BANK OF ENGLAND

Speech

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Speech given by

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I have to confess that for me, as a banker - even if I'm a central banker rather than a commercial banker - to be invited to address this audience in the magnificent setting of this cathedral is a somewhat daunting experience. But if it's a daunting experience, I recognise that it is a great honour, which I very much appreciate; and I welcome the opportunity it gives me to share with you this evening some thoughts on the age-old question, which continues to trouble right-minded people everywhere - how can we explain, let alone justify or tolerate, the coexistence of obvious affluence and well-being cheek by jowl with equally obvious poverty and deprivation. It's a question of very broad relevance, with personal, local, national and international dimensions. It's a question to which great minds have applied themselves across the centuries. I should like, more modestly, in my remarks to offer some reflections, based upon my nearly forty years experience of working at the Bank, on the relevance, first, of monetary and broader economic policy to that question; on the relevance, secondly, of the activity of the City financial institutions; and on the relevance, finally, of the work of the international financial institutions with which the Bank of England is involved.

But let me at the outset identify a common theme that underlies my remarks on all three of these areas. Don't think that the root of the problem is that people generally simply don't care. The harsh reality is that, with the best will in the world, we do not have - personally as far as most of us are concerned but certainly, collectively - locally, nationally or internationally - sufficient resources to satisfy all our aspirations. And since those aspirations are continuously increasing as standards do in fact gradually rise, I don't suppose we ever will have that capacity. So we are obliged to make choices: if we devote resources to this or that purpose we will not have resources to devote to this or that other purpose - however desirable in itself that other purpose may be.

An absolutely fundamental issue is, of course, how and by whom such collective decisions are taken. I imagine that, while we could no doubt argue about some of the details, all of us would accept that a genuine democratic process - based on universal suffrage and underpinned by transparency and accountability, and supported by freedom of speech, including freedom of the press, is a sine qua non.

Within that framework, there is plenty of room for ongoing debate about the role of government, at different levels, in striking a balance between protecting the interests of society as a whole and of particular groups within society, on the one hand, and preserving individual freedoms on the other. In the economic field the debate can become polarised between those who favour free markets, in the interests of economic efficiency and growth, and those who favour government intervention, in the interests of social protection. In fact I don't think I know many people actually involved in public policy issues who do not see general economic prosperity as the ultimate objective; and I don't know many people either who do not recognise the need for government intervention to maintain at least the minimum standards necessary for the effective functioning of free markets. So the real debate it seems to me is a narrower one: it is about means rather than ends; and the real issues are typically about matters of degree rather than absolute matters of basic principle.

Against that background let me talk first about overall economic policy - and its relevance to the issue of poverty.

For many years after the second world war in this country, during the 1960's and 1970's, macro-economic policy - overall fiscal policy and monetary policy operating together and with various forms of direct control - was aimed at juggling what were seen as the conflicting objectives of economic growth and falling unemployment on the one hand and limiting inflation and maintaining a manageable balance of payments position on the other. Essentially the policy levers would be set initially at go, to stimulate demand and encourage growth and employment, until the evidence of over-heating became intolerable, when the levers were thrown abruptly into reverse, to bring about a juddering economic slowdown. This was the infamous go-stop economic policy cycle which led to the boom-bust economic cycle. While the objective was no doubt to ensure that we never again experienced the depression and mass unemployment of the inter-war period, the effect was to induce uncertainty and short-term economic decision-making, with an increasingly damaging impact on our overall economic performance. And the situation became progressively worse from one economic cycle to the next as each peak produced higher and higher inflation and each trough higher and higher rates of unemployment - with the peaks becoming progressively shorter-lived. It became a classic example of more haste less speed.

We eventually learned from that experience that there really is no trade-off between growth and employment and inflation, except possibly in the short term, and that stability, defined as consistently low inflation - and achieved by keeping overall demand continuously broadly in line with the underlying structural, supply-side, capacity of the economy to meet that demand - is a necessary condition for sustainable growth. We learned that governments cannot sensibly seek to achieve their social objectives - however worthy they may be - by simply borrowing, or "printing", the money to finance its expenditures, but needs to balance its current receipts and expenditures over the economic cycle, borrowing only to finance productive investments. And we learned that the task of shorter term economic stabilisation was most appropriately left to the operation of monetary policy. That, very broadly speaking, is today's macro-economic orthodoxy not just across a broad part of the political spectrum in this country but in most of the rest of the world.

Now many people were initially sceptical about this change of emphasis - no doubt some still are. Fiscal responsibility, including tight control over all forms of expenditure, for example, on social security and pension provision, and on health and education - and monetary policy directed specifically at consistent stable, low, inflation - all sounds somewhat austere. What in particular does it mean in terms of its impact on the poorer sectors of our society?

