

July 14, 1972 - 72/100

Statement by Mr. Mitchell on the United Kingdom  
Executive Board Meeting 72/78  
July 17, 1972

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1. I should like to compliment the Staff on a very thorough and perceptive Report, notable for its lucidity and balance.
2. The Report sets out quite clearly the problems and difficulties for policy. Economic policy has had to operate during recent years and particularly during the past twelve months in unusually difficult circumstances. On the one hand we have had a very strong recorded balance of payments surplus, standing up very well to the recessionary trends in world trade, together with reserves which have been at unprecedentedly high levels for the U.K.--despite the repayment of all our outstanding short and medium term external debt; and yet, on the other hand, there has been a combination of high unemployment with cost and price inflation, both at unacceptable levels. It is against this background and also against the extremely unsettled international financial environment that the policies pursued have to be judged.
3. While we can accept most of the analysis and comment in the Staff Appraisal, I would like to offer some comments on particular aspects. These comments will show that where we differ it is rarely more than on degrees of emphasis.
4. Domestic demand and the prospects for growth

The third paragraph of the Staff Appraisal on page 22 suggests at times in the past policy may have erred on the side of "too much too late." However, I have to make it clear that whatever may have been true of the past, we do not believe that the circumstances of 1968/69, and the wholly different domestic and external economic environment at that time, provide a very reliable basis on which to draw serious conclusions about the expansionary measures of 1971 and 1972. We share the more encouraging and optimistic note sounded later in the second and third paragraphs of page 23. The U.K. authorities believe that the economy is now set on a path of stronger growth. Some of the statistics available so far this year have been very difficult to interpret because of the coal and power strikes during the spring which widely affected demand and activity, particularly during the first quarter. But most indicators for the second quarter point to a stronger underlying growth of output--for instance, industrial production in May was some 3 1/2 per cent higher than a year earlier, and there has been a sharp and welcome fall in the seasonally adjusted total of wholly unemployed.
5. Wages and Prices

Since the consultations took place in May, there has been the widely reported 13 per cent pay settlement for railwaymen, which was, admittedly, something of a setback for the Government's policy of de-escalation. But

it would be wrong not to recognise that this was a wholly exceptional settlement. The average level of settlements in both public and private sectors so far this year has been significantly below the levels of a year ago. If we look at the 39 individual settlements in the public sector agreed since the coal miners' settlement of last March, the average increase, weighted to take account of the number of workers involved, was just over 9 per cent; and if the railwaymen's settlement is excluded from this calculation, the average comes out at under 9 per cent. It is true that average earnings have moved up in recent months compared with a year ago, but this is what one would expect during the early stages of rising output before firms have begun significantly to take on new labour. Much more indicative of the success of Government policies has been the sharp drop in the rate of increase of retail prices compared with a year earlier--they were rising at 10 per cent in April 1971, but in April this year the rise was down to about 6 per cent.

6. The Appraisal is quite right to point out on page 25 that the problem of influencing prices and costs raises a whole spectrum of socio-political issues which cannot be handled solely in economic terms. My authorities have been acting on this view for some time and it is one that I have myself repeatedly stressed to the Board--and not only in relation to the U.K. The most recent move has been for the Government to call on employers, trade unions, and workers to make a renewed effort to tackle this central issue of inflation. The Prime Minister has invited the Trade Union Congress and Confederation of British Industries to discuss urgent issues affecting industrial relations and the economy including new conciliation machinery, the problem of the lower paid in industry, the proposals for a link between the cost of living and wages by way of threshold agreements, and the importance of the U.K.'s competitive position abroad.

#### 7. Monetary Policy

Since the Mission's visit there have been further developments in this area. As the Chancellor in his budget speech last March indicated that it would be, monetary policy is being operated flexibly with a view to steering the very difficult middle course between undue restriction and excessive expansion. He was particularly conscious at that time that it would have been quite wrong to have restricted the growth of the money supply in a way which would have hindered the rate of economic growth at which the Government was aiming. More recently, recognising that the recent growth of money and credit had become faster than was appropriate to support the growing economic activity, the Government has demonstrated that it intends to keep the rate of expansion under control, even if that means accepting a higher level of interest rates, long term as well as short. Thus the rise in Bank rate of 1 per cent on 22 June kept that rate in line with market rates which had already begun to edge up, and also imposed some restraint on the growth of the money supply. And my authorities intend to continue to operate flexibly in this way, taking appropriate action when it becomes needed.

8. Balance of Payments

First, I should say that we fully share the Staff view about the effect of cyclical factors on the balance of payments. The cyclical downturn in the domestic economy was important in helping to produce the extremely favourable balance we had last year. Thus we recognise that the underlying current account position during 1971 was not as strong as is suggested by the actual figures. More recently, falling unemployment in response to the rise in domestic demand has moved the import side of the current account nearer to what might be considered a trend rate of growth. Against this, one should not of course overlook the adverse cyclical effects on the export side, particularly during the past nine months, stemming from the virtual absence of growth in world trade. Also we believe that the adverse effect of depressed commodity prices on the earnings of some primary producing countries, particularly in the overseas sterling area, has been responsible for the marked decline in our exports, both in value and in volume terms, to these still important markets for the U.K. Apart from these cyclical factors, I would mention that the miners' strike was probably still depressing our export figures in April and possibly also in May. The latest trade figures for June support the assessment that the underlying position did not justify the outflow of short term capital which occurred just prior to the decision to float.

9. There are various references in the report to a forecast current account surplus of £500 million in 1972. Of course, all such forecasts are subject to a wide range of possible error and there is now the additional uncertainties inherent in the sterling float. The immediate J-curve effect may be to widen the trade deficit in the coming months although, thanks to our large surplus on invisibles, we should continue to earn a substantial current surplus both in 1972 and 1973.

10. Finally, there is the implication on pages 23-24 that the Staff regard a current account surplus of £500 million as an appropriate medium-term objective for the U.K. current account. My authorities accept the general considerations set out in the second full paragraph of page 19, but I should make it clear that the figure of £500 million is by no means an official target; indeed it seems somewhat on the high side.

11. This is a longer statement than I have usually made on these occasions but I was anxious to show at the outset what close study we have given to the Appraisal Report and to offer as much further information as possible to assist the Board in our discussion.