

DRAFT: FINAL ON 15/6/94

## MANSION HOUSE SPEECH

### Introduction

My Lord Mayor, Mr Governor, My Lords and Ministers, Aldermen, Mr Recorder, Sheriffs, Ladies and Gentlemen, it is a great honour to be invited to reply to the Lord Mayor's toast. Tonight, by coincidence, the Foreign secretary is giving his great speech to the diplomatic world. Our message is the same - that we both want to see British influence strong in the world and strong in Europe, and that strength depends first and foremost on our having a strong economy. Like the Pope, we are conveying our message to the City and the world simultaneously - "urbi et orbi" you might say.

2. When we talk of our strengths in the European Union, we must not forget that the City is the only truly world-class financial centre in Europe. The City also plays a pivotal role in British economic life, both in the provision of financial services to customers on a world wide scale and also in channelling investment into UK businesses. Its great success has been founded on a policy of open access and competition, the professionalism and efficiency of its member firms and its high reputation for innovation, fair markets and honest dealing. The Government has a duty to ensure that you are able to continue to succeed on a world wide scale.

### Economy

3. When I replied to your toast last year, I was making my first major speech as a brand new Chancellor. I asserted my links with the industrial Midlands and made the aim of my policy that of

making it easier to earn a living in business. I mentioned then, as I still believe now, that the ultimate goal of economic policy was to improve living standards, and the only way to achieve that was through sustained economic growth based on low inflation and sound public finance.

4. This time last year there were widespread doubts about the sustainability of the recovery. The forecasts then for 1993 were for growth to be just over 1 per cent and inflation to be around 4 per cent at the end of 1993. That actually was not the worst that forecasters have ever achieved. To be fair, they got the nominal growth of output right, but the inflation-output split wrong. But it has reinforced the intention I already had to treat forecasts with considerable caution and not to become too mesmerised by them.

5. We have actually seen over the last twelve months a strong recovery with a better split between real growth and inflation and an earlier fall in unemployment than would have been expected based on British experiences in earlier recessions. Today's figures confirm that unemployment is continuing to fall with wage and price inflation remaining subdued. I firmly believe that our more buoyant performance so far in this recovery is largely explained by the improvements that the Government made to the supply-side of the economy in the 1980s. We transformed the environment in which businesses operated by privatising the state-owned industries, encouraging competition and ending Government intervention in the affairs of private industry. We made significant reforms to our labour markets with our Trades Union reforms and our changes to the culture of pay bargaining. We reduced our marginal direct tax rates and our main corporate tax rate which is now the lowest of any major developed country. In short, we re-established the enterprise culture in Britain.

6. The reforms of the 1980s have turned us into a dynamic modern economy. Since 1979, British firms increased their productivity faster than any other major country in Europe. We are closing the productivity gap. One recent study showed UK productivity levels in manufacturing to be above those in Japan.

7. We already have one of the most flexible labour markets in Europe. Virtually all of the recommendations of the recent OECD study have been put in place in the United Kingdom over the last 15 years. The small firms sector, universally accepted as the key innovative force in a modern economy, grew faster here than in the rest of Europe, in the US and in Japan. And our industrial relations have gone from being the worst in Europe to being the best.

8. These underlying strengths have been recognised beyond these shores. Our policies have made this country a magnet for foreign investors. Around 40 percent of Japanese and US investment in Europe has come to Britain: not for diplomatic reasons, not for grants, but because it makes good hard-headed business sense. These are the underlying strengths which give us the chance to achieve more success in the 1990s.

9. But despite these strengths, I do realise that there are still concerns in some quarters that we in Britain will throw away all these hard fought gains again and that yet another recovery will not be sustained. I can assure you that as far as the government is concerned we will do no such thing. We have not created the conditions for the strongest recovery in Europe in order to throw it away by creating yet another boom followed by a bust. I believe our economy is now strong enough to sustain the growth rates that everyone knows that I would like to see. But the concerns are only too understandable, given our economic history since the war. I believe that we can avoid these problems

of the past. Tonight I would like to explain why I am confident that history will not repeat itself and why I see the prospect of recovery being sustained.

