Europe, 1992 and the City

Commenting[1] on the work of the Delors Committee to identify the steps that would have to be taken if economic and monetary union within the European Community were to be pursued, the ***Governor*** *emphasises the need for a gradualist approach that concentrates on the immediate and practical aspects of integration in the Community, where a consensus already exists. He goes on to discuss the challenges completion of the internal market in 1992 would pose for the City: and argues in particular that the strengthened framework of supervision, now largely in place, should benefit London in its efforts to maintain or enhance its position as an international financial centre.*

... When I stood here a year ago, I might have expected my agenda tonight to include the European Single Market, the challenges facing our institutions in Europe and the City's role as a European financial centre. So it does, and I shall have something to say on all of these questions. But I confess that I would not have foreseen European Monetary Union as a likely topic for my remarks this evening; and the fact that it has so suddenly arrived on our agenda must I think cause us to analyse carefully the timeliness of the present exercise.

Monetary union

You will know that the Governors of the Community Central Banks have been participating in a Committee chaired by the President of the Commission, considering the ways in which economic and monetary union might be realised. But the purpose of the Committee is, I fear, rather widely misunderstood. Its job is not to determine whether or not monetary union is desirable; nor to provide detailed plans for something which is agreed to be necessary. Rather, it is to answer the question—if economic and monetary union is seen by Heads of Governments to be worth pursuing, then how might it be achieved? What are the steps, the concrete stages as our mandate puts it, that would have to be taken? What sort of plans would have to be laid? What are the stages that would lead to monetary union; and how might they fit together?

A committee of largely Central Bank Governors can answer these questions; or at least they can try. They can describe what economic and monetary union means, how it might work, and how one might get there; they can even guess at what it might cost. But that is all they can do; indeed it is all we have been asked to do. Decisions as to whether the paths they describe are worth pursuing, how far the costs are worth paying, and when any of this might happen, are entirely for sovereign governments. This must be so, for these questions go to the very heart of sovereignty. Fundamental changes would be needed in the formulation of economic policy, in the balance of power between the Community and individual Member States and in the democratic institutions of the Community itself.

I say this now because some will try to interpret the report of the Delors Committee, when it is completed, as a far-reaching 'blueprint' for monetary union; and there is an understandable tendency to assume that blueprints are produced only when something is about to be constructed. In this sense, our work may be thought premature, for there seems to me at present no consensus among European governments that a structure going beyond the first stages of policy co-ordination through existing institutions should be put in place at all; and by the time major institutional developments are required, any plans that we can produce now are bound to be out of date—and, I suspect, today's architects long forgotten.

We must be careful that this sudden preoccupation with the mechanics of eventual monetary union does not make it more, rather than less, difficult to proceed with the immediate and practical aspects of integration in the Community, where a degree of consensus really does exist. Much is already being done in the field of policy co-ordination, particularly since the Basle/Nyborg agreements of 1987, which provided among other things for joint monitoring of economic and monetary developments. The decision to liberalise all capital movements between most Member States by the middle of 1990 is a further example of significant practical progress, and will itself provide an important stimulus to integration.

I am conscious that this gradualist approach may not be palatable to some in Europe who would like to make the running through early institutional change. I can understand the impatience of those who want quick progress and clearly articulated goals. But they in turn might perhaps reflect that these are not simply technical matters but raise, as I have suggested, fundamental questions about the nature of the European Community. They might also consider how different in reality the EMS has turned out from the blueprint that emerged from

(1) In a speech at the annual dinner of the Overseas Bankers Club, on 6 February.

Bremen some ten years ago, without any impairment of its eventual effectiveness.

The single market

Meanwhile there is already on our agenda the important and difficult work of completing the internal market by 1992. I have no doubt that implementation of the single market programme will in itself provide a powerful impetus towards the convergence of economic performance which is a necessary condition for any move towards economic and monetary union. It will also present financial markets within the Community with a considerable challenge at a time when pressures from international competition will also be increasing.

London, as Europe's leading international financial centre, must be ready to meet that challenge.

Over the past twelve months, awareness of the opportunities presented by the single market programme has increased tremendously. The City is now much more familiar with the legislative framework for 1992 which is so rapidly taking shape in Brussels, and many institutions have gone a long way towards developing and implementing plans that will enable them to take full advantage of what is in prospect. This is all very welcome. Although three years have still to pass before 1992 officially dawns, in terms of corporate strategy the single market is already with us. 1989, rather than 1992, may well prove to be the year in which European business starts to treat the market as a single one, even though the formal processes have some way to go.