Well I don't for a moment suggest it is the solution to all our problems. But it certainly has helped us to achieve a significantly better macro-economic performance over the past few years, and that in itself has helped in addressing at least some of our social problems.

Over the eight years or so since the last recession in the early 1990's retail price inflation - on the Government's target measure - has averaged some 23/4. That's a lower rate for longer than anyone can remember.

This much greater degree of price stability is a "good thing" in itself - economically because it contributes to more rational, longer-term, decision making, but also socially, because it is typically the poorer, less financially sophisticated, sectors of society - for example those living on low fixed incomes - that suffer most from inflation.

But low inflation is not simply an end in itself. The real benefit is that alongside sustained stability we have experienced the longest period of quarter-by-quarter growth since quarterly records began. Over the whole period annual output growth has averaged a little over 23/4% which is significantly higher than the earlier trend rate of around 2 1/4%. But more even than that, employment has increased steadily by nearly 21/2 m people over the same period, so that the number in work is today the highest on record. And unemployment has progressively fallen almost month by month on a claimant count basis (though with a slight setback last month) and the rate of unemployment - is just about the lowest rate we've seen for about 25 years in the UK as a whole. And, notwithstanding the legitimate debate about the North-South divide, unemployment is at around its lowest rate in every individual region of the UK for some 20 years. It's not the Holy Grail but there's no doubt that things are better than they were.

But sadly that is not - indeed cannot be - true for everyone. Even in a stable macro-economic environment, economic progress depends upon structural change with some industries and individual businesses declining while others develop to take their place. That process of structural change, is of course I understand, immensely painful for those businesses that run down and for those people who lose their jobs as a result, even if they are able to find new activity or employment in an economy operating close to capacity. What is more, these structural pressures have been aggravated over the past few years by the strength of sterling's exchange rate against both a range of weakening emerging market currencies following the financial crisis which started in Asia three years or so ago and against the weakening euro. The hard choice - and it is a hard choice - for macro-economic policy, or more specifically for monetary policy, in this context is could we - or should we - seek to protect the suffering sectors or failing businesses even if that meant consciously putting at risk the stability of the economy as a whole? Few people - even in the suffering sectors - argue that we should - not because of insensitivity to the economic and social distress that can result for those communities that are most affected, but because of the more extensive damage that it would be likely to cause to the wider community.

I said a moment ago macro-economic stability depends upon keeping overall demand growth continuously broadly in line with the underlying structural, supply-side, capacity of the economy to meet that demand. There is not a lot frankly that macro-economic policy itself can do directly to affect the supply side which is obviously crucial in determining the rate of growth we can sustain. That depends fundamentally on the ability of management and the skills of the workforce, though it can be importantly affected by the whole range of government policies beyond overall fiscal and monetary policy. These policy choices are far more complicated than the more technical choices at the macro-economic level - and they are way beyond my area of competence. But they are essential to the present debate so let me offer a view, as it were from the sidelines.

A key issue in this area concerns the respective roles of government on the one hand and private markets on the other. And there is little doubt that the tide has recently been flowing in favour of private markets - certainly as far as direct government involvement in the processes of production is concerned. The extreme example is of course the collapse of communism but the global spread of privatisation, for example, is part of the same phenomenon. This change may have less to do with a sudden dramatic shift in philosophical conviction than with a broadly-based, pragmatic, recognition that the incentives of private ownership within a market economy make for greater productive efficiency and greater sensitivity to changing consumer demands. In other words, whether we like it or not, the market economy is seen as the most effective mechanism we have for allocating scarce resources to where they can be most productively employed in meeting the needs of consumers as a whole - and in that sense raising the underlying productive potential of the economy.

But of course that presumption is not absolute.

No one questions the role of government in meeting the collective needs of society as a whole, in relation to defence or law and order, for example, or in providing public heath and education services or social security protection.

Nor do many people seriously question the need to constrain purely free market behaviour through some degree of regulation of employment practices, health and safety standards, or competition or consumer protection law. The debate is about questions of degree.

All forms of government intervention involve costs - direct expenditures have to be paid for through taxation and the costs of complying with regulation are born directly by the private sector, which is why of course we hear so much about "red tape". The net effect of particular forms of intervention may enhance the capacity of the private sector to create wealth and employment - I imagine that most people would generally regard public health and education services, for example, in this way, or forms of regulation that enable markets to function more effectively. But even then there are questions of degree. And other forms of intervention may be more likely to reduce the wealth- creating capacity of the private sector by, for example, blunting incentives either to provide or to take up employment. That is not, of course, to say that they are in any sense necessarily wrong, merely to point out that here again choices to be made, the difficulty often being to know where to strike the balance between conflicting objectives.