10. The threats are all too clear. In my opinion, three major problems have derailed recoveries in the past:

- unsustainable public borrowing, which eventually required a sharp tightening of fiscal policy;
- a failure to keep inflation under control and prevent recovery turning into boom, with much the same result;
- problems on the supply side, reflected in bottlenecks, shortages of capacity and skilled labour, and burgeoning current account deficits.

11. If I am right and if history need not repeat itself, we have to face and to avoid all these risks in the current upturn.

### Public Finance

12. First, public finance. The public finances were put on a sustainable footing in the 1993 budgets. The issue now is to stick to that prospectus and, above all, to maintain tight control of public expenditure. I set out the limits for the New Control Totals in my Budget. Those totals are ceilings, and my medium-term aim is to see General Government Expenditure falling below 40 per cent of GDP once again. The New Control Total approach allows us to keep much better control of public expenditure than we used to as the economy recovers. Low expenditure is the key to lower taxes. We will cut taxes again, but only when we can afford to do so and not before we can afford to do so. The public are usually more sensible than politicians or the press. They will

not put their confidence in a government that cuts taxes before getting borrowing under control.

### Inflation

13. I am also determined that my second spectre of inflation does not return to haunt us.

14. Three times in our recent history a burst in inflation has destroyed a recovery and taken us back to deep recession. The effects of inflation are insidious and affect us all. We should not lose sight of them. Inflation breeds uncertainty. And uncertainty distorts business decisions, discourages investment and unsettles savers. That means a less efficient economy, less investment and less prosperity. Inflation is a silent thief that robs the elderly and cheats the saver. Low inflation is not an optional extra. It is the necessary condition for the steady and sustained growth that I want to see in the 1990s and beyond.

15. I often hear, sometimes from people in the City, the fear that politicians might still secretly hanker after a little inflation. After all, a little inflation leads to higher interest rates for savers, higher wages for workers and higher house prices for home owners. What a temptation to Ministers who need a "feel good" factor to go with the recovery. Speaking as a politician, I say that would be very bad politics. A little more inflation is simply not an option for this Government. A little more inflation will not make savers, workers or home owners feel good for long. A fraudulent inflationary "feel good" would soon turn to "feel very bad" as the bust followed the boom. As I have already said, our masters the public are usually more sensible than their politicians or the press. They feel good when they have recovery that is going to last with low inflation.

Monetary Policy

16. I shall continue to set monetary policy to keep underlying inflation within the 1-4 per cent range, and to reduce it to the lower half of that band by the end of the present Parliament.

17. I decided that my prospects of success in achieving that target could only be enhanced by a properly informed open debate about the causes of inflation, and the policy measures required to control it. In my opinion, the most important decision I have made in monetary policy so far has not been either of my interest rate moves, but the decision to publish the minutes of my monthly meetings with Eddie George. You won't have to wait until this dinner comes round once a year to hear what I think of monetary conditions. You will see it every month, with only a short lag to allow the Bank time to carry out any operations I decide upon.

18. On top of the Bank's quarterly inflation report, and the point-by-point explanations of interest rate changes that we have also introduced over the last couple of years, that will add to the credibility of our monetary policy. I have deliberately created a system of decision-taking about interest rates in this country which is one of the most open and transparent in the world. I have given today's politicians and tomorrow's politicians no choice but to pursue the path of low inflation to which we are so clearly publicly committed.

19. My Lord Mayor, long-term bond yields have been rising all around the world this year, but they have risen by more in the UK than in most countries. But, the markets seem to be schizophrenic. They appear to believe I am going to put up interest rates, but they also believe that inflation will rise out of its target range regardless.

20. The traders and investors who are demanding these high yields seem to be paying no attention to the analysts in the next office, most of whom are forecasting inflation to stay on target.

21. I think it is the analysts who are right. And I am determined to prove that to the traders, and to others, such as wage bargainers, whose suspicions of higher inflation might themselves add to inflationary pressures.

22. I do not pretend that the increase in credibility will happen instantly. It will require proof that I can justify any decision that I make on objective economic grounds alone. But the changes that I have made to the conduct of monetary policy will help ensure that no one will be able to sell-out our strong anti-inflation strategy.

