



BANK OF ENGLAND

Speech

Before the Millennium: From the City of London

Speech given by

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Mr Chairman, Ladies and Gentlemen,

As we approach the end of every year we naturally tend to look back at the past, to take stock, and to look forward to the challenges ahead. The temptation to do that this year on the brink of the new Millennium, is almost irresistible.

But take courage - I will at least try not to dwell upon the historical origins of the City this morning. Instead, I will start from where we are now - which is a good place to start because by and large the City is in pretty good shape.

It is, of course, the hub of the financial and business services industry of this country, which, broadly defined to include shipping and real estate as well as other forms of intermediation, and the accountancy and legal professions, contributes directly something like a quarter of total national output - with some 7-8% coming from the financial services sector alone.

And, whatever the periodic outcry whenever something goes wrong - as it will from time to time - the demand for these services does not of course exist in a vacuum; it exists because of the very positive contribution that the business services sectors, including financial services, make to growth and employment and rising living standards in the wider economy. That is true nationally, but it is equally true in a global context. Indeed the unique characteristic of the City is its role as the predominant international financial centre. It accounts for a fifth of all international cross-border lending, for example; for a third of global turnover in foreign exchange and OTC derivatives, and as much as two-thirds of issuance and secondary trading in eurobonds, or of global turnover in international equities, with more foreign firms listed on the LSE than on any other exchange. And London has a near-monopoly in exchange-traded short-term euro interest rate derivatives.

I will not labour the point further, Mr Chairman. Despite - or perhaps driven by - a continuous stream of shocks and competitive challenges, the City has in fact gone from strength to strength, most recently coming through the global financial turbulence of the last couple of years as well as the advent of the euro at least as strong as before.

It is perhaps worth asking why the City is as strong as it is.

Certainly it does have to do partly with history. The emergence of the City owed a good deal to Britain's earlier position as the world's leading industrial and trading nation and international power. But that does not explain its continuing strength.

To explain that there are lots of factors one might point to - the English language, the European time zone, the sheer momentum of the City's critical mass, supported by the availability of a professionally-qualified and

technically-skilled work force which gives the City remarkable resilience and flexibility, aspects of our commercial and physical infrastructure, and so on. All of these factors are certainly relevant factors.

But if I had to identify one factor above all that helped to explain the continuing phenomenon of the City, it would be what I can only rather vaguely describe as the surrounding ethos of a free, competitive, market place.

I do not at all mean by that that the City is a lawless jungle where anything goes! In fact quite the reverse. You cannot have an effective competitive market without reasonably clear rules of the game, both to protect society as a whole from disruption and to retain the confidence of both the providers and users of the market by ensuring that they know what is expected of them and what they can reasonably expect of others. The evolving legal and regulatory framework in this country, together with the self-regulatory disciplines applied by the relevant market organisations and professional bodies have been - and remain - a vitally important asset for the City in this context.

It is not just the structure of these arrangements but their substance and the manner of application of the rules of the game that matters.

It is all too easy to err on either side. The rules may be so loosely drawn that market participants and market users lose confidence and go elsewhere; or they may be so tightly drawn that they discourage competition and inhibit innovation. Equally, the actual, as distinct from the intended, balance between social protection and fairness on the one hand, and competition on the other, may be affected by the approach adopted by the various arbitrators. Theirs is a difficult job at the best of times. We've all seen matches ruined by either unduly lax or unduly officious refereeing. But ultimately the character of the game depends upon the self-discipline, as well as the skills, of the players.

In general I believe that we in this country have been well served in these respects. There has been relatively little systemic disturbance in recent years, and what there has been has required relatively modest commitment of public funds. There have, it is true, been periodic concerns about business behaviour. Where these have been general concerns - often reflecting the rapid evolution of the market place or rising public expectations - they have mostly been addressed by reinforcing the rules of the game. Or where they have reflected the behaviour of individual firms or their employees they have been pursued - not least to encourage others. Of course we need to remain constantly vigilant in all these areas to retain confidence in our market place. But all the evidence suggests that such confidence remains strong by any international standards.

There are three characteristics of the City's market ethos that I would point to in particular.

