeed the cash inflow of these institutions and the relative shortage of equity available for purchase in the market may be an important element in the comparative strength of the equity market despite the poor profitability of much of British industry. The large stake of the institutions necessarily raises the question as to the appropriate form and content of their relationships with companies of which they are major shareholders.

The responsibility of the institutions is, and must remain, to their shareholders and policy-holders, or pension contributors and pensioners. But this does not mean that they must maintain only a distant relationship with the companies whose shares they hold. Given the size of their stake in the equity of British industry, the time has passed when the institutions can avoid closer involvement. In at least some cases, it will be inevitable that they assume a more direct responsibility for the fortunes of companies they partly own. Complete withdrawal and disposal of shares of companies in which they have lost faith is possible when the stake is small, but not always so easy where it is large; it may be possible for an individual institution in individual cases but, clearly, it is not feasible for the institutions as a whole in relation to companies as a whole.

There is no doubt that if it cares to exercise it, an institution may often have considerable leverage. The potential sanction of a share sale, or the possibility that an institutional shareholder might be ready to accept the terms of a bid that the board would prefer to see rejected, may often be factors that influence a company's board. Likewise, institutional buying can be a powerful support for companies that are doing well.

An institution may in many cases best fulfil its primary responsibilities—to shareholders, policy-holders and pension fund participants—by an appropriate continuing relationship with the companies in which it holds a sizable stake.

Without wishing to propose any dogmatic prescription, it is clear that if wisely used this kind of relationship can also make a material contribution to industrial companies. For

companies in trouble, a phase of patient commitment may be required, entailing in particular the need to give a company a degree of assurance of continued support, if subject often, no doubt, to remedial action being initiated and persevered with. In this respect, there is a possibility, mentioned by the Wilson Committee, of collective action by institutions. There may be instances where such action has a role to play among an *ad hoc* group of shareholders. But I am speaking primarily of the individual relationships between institutional shareholders and the companies in which they have holdings.

I touched on these matters in a lecture to the Institute of Directors in November 1978.⁽¹⁾ I do not want to repeat here all that I said on that occasion, but what I would underline is that it may on occasion be right for institutions both in their own interest and in the wider interest to insist that companies in which they have important stakes have boards of adequate strength and experience. I would like to reiterate here the valuable contribution that can be made by well-chosen non-executive directors, in particular by virtue of their independence and experience, as well as the distinctness of their viewpoint. This is a matter to which the Wilson Committee very properly drew attention. I find it encouraging that the number of companies making use of outside directors has been growing markedly in the last few years and I hope that institutional shareholders and others will continue to stimulate this development.

I turn now from the continuing role of the institutional shareholders to the responsibility of the banks, and to the contribution they can make to industry beyond the direct provision of finance. I have in mind in particular the need for a bank, more especially when a major creditor, to be well and regularly informed. The banker should be in a position in which, if the business of a customer suffers a downturn, he is promptly aware of what is happening. Some developments have complicated the position of the clearing banks in this respect. Competition in banking, including competition from foreign banks, has grown greatly over the past decade; and especially where corporate clients have a multiplicity of banks, it has sometimes been difficult to maintain the flow of information required for adequate monitoring and to keep track of the range and extent of facilities being used. Yet, if it needs emphasis, the importance of monitoring now seems greater than ever; and, as in medicine, early diagnosis and treatment of incipient problems can be of enormous help. I do not think that it would be appropriate to seek to reproduce in our system the degree of intertwining of banker and industrial client that we see in some other developed countries. But there is a path to be trodden involving close association between banker and industrial customer that will be advantageous to both.

I believe that, with continuing skilful direction and management in the investing institutions and in the banks, further development in their relationships could make a helpful contribution to British industry. I am encouraged

by my contacts with the main financial institutions, banks and investors alike, to think that substantial further progress in this area will be made over the next few years, in part spurred by the very debate associated with the deliberations of the Wilson Committee, and its Report.

Investment and North Sea revenues

I now come to my third major group of questions, which are discussed at some length by the Wilson Committee in Chapter XX of their Report. This chapter sets out the merits and demerits of proposals made for some form of new investment institution to complement existing private sector sources of finance. The object of such proposals—as of the recent contribution to discussion in this area by Lord Lever and Mr Edwards—is to encourage additional investment by industry. Having myself recently argued publicly⁽²⁾ that, as we use up North Sea oil, we should to a considerable extent replace it with other assets, by greater investment at home or abroad, I feel an obligation to address the issue somewhat further now, though I fear that I am liable to disappoint those who seek from me any specific prescription.

In discussing the desirability of encouraging investment, I think one needs to distinguish the immediate situation, where the need to defeat inflation is paramount, from the long-term. A serious feature at present is the extent to which the corporate sector, including many good companies with good management and good products, is having in the face of current financial pressures to cut back not only on stocks but also on fixed investment and on research and development. On the other hand, present conditions have stimulated a great deal of much-needed streamlining and better work practices in many areas.

The Wilson Committee, however, was mainly concerned with the longer-term trend. This has long given grounds for concern. There has been a significant difference over much of the post-war period between rates of productive investment here and the higher rates fairly consistently achieved in many other developed countries. It is no doubt for reasons of this sort that the Trades Union Congress members of the Wilson Committee in particular argued for a large new national investment institution or bank, partly funded by the long-term institutions and partly by Government, drawing on North Sea revenues.

I have to say that I have throughout seen difficulty with this prescription, not because of doubt about the desirability of a higher pace of investment but about whether what would be effectively a process of forced feeding would generate productive investment of the right kind and magnitude. In the first place, I doubt whether there is any substantial financing gap that impedes or disables commercially viable projects. In the second place, I am sure that it would be wrong to concentrate in this way both large-scale finance and decision-taking in a single institution, subject to the maximum of pressures from

(1) Reproduced in the December 1978 *Bulletin*, page 536.

(2) In the Ashridge Lecture, reproduced in the December 1980 *Bulletin*, page 449.

special interests of all kinds. Experience in this country in the last twenty years underlines how vulnerable we are to such pressures, which have led to some conspicuous examples of waste of national resources. While there may be improvements to be made in the way we finance particular areas—perhaps high technology is one—these would not require an annual fund on anything like the scale that has been suggested and might be frustrated by the concentration of decision-taking. In short, I find it hard to believe that the provision of finance by such a new institution would result in more productive investment or a better allocation of investment as between different industries or different projects. There are no doubt many other points that will be made on these questions, which remain a matter for controversy.

If we are to be realistic, I think we are forced to recognise that the task of strengthening our base of productive capital will plainly take time. For the inheritance of defensive

attitudes and the extent to which inflation has become ingrained have interacted in pernicious combination, limiting the scope for the expansion that might more naturally occur in a less inflationary environment. As these constraints ease, it will be an important objective to ensure that priority is given to investment, in both public and private sectors. But realism suggests that we have to look for gradual progress rather than a quantum jump.

In the meantime, there is undoubtedly need for continuing flexibility in our own financial arrangements and readiness to adapt them to support the exceptional task of restructuring much of our existing industry and the development of new product areas over the next few years. Rather than seeking to imitate the specific institutional arrangements of other countries, the best approach is, I suggest, to persevere with this task within the strong financial framework that we have.