23. But though low inflation and sound public finances are necessary, they are not sufficient conditions to achieve what we really want to see. My aim is a long period of healthy balanced growth, which creates jobs and sees gradually higher living standards for all. Our ability to sustain satisfactory growth rates will depend on supply side considerations. We have to ensure that increases in demand are translated into more growth, not more inflation. That means tackling our third historic failure and eliminating the skills shortages and bottlenecks that have blocked progress in the past.

### The Changing World

24. It is now commonplace that the world is becoming an ever more competitive place. Given the pace of change in technology and business organisation, none of us can predict, with any confidence, which will be the new industries of the future, nor where the new jobs will come from, nor what skills will be

required to fill them. The most successful economies will be those which respond quickest and most wholeheartedly to new markets and new competition. Within economies, the most competitive companies, and the most successful individuals, will be the most flexible and adaptable. I believe this recovery will last because we are adding to the measures which created a modern dynamic economy in the 1980s, and are creating an ever more adaptable better real economy for the 1990s.

### Education and Training

25. My Lord Mayor, this government believes in the need for ongoing improvements to the supply side of the economy. This is why we place so much importance on the recent White Paper on competitiveness. That White Paper set out a broad range of policy initiatives that we are taking to push forward the supply-side agenda. One area that I believe is particularly important to the future strength of our economy is education and training. The UK entered this recovery with a workforce that is being far better educated than in the recent past. 70 per cent of 16 year-olds now stay on in full-time education - up from 42 per cent in 1979. One young person in three now enters higher education, compared to just one in eight only a decade ago. This gives us the highest graduation rate in Europe.

26. Since 1979, we also have introduced a host of reforms to raise choice and quality in our schools. But better basic and academic education needs to be complemented by effective vocational training. The primary responsibility for this must lie with employers. But the government also has a role to play, in establishing the right framework. We have created a brand new framework of vocational qualifications based on the assessment of skills relevant to the needs of industry and commerce. The package of measures in the recent White Paper on competitiveness

demonstrates our continuing commitment to better training and a higher level of skills.

27. Developing the productive potential of our workforce means active labour market policies focusing on the unemployed as well. The Restart programme of the 1980s was the first step forward, keeping the unemployed in closer touch with the labour market. This helped address the real problems faced by the long-term unemployed, as well as maintaining downward pressure on wages. In the 1990s, the Jobseeker's Allowance will take the next big step forward, providing the right incentives for all unemployed workers to participate in mainstream economic life. In 1988 we introduced Family Credit - it now helps 500,000 low income families to be better off in work. The recent OECD report on employment particularly mentioned Family Credit as an example of a positive work incentive measure. It is extremely important that a modern and affordable welfare system functions at every possible point to put people into work.

#### Balance of the Recovery

28. Thanks to the supply-side reforms, Britain is also well placed to see growth this time balanced between consumer demand, investment, and exports.

29. There has already been strong growth in consumer demand and retail sales are at record levels. But now, there are an increasing number of signs that this pick up in consumer spending is being supported by exports and investment. Export growth is proving resilient to recession in continental Europe. And exports to non-EC countries are on a firm upward trend.

30. Investment activity has also picked up, with the modest recovery seen in the second half of last year being sustained this

year. Forward-looking surveys show that this upturn in investment looks set to continue. But the volume of investment is not of itself the key indicator. Structural policy must aim to create the conditions for profitable investment, and I would like to see the improvements in capital productivity seen in the 1980s built upon in the 1990s. More effective use of capital and labour will help us unplug the blockages which have resulted in high inflation and balance of payments problems, and ultimately derailed the economic recovery.

### Conclusion

31. My Lord Mayor, in some ways, the most heartening feature of this year is that businesses have recovered their self-confidence. One of the many gains of the 1980s was the recovery of the confidence that British goods and services could beat the rest of the world - a confidence lost in the 1960s and 1970s. That confidence was shaken again, understandably, by the long, deep, and bruising recession. But it is now returning. The ingredients and policies are in place for lasting success.

32. That lasting success means our firms outcompeting and outfighting those of our friends and trading partners in Europe and elsewhere. Twenty years ago, nobody would have believed that possible. It is possible today. I am determined to turn that prospect into reality and I have explained to you why I am convinced that we will do it.

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