Quite early on in my career at the Bank - more years ago than I care to remember - I was profoundly influenced by the man then responsible for administering Exchange Control - Brian Bennett. He had, framed on his desk, a wartime poster which read "Freedom is in peril - defend it with all your might." And he explained to me that this was to remind him that his job was not simply to apply the 4 Exchange Control regulations - though that certainly was his job; it was also to help people to do what they were seeking to do consistently with both the spirit and the letter of the law. I like to think that that philosophy has informed - and continues to inform - the approach to applying the rules of the game more generally in the City.

A related characteristic is that apart from defining, and applying, constructively, the rules of the game, the various authorities do then leave the market to get on with it - they do not by and large seek to tell the various markets, or firms operating within them, what they should or should not do. In the Bank, for example, we always stand ready to help when market participants collectively seek our help - say, in relation to market infrastructure projects where, working with market participants, we took on the development and introduction of new settlements systems for the Gilt-Edged, Money and Equity markets and new wholesale payments systems - but we try to avoid either dirigisme or unnecessary conservative resistance to market initiatives, whether collective initiatives, such as the creation of LIFFE, or initiatives at the level of the individual firm. We may act as a catalyst, encouraging different sectors of the market to address emerging problems, either on their own or by coming together, but essentially we take the view that the markets and firms themselves are best placed to find the way ahead.

The third characteristic of what I've called the free market ethos - and one which is absolutely crucial to the City's success - is impartiality and even-handedness, both in the application of the rules of the game and in terms of business opportunities - applying the same standards to all market participants or would-be participants, regardless in particular of nationality.

Some people still find this difficult to understand. A few years ago Japanese bankers used to tease me by asking what I thought of the "Wimbledonisation" of the City - meaning that this country organised the best competition in the world but the visitors carried off the prizes. I used to explain to them that it was activity - rather than nationality of ownership or even control - that mattered in terms of the City's contribution to the wider economy, and in terms of its direct contribution to growth or employment, or of income or tax base in this country; I even suggested that Tokyo would benefit as a financial centre if it became more open to overseas players. I don't think that they were convinced at the time. But now that has begun to happen, and some of my Japanese banker friends tell me they finally see the point. It is in fact of course more generally a lot harder to see the benefits of increasing global competition if you are an existing producer, whether an individual business or the national representatives of businesses directly in the firing line than if you are looking at it in terms of the health of the macro-economy. But there is no doubt that it is this characteristic of openness to competition perhaps above all that explains the uniquely international nature of the City (with more foreign banks represented here than in any other centre) and accounts for much of the City's continuing success.

So much then, Mr Chairman, for the past, let me turn now to the challenges and prospects for the future.

The most immediate challenge is to get through to the next millennium without significant mishap - to demonstrate that we have indeed succeeded in overcoming the Y2K bug. In fact I have no misgivings on that score as far as the City is concerned. The preparation has been immensely thorough. The Bank, with our colleagues in the FSA, and with our counterparts abroad, has worked with the financial markets, both on that technical preparation and to ensure that the necessary liquidity will be in place. That in turn has provided a degree of reassurance - to financial intermediaries and to the public more broadly - that should help to avoid undue precautionary behaviour which might otherwise prove disruptive.

A second challenge is the advent of the euro - and on this score, too, I have very few misgivings. Even before the introduction of the new currency the City played a very positive role in its technical preparation - and one which has been widely acknowledged. And since that introduction the City has continued to play a very active part in the development of the broader, more liquid, financial markets which the euro has made possible, and which are vital to its success as a widely-used international trading and investment currency. This activity is in fact the greatest contribution that the UK can make to that success from the outside. Of course the City is in competition with other financial centres elsewhere in Europe. But as I have often pointed out before, at the macro-economic level such competition is a positive- - not a zero- - sum game from which we collectively, borrowers and lenders and market intermediaries, all stand to gain. I have every confidence in the ability of the City to thrive in this competitive environment - but it will thrive not at the expense of the rest of Europe but alongside other European financial centres. And in that context suggestions that we should be somehow artificially disadvantaged are irrational.

