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Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

19 October 1988

Paul Gray Esq
10 Downing Street

Note
Added 6 paras 11 + 35
discussed with Treasury.

Dear Paul,

ALG
25/10

MANSION HOUSE SPEECH

I attach the latest draft. The Chancellor will be
finalising it after tomorrow morning's meetings.

Yours sincerely,

Andrew Hudson

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MANSION HOUSE SPEECH: FIFTH DRAFT

Introduction

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1. It is with very great pleasure that I rise once again at this great annual occasion to respond to the toast "prosperity to the public purse" and the health of the Chancellor of the Exchequer. Not least because the toasting your recent predecessors have done has been so conspicuously successful. I refer not so much to my health - though there is nothing wrong with that, I am glad to say - but to the prosperity of the public purse.

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2. Last year, for only the second occasion since our Queen ascended the throne, this country secured a Budget surplus. This year, that surplus will be even larger. And I intend to see that there is a substantial surplus ^{next year,} too.

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3. This the sixth time I have had the honour of speaking to you here as Chancellor. But that is a puny score compared with the record of my fellow-guest, the Chairman of the Stock Exchange, Nicholas Goodison, who will shortly be entertaining and edifying us for the twelfth year in succession, a record unmatched since the war. But this is also ~~Nicholas~~, sadly, the last time ^{he} you

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x presided with wisdom and real leadership over the most
x far reaching changes any one can remember in a vitally
x important part of the City. By acting as midwife to the
International Stock Exchange, he has played a critical
and decisive part in consolidating London's position as a
x global financial centre. And he has consistently
Para x championed the cause of wider shareownership.// I thank
x him most warmly for all he has done, and wish him, and
x his successor ^{well} for the future.
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Global Markets

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other things, was a perhaps uncomfortably vivid reminder
of the extent to which we now live in a global market
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^ 5. Although we now take it for granted that the
financial sector is one of the most international of all,
this was not really the case for most of the post-war
period. While Governments throughout the world, rightly
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1930s, committed themselves to free trade and open

h markets, far reaching controls on the movement of capital became accepted, for the most part, as a fact of life. But over the past few years all that has changed; and we now have a degree of freedom that has probably not existed ^{since} before the First World War - with the development of information technology making the global financial market-place even more of a reality than it was then.

6. This has obvious implications, first of all, for the co-ordination of prudential supervision, where the Basle Committee has done such important work. I warmly welcome the historic agreement on capital adequacy reached earlier this year, in which Robin Leigh-Pemberton and Peter Cooke played such a key role.

7. But the consequences of global markets go far beyond questions of supervision, to the very heart of the conduct of economic policy.

10 8. Finance Ministers and Central Bank Governors today have to come to terms with a world in which the amount of mobile capital is far larger than it has ever been before.

11 9. This has a number of advantages. Savers have a wider range of opportunities, and borrowers have access to a much larger pool of funds. There is now no reason why investment should be financed exclusively from domestic sources. Net capital flows between countries

are inevitable and desirable, and may last for some years in the same direction, with current account imbalances as the inevitable counterpart.

12 10. But by the same token, the scale of mobile capital imposes a discipline on policy, irrespective of the state of the current account balance.

11 11. Monetary policy has had to adapt, since the expansion in global capital flows has increased the potential for exchange rate volatility, as we have seen with the dollar. As a result, all the major countries have now recognised the need to pursue policies that will achieve and maintain a reasonable degree of exchange rate stability. And for over three years, now, there has been international co-operation to that end.

X 12 12. And for those who wish to know in greater detail what that co-operation is about, I can do no better than refer to the official history of the Bank of England, where you will find a description by a senior Bank official in 1937 of the essential characteristics of the system of managed floating that had followed the collapse of the gold standard a few years earlier. ^A~~The~~ key characteristic, he wrote, and I quote, was

"Readiness on the part of the Governor and of the Bank to be identified with an exchange policy which is never formulated, explained or justified, but which is all the time having cumulative effects that

must eventually thrust themselves upon public attention."

15 13. But the discipline imposed by mobile capital extends beyond the exchange rate. To attract the savings needed to finance investment, whether those savings originate at home or abroad, countries need to maintain an overall policy stance that commands the confidence of investors.