The question of relieving poverty needs to be addressed within this framework. Our social conscience may say that we should lean more towards redistribution in favour of the poorer sectors of our community generally, or in favour of those who are particularly disadvantaged in one way or another - and goodness knows there are endless causes that in themselves are worthy of our collective support. But it is important to recognise that in doing so, we could reduce the wealth and income generating capacity of the economy as a whole, and so reduce our ability to provide rising living standards to all sectors of society, including rising absolute living standards of the poorer sectors we were seeking to help. In other words, in trying to divide up the cake more equally we could, if we are not careful, end up reducing its overall size. The trick it seems to me is to find ways of having our cake and eating it - which some forms of government intervention can, as I say, achieve. But that's a great deal easier said than done. I only thank my lucky stars that I am not a politician!

Where then do the financial institutions of the City fit in to all of this? Well, money changers have never been exactly popular. That is partly because of a perception that while the rest of the community earn their living making things, bankers simply make money - and what's more they make money by using "our" money. But it is partly because of a perception that people who work in the financial services industry are pretty heartless people anyway.

In fact financial intermediation is a critically important component of a market economy. Behind the popular - or perhaps unpopular - image of erratic and speculative, short-term, financial market trading, which is in fact an important element in the process of price discovery - the essential role of financial intermediation is to gather together our collective financial resources - our savings if you like - and to direct their investment into those activities in which they can be most productivity employed. That underlying activity - based upon expert and objective assessment of prospective profitability relative to potential risk, clearly can, in itself, make a significant difference to the productive capacity - the sustainable rate of growth - of the wider economy.

In addition, of course, financial intermediaries provide essential banking, insurance and other services, without which the non-financial economy would find it impossible to function.

Of course it is true that financial intermediaries are motivated by profit. Prospective profitability is the measure by which they decide how to direct resources to their most productive use, which is, as I say, their essential economic function. Moreover, they are for the most part lending, or investing, or advising on the investment of, funds which ultimately belong to others, and they have to aim to maximise the return on those funds in the interest of their customers, as well as on their own account, if they are to stay in business for the longer term.

Recent international history is littered with instances in which misallocation of financial resources to non-productive investment, followed by disruption of the financial system, has resulted in massive economic and consequent social damage. It was a major factor, for example, behind the Asian crisis and its aftermath. As with other forms of economic activity the financial services sector is subject to government intervention; indeed because of the sector's critical importance such intervention - in the form of regulation and supervision of both the prudential behaviour and the business conduct of financial intermediaries - is more intrusive than in many other areas. And in this case, too, there is a need to strike a balance between the needs of social protection in its various relevant forms and market efficiency. Here, too, there are certainly areas where these objectives run in the same direction: market regulation can, for example, improve user confidence in the market and contribute to its depth and liquidity; and minimum capital and liquidity standards applied to individual financial institutions can protect not just the depositors or investors with that institution but the stability of the financial system as a whole. But clearly intervention can - if we are not careful - go too far, imposing excessive costs or reducing effective competition, which can impair the ability of the system of financial intermediation to fulfil its essential purpose. It is a particular - if rather special - case of the general proposition which I made earlier.

Statutory regulation is not, of course, the only means of seeking to reconcile free market and social concerns. In many areas - including the financial services sector - dialogue and persuasion can be effective complements or even alternatives. I am impressed, for example, by the extent to which sexual and racial equality is increasingly - even if not yet sufficiently - seen as a business issue - we simply cannot afford, collectively or in the context of our individual business activities, to neglect any sector of the community, if we want to improve our productive capacity. And in the context of the financial sector more specifically, I have been encouraged by the progress - through a process of dialogue in which the Bank of England has been involved - towards a better understanding between the banks and other finance providers on the one hand and small and medium-sized businesses on the other, which is certainly in my view contributing to the more effective functioning of this sector of the market with positive social as well as economic results. I am hopeful that similar dialogue between finance providers and users can contribute to better outcomes in other areas where there appear to be deficiencies, including, for example, the financing of ethnic minority businesses, or the financing of excluded or deprived communities, where the mainstream financial providers need to work closely with community development financial institutions. Such dialogue is not only valuable in itself, it can form a useful part of the process helping government to identify better-targeted means of encouraging a closer alignment between social and economic objectives.