The third challenge confronting the City - and a much more fundamental one - is the accelerating advance of information and communications technology which is currently sweeping across the whole of the global economy. In the financial services sector in particular it is the major driver of change and innovation. It makes possible the introduction of a whole raft of essentially new financial services and products, and it is radically changing the way in which they and existing services and products are delivered, whether in wholesale or retail financial markets, at a fraction of the existing cost. In wholesale markets it will affect the whole spectrum of activity - from trading through payments and settlements, across the whole range of financial instruments, across national boundaries - not simply within Europe although that is an immediate focus of attention - and it has the potential to alter fundamentally the relationships between end-users of the markets, intermediaries and exchanges. And, at the retail level, too, we will all eventually need to learn to live with totally new, and more efficient, ways of doing things - though that will no doubt come harder to people of my generation!

I don't think anyone at this stage can see at all clearly the end-point of all this or even necessarily the appropriate next steps. And that is why we are seeing a continuous, and often bewildering, stream of new individual and collective initiatives, many of them involving the same participants, both in this country and

abroad. Some of these initiatives will inevitably fall by the wayside - that's part of the process by which the market as a whole discovers the way ahead. But those that do succeed will succeed because they add value by meeting more effectively the needs of the consumers of the products and services they provide. As an intensely interested - but non-commercial - observer of it all, I find the whole process hugely stimulating and encouraging. I recognise that I might feel differently if I were a commercial rather than a central banker, but I'm impressed by the fact that most of the commercial bankers I talk to see it in terms of opportunities rather than threats.

The other challenge to the City that I would draw attention to is the quite different challenge associated with growing social concerns and rising public expectations, which are probably heightened by the rapid pace of financial change associated with advancing technology.

In part these concerns relate to perceptions of increased risk of financial instability. There has been, and I suspect will continue to be, increasing public emphasis - both domestically and internationally - within the IMF, the new Financial Stability Forum and the BIS, for example, notably in the wake of the recent global financial turmoil - on reducing systemic financial risk and on how to handle systemic disturbances when they occur.

But the social concerns go well beyond this sort of systemic issue. They include growing concerns about organised criminal abuse of the financial system, for example; they include an increasing emphasis on consumer protection - particularly protection of the less financially-sophisticated in an increasingly complex environment; and they include questions relating to the financial exclusion of disadvantaged sectors of the community. In all these respects, too, the concerns are not just domestic concerns but have close parallels internationally.

It seems to me that in many instances the new technologies, appropriately deployed, actually improve the capacity of the financial system to address these concerns. But if they are not adequately addressed - whether within the system as a whole or at the level of the individual market or individual firm - they could - like purely financial failures - weaken public confidence or attract public responses, which would have a damaging effect on overall activity.

Mr Chairman, I can't imagine that anyone working in the City will become bored as we move into the new millennium in the face of these challenges.

How successful we are in confronting them will depend, as in the past, upon the interaction of the technical and professional skills and self-discipline of the market and the structure, substance and application of the rules of the game as they are reflected in public policy.

We have unique experience within the City on which to build.

The market has repeatedly demonstrated its capacity to respond successfully to new challenges and currently attracts representatives of the strongest participants from all parts of the world. It is supported by very highly qualified professionals and professional bodies which play an important role in setting and maintaining standards. It is supported, too, by an extraordinary range of specialist professional and technical organisations, which help to ensure that the rules of the game are sensibly formulated and clearly understood. And it is supported by a very strong tradition of technical training and education through the various financial institutes, a tradition which I hope may soon be bolstered by the development of a coherent set of professional qualifications across the different financial market sectors.

But how far we remain successful will depend importantly, too, on how far we are able to maintain what I have described as the ethos of the competitive market place in a rapidly changing environment and that will represent a considerable challenge to public policy. Given market self-discipline, I have every confidence, Mr Chairman, that the various competent authorities will remain constructive and impartial in their approach to defining and applying the rules of the game, and open to innovation and wide participation, so that the City retains its position as an attractive location for the provision of financial and business services.

So, Mr Chairman, I look to the future of the City with very considerable confidence. On recent form it has little to fear and great opportunities to look forward to. But I don't say that it will be easy.