16 14. That clearly means a sound fiscal and monetary policy and a firm stand against inflation. But it also means regulatory and tax policies that make for business success. For example, no country can afford a tax regime which drives away top managers, entrepreneurs, and scientists, any more than a tax regime which deters capital investment. It was to ensure that Britain can retain, attract and motivate such people that I introduced the far-reaching personal tax reforms contained in this year's Budget.

17 15 So the globalisation of markets has implications going well beyond the operation of the markets themselves. It affects the whole conduct of economic policy. And it may be no coincidence that the 1980s have seen not merely global integration of markets, but a growing global consensus on an economic policy based on sound money and less government intervention in the economy.

1992

16. That conclusion has profound implications for our approach to the completion of the single European market in 1992.

17. I have spoken before about the two routes which Europe could adopt: either on the one hand, liberalisation and deregulation to the greatest extent practicable; or, on the other, the ^{can} ~~b~~ureaucratic imposition of harmonised regulation based on some average of the existing practices, good and bad alike, of the various member states.

18. It is vital, not just for this country but for Europe as a whole, that the first approach is adopted. For the Community cannot insulate itself from the global market, any more than an individual country can. There is abundant evidence of the benefits of free trade - indeed, that is the reason for completing the single market in the first place. But these benefits will be put at risk if Europe fails to respond to the challenges offered by the wider world market. The Fortress Europe mentality is profoundly damaging to the single market ideal, which above all must be about making the European economy more competitive in world markets.

19. The question of access to the single market is, of course, of particular interest to the City, not least given the widespread concern about Commission proposals

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to make access to the internal market in financial services and banking conditional on the achievement of reciprocity. Let me make it clear that those proposals are a long way from being agreed. The British Government, for one, has made plain its commitment to reducing barriers and to opening markets.// In financial services, more than almost any other sector, all countries would stand to lose if the Community were to try to erect a wall between itself and the rest of the world. Before long, the business would simply go elsewhere.

20. As the Heads of Government put it, at the European Council meeting at Hanover in June:

"The internal market should not close in on itself. In conformity with the provisions of GATT, the Community should be open to third countries, and must negotiate with those countries where necessary to secure access to their markets ...".

21. This is the spirit in which the UK has always approached reciprocity: as a tool for improving access to other markets, not as a pretext for restricting access to our own.

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22. The right approach is the one adopted in the recently approved Capital Liberalisation Directive. Those Community countries who had not already done so agreed not just to abolish remaining restrictions on

capital movements between Member States, but to seek to achieve the same degree of liberalisation erga omnes - that is, with the rest of the world as well. And they did so, frankly, because no other approach makes sense in today's global markets.

23. Finally on 1992, let me say this.

h 24. There are some who claim that the single market can operate successfully only if Europe moves ^{to} monetary union, _h by which they mean a common currency.

25. This is manifest nonsense: a view held only by politicians who know nothing about economics and by economists who are oblivious to the realities of politics.

xx 26. The current talk about all this is not new. It has surfaced before, at the time of the Werner Report of 1970. If I may quote from what I wrote in the Sunday Times at the time, some eighteen years ago:

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"A national currency lies at the very heart of national sovereignty. A common currency is something that can only properly follow political union: it cannot precede it. It is significant that whereas the Zollverein or customs union paved the way to the German Federation a century ago, it was only after Prussia and Bismarck had achieved a political union, with blood and iron, that a common German

currency could be borne."

And so far as the European Community is concerned that political union is not on the agenda.

27. I think I can fairly claim to have demonstrated my commitment to international financial co-operation, both among the major powers and within Europe; and I would like to see that co-operation taken further. But I find myself in wholehearted agreement with Herr Karl-Otto Pohl, the Chairman of the German Bundesbank, when he wrote recently:

X "One does not have to be a defeatist about European integration to doubt whether there is really political scope for such fundamental decisions and the sacrifices of national sovereignty that would be required by the creation of a European central bank and currency."