It is of course not easy for firms to plan in what, by any historical standard, is such a rapidly changing environment. Experience shows how easy it is for institutions to be carried away by the fashion of the moment, only to endure painful adjustment later. But I have been encouraged by the realistic and forward-looking way in which firms here—whether British or overseas owned—have been considering and developing their European strategies.

The liberalisation of market access in Europe creates challenges, too, for London as a financial centre. As opportunities increase elsewhere in Europe, we must expect individual national markets to become more innovative and efficient. London cannot expect to monopolise the capital market of Europe. But we can, I think, hope to maintain and even enhance our position as an international financial centre. The past decade—contrary to the fears of some—has seen a great strengthening of our role, and I see no indication of any gravitation away from London—if anything, the reverse.

But we cannot be complacent. Although we may have, as the Cecchini Report tells us, the most competitive financial services industry in Europe, we can no longer class London as a cheap place to do business; and we must be sensitive about adding to the cost of operating here. We start with great natural advantages, not least that we have achieved that 'critical mass' which enables a market to function effectively as a major international, as well as a domestic, financial centre. But it may be that only a small shift in the balance of advantage would be enough to start a process of attrition. And I am well aware that other centres—in Europe and elsewhere—are far from devoid of attraction or potential.

The regulatory environment

In considering this balance of advantage, some would say that recent changes in the regulatory climate here may erode our traditionally pragmatic system of supervision, and make London less attractive as a place to do business.

I would not deny that there has been a change in the quality and quantity of supervision in the London market. But I make no apology for that. As regards banking, the past three years have seen a substantial reshaping of the supervisory framework in the light of the recommendations of my review committee in 1985 and of the resulting new Banking Act; and we have also responded, as we must, to changes in institutions and markets that create new risks for participants and for the system as a whole. This process is now close to completion: while supervision can never stand still, the new framework is largely in place and banks can feel confident, I suggest, in developing their business against a known and reasonably stable supervisory background. Our regime has, as in the past, been developed in close consultation with participants in the market; and you will all of you know that within our revised framework there is ample provision for the exercise of discretion and flexibility. Whatever some may have feared, we believe very deeply that management is the task of managers, not supervisors.

I know also that some banks here believe that they are disadvantaged because of what they see as the Bank of England's tendency to lead supervisory developments internationally. As one bank put it to us: 'why do *you* always have to lead with *our* chins?' I have to admit to being unpersuaded by this argument. We are prompted not by a desire to be first, but by a need to satisfy ourselves that we understand fully the risks that banks are running. Having done so, it must be right to seek banks' agreement in devising safeguards against these risks and bringing them into the supervisory scheme of things.

Of course we must try to bring others along with us and the recent capital convergence exercise, I believe, did precisely that. We will continue to seek greater equality in the market place, but at the same time we believe that London benefits from operating as a mature and well-regulated centre. Equality does not mean the pursuit of the lowest common denominator: standards can and should be levelled *up* where this is appropriate.

The past three years have also seen the introduction of new arrangements under the Financial Services Act, which have if anything been more controversial because of their complexity and novelty, and because of the wide coverage of the legislation. Again, the new regime has begun to settle down and much is being done to simplify it and to deal with some of the understandable concerns of market professionals. In many respects, there have been important and welcome improvements in the quality of investor protection at the retail level. And we may see benefits even in some wholesale markets, where the new arrangements have given a useful impetus to developments like the trade confirmation system in eurobonds, which many professionals have welcomed.

But our position as an international centre does not turn just on the vigilance or benevolence of the regulators. It depends on the individual success of the firms here; and sometimes it requires, even on the part of the rugged individualists who populate our markets, a degree of collective effort, of co-operation. In this last respect we may sometimes have been rather slow in the past, and you will know that I have voiced concern about the need for co-operation in maintaining and improving the City infrastructure—payments and settlements system, dealing arrangements and so on. Needless conflict in these very sensitive areas could rapidly undermine the efficiency and credibility of our money and capital markets.

London cannot claim any right to have things all its own way or to be spared challenge from other centres in Europe and elsewhere. I am convinced, however, that we are in good shape and, above all, that we have the right blend of watchfulness and understanding to rise to the challenges ahead.