I am also encouraged that City-based organisations are becoming increasingly directly involved not simply in a financing context with deprived communities - including those on our own doorstep. The City has a long history of charitable and community involvement. But it is my impression that this involvement has been increasing in recent years, with many businesses recognising that it can not only have an important impact on the communities that they are supporting, but a powerful impact, too, on the motivation and morale of their own staff engaged in community projects. It is to encourage those City organisations already active in this field, and, by drawing attention to it, to stimulate others to become more actively engaged, that the Lord Mayor, Sir Howard Davies of the FSA and I have together recently launched the "Heart of the City" project, which Andrew Buxton is now directing - and which will culminate in a day of celebration of the City's community involvement in June next year. The positive response we have received from the City - including the churches of the City - and our surrounding boroughs leads me to hope that this might become a regular event.

Let me finally, Chairman, turn to the international dimension of all this, where I know only too well, from first-hand experience, that there is deeply-felt concern, sometimes sadly expressed in violent protest, at aspects of the general economic approach which I have described, particularly as it bears on the developing world through "globalisation".

The protesters, it must be said, form something of a rainbow coalition. Some - at the violent end of the spectrum - appear to be pure anarchists who are clearly against the present system but offer no coherent alternative. Others - of whom there appear to be many more - seek to make either the more general point that the present international financial system operates unfairly in relation to poorer countries or does not take adequate account of wider social concerns like poverty or the environment, or they make particular points about the burden of third-world debt or particular development projects which they see as having unacceptable social or environmental impact on the countries in which the project is to be undertaken.

Many of these issues are essentially the international dimension of issues that I have touched upon already in our own domestic context - though the contrast between poverty and affluence at the international level is of course even starker. And there is a good deal of underlying sympathy within the international official community with many of the points the protesters are seeking to make - perhaps more than they appreciate. As a matter of fact I can't remember a time when poverty reduction has been higher on the agenda of the international financial institutions. But the same harsh constraint - that we do not collectively have the resources to address all of these problems however much we would wish to do so - applies. There is the same need therefore to make hard choices between alternative means, and the international process for making those choices is inevitably more complicated than in our national environment.

To take some examples, there is substantial evidence that increasingly free world trade and increasing freedom of international capital flows are contributing to unprecedented rates of growth in the global economy as a whole and more rapidly rising living standards in almost every region of the global economy. It is certainly possible to argue even so that the free trade playing field remains tilted against poorer countries, or that it should be tilted more in their favour: distinguishing between self-interested protectionism and "fairness" or equality of competition is not wholly straightforward. But there would be a real cost to all of us, including particularly the poorer countries, if we were to be tempted to throw the baby out with the bath water and retreat behind trade barriers.

Similarly we have recently seen all too clearly the damage that can be caused by the volatility of international capital flows - but we need to set that against the positive benefits - in terms of potential growth rates - that had previously resulted from massively greater private sector capital investment in many of the emerging markets, and which has now resumed. Certainly we need to reform the system to try to ensure greater stability - and a great deal of effort has been expended on precisely that over the past few years - by developing standards and codes of best practice by national authorities, for example, designed to help them to help themselves to take greater advantage of the opportunities presented by globalisation. More certainly needs to be - and is being - done, recognising the particular problems facing different countries at different stages of development. But it would be a terrible mistake to turn the clock back and retreat from "globalisation" into a world of nation states linked together predominantly by official financing. None of the poorer countries themselves are arguing for that, yet that is what some of the protests seem to imply.

And so it is with some of the more specific issues - like pushing for higher labour standards in developing countries, which is fine up to a point, but if pushed too far could mean lower activity and higher unemployment in those countries; or debt forgiveness not tied to programs designed to improve the lot of the people living in the debtor countries; or the appropriateness of particular development projects and so on - we cannot simply focus on particular aspects of the problem in isolation, we need to examine both the pros and the cons in each case to try to find the best means to what is quite likely to be an agreed end. And dialogue in my view is likely to be a better and more productive approach to that than attempts at direct action.

Mr Chairman, it is absolutely right that not just the Church but anyone with a sense of humanity should react against the extent of the inequality that we see around us locally, nationally and internationally. It is, however, wrong in my view to attribute that inequality simply to the nature of the financial system. No doubt that system has its deficiencies which we need continually to address. But by and large it is the best system that we have - or indeed that we have had. Within it we have collectively to make all kinds of trade-offs between what may be seen, at least in the short run, as conflicting objectives. In that process we must all be free to follow our consciences and express our concerns. But I hope that my remarks this evening may have persuaded some of you at least that there are rarely - in this field as in many others - obvious and absolute right answers. We are fortunate, I believe, in having a democratic process through which our concerns can be weighed in the balance.