X 28. 1992 will offer both opportunities and challenges to British businesses. I know that, in the past year, the City has got down to the necessary hard thinking about how best to prepare itself. Given the right framework, which this Government will work for, I have no doubt that you will benefit from the wider opportunities in Europe, as you have done elsewhere in the world. —

Funding and monetary policy

29. To return to the home front, I mentioned at the start of my remarks how we have progressed from public

sector borrowing to the net repayment of public sector debt.

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30. 31. But this does not affect our overall funding policy which remains the same as it has been in recent years: a full fund, which neutralises the impact of the public sector on the monetary system and does neither less nor more than that. I said a full fund but I should perhaps now say a full unfund over the year as a whole.

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31. 32. That means, in our new circumstances, and taking full account of the need to fund any underlying net increase in our foreign exchange reserves, that the Bank of England are now required to purchase gilts rather than to sell them, thus bringing about the reduction in the national debt. It does not necessarily mean that the required unfunding will be fully completed within the course of the financial year, as I explained on this occasion last year. But it does mean, among other things, that there will be no more gilt auctions for the foreseeable future.

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32. 33. The strength of the public finances provides an important buttress to monetary policy in the fight against inflation.

33. When I spoke here last year, in the immediate

aftermath ~~of~~ the stock market crash, I said that this country was well placed to cope with the repercussions of the crash, and that the improved performance of recent years would not be blown away by a financial blizzard.

34. There were some, I recall, who thought that was verging on the Panglossian. In the event, the economy has forged ahead.

35. As far as monetary policy is concerned, the ride has not always been a smooth one. At times interest rates have had to come down, first in response to the crash itself, and later when the objective of reasonable exchange rate stability came under threat. At other times, interest rates have had to go up, as the evidence of the strength of ^{domestic} demand became increasingly apparent. But the point is that the necessary action has been taken, and taken promptly, to ⁿmaintain _h the appropriate degree of tightness, taking the effect of interest rates and the exchange rate together.

36. And I have little doubt that historians of the future will judge that the loosening of monetary policy in the wake of the crash, even though it may have stored up some problems later on, was infinitely to be preferred to the terrifying risks attendant on doing nothing at that fragile time.

37. Meanwhile, the tightening of monetary policy last

summer has already had an impact on the housing market, with price rises slowing and new mortgage commitments sharply down. This is particularly important, given the central role that the housing market has played in the sharp decline in the savings ratio in this country. And there are some tentative indications that retail sales may also be slowing. ~~though it is never wise to read too much into one set of data.~~

38. Inevitably, however, it will take some time before the full effects come through. But although I cannot share the almost magical properties assigned to interest rate changes by those who profess to see enormous consequences in the reduction of base rates to $7\frac{1}{2}$ per cent for all of two weeks, interest rates will do the job - which, of course, is why every other major nation relies on them in the conduct of policy. *And in*

~~39. In~~ Britain today, with the personal sector a net payer of interest for the first time ever, interest rates can be expected to be more effective than at any time in the past.

~~39 40.~~ As a result, inflation is likely to peak, at only a little above its present level, during the course of next year. But it may well take until the following year before we see a significant reduction in the current

account deficit. Meanwhile, let me repeat that interest rates will remain as high as it takes, for as long as it takes, to get on top of inflation.

41. After several years of strong growth at a little over 3 per cent a year we have now had two years - 1987 and 1988 - in which growth has been rather faster. Following that spurt, it is now likely that we will see a year or two of slower growth as the economy catches its breath.

X 42. But that is no cause for alarm. The underlying supply performance of the economy has improved dramatically as a result of the policies we have pursued - including deregulation, competition, and improved incentives - and it will be possible to combine the necessary slowing down with what is, by historical standards, a perfectly respectable growth rate.

43. Over the past six years the growth of UK output has averaged over $3\frac{1}{2}$ per cent a year, while inflation has averaged some $4\frac{1}{2}$ per cent, and employment has risen by getting on for 2 million. At the same time, we have held our share of world trade in manufactured goods after decades of decline.

44. All in all, it is an impressive performance, born out of the determination to pursue supply side reform within a sound macro-economic framework. It has been an

effective combination, and ^{it} will remain the thrust of this
Government's economic policy.

45. I can assure you, my Lord Mayor, that the Government will continue to do all in its power to ensure that the years ahead are years of prosperity, not just for the public purse, but for the whole nation.

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