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Statement by the Chancellor on the central economic objectives of the new government

The central economic objectives of the new government are high and stable levels of growth and employment. Our aim therefore is to rebuild British economic strength with a modern industrial base, high levels of investment and a culture of entrepreneurship that, through economic opportunity for all, unlocks British economic potential.

This can only happen if we build from solid foundations of prudent economic management and sound finance. The enemy of growth, and the investment necessary for it, is the instability of short periodic bursts of high growth followed by recession.

So we must break from the short termism of the past - the economic instability that has characterised the British economy not just in recent years but for most of the century. That is why I want British economic success to be built on the solid rock of prudent and consistent economic management, not the shifting sands of boom and bust.

Now is the time for long-termism. This is the time to set the British economy on a new long term course that will deliver high levels of growth and employment through lasting stability.

First interest rates. Over the last few days, I have been scrutinising all the available economic data and taking a view on the economic outlook, informed by the latest Treasury forecast. Having looked at the latest internal information now available to me, my judgement is that we have inherited a situation in which, in the absence of corrective action, inflation will overshoot the Government's inflation target next year. This view, in fact, confirms what the Bank of England has repeatedly advised over recent months, as reflected in the published minutes of the monthly monetary meetings.

I have to make decisions on interest rates the results of which will only be clear eighteen months ahead. In reaching my decision I am influenced by the forecasts I have now received for inflation in 1998. But I have also been influenced by what we see in the economy today, which affects these forecasts:

- recent rapid growth of consumer spending which has grown by 4 per cent over the last year;
- house prices, which are currently rising at an annual rate of 6 to 9 per cent, and are rising particularly rapidly in the south east;
- the recent pick up in average earnings, which are currently growing at 5 per cent a year;
- and the rate of growth of broad money which has been above its monitoring range for over a year.

Against these pressures, I have had to weigh the current strength of sterling, particularly against the Deutsche Mark. And I have also taken into account the subdued level of producer price inflation, disappointing levels of manufacturing activity, the weakness of industrial investment and the reduced optimism about prospects for exports, all of which are associated with sterling's strength.

No one should doubt my determination to create the conditions in which British business, and manufacturing, can flourish. But because inflation is the enemy of investment, we must ensure that it is under control, as it has not been so often in the recent past. We want a stable and competitive pound over the medium-term, consistent with

our objective of price stability. I am convinced that it is in the interests of industry that our commitment to low inflation is delivered in practice.

Looking at all the evidence, I believe that the case for an immediate tightening of policy is conclusive. I have decided to raise interest rates by 1/4 per cent with immediate effect. The Governor has indicated his positive agreement with my decision.

Price stability is, as I have said, an essential precondition for the Government's objectives of high and sustainable levels of growth and employment. The question is how to achieve the long-term stability that we seek?

As the Prime Minister and I have always made clear, this is a new Government that is going to move beyond the old dogmas of the past, and provide a modern and lasting framework for economic prosperity. I have said on repeated occasions that we must tackle the underlying weakness of the British economy- low investment, skill shortages and inadequate infrastructure - all of which have beset the British economy in recent years. These problems are themselves some of the underlying causes of inflation.

I have also made clear that reform is required to put monetary policy on a stable, long-term footing. In a speech in May 1995 and subsequently in our 1995 policy document, A New Economic Future for Britain, I set out my view of the proper roles of the Government and the Bank of England in economic policy.

Government has a responsibility to the public in setting the objectives of economic policy and that means that the Government rather than the Bank of England must set the targets for monetary policy.

However, as I have repeatedly made clear since 1995, we will only build a fully credible framework for monetary policy if the long-term needs of the economy, not short-term political considerations, guide monetary decision-making. We must remove the suspicion that short-term party political considerations are influencing the setting of interest rates.

As our election manifesto said:

"We will reform the Bank of England to ensure that decision-making on monetary policy is more effective, open, accountable and free from short-term political manipulation."

It has become increasingly clear that the present arrangements for policy-making are not generating the confidence that is necessary. That is one reason why Britain has higher long-term interest rates than most of our major competitors. And the perception that monetary policy decisions have been dominated by short-term political considerations has grown.

I am now satisfied that we can put in place, with immediate effect, reforms of the Bank of England to ensure that it can discharge responsibilities for setting interest rates in an effective, open and accountable way.

This is the time to take the tough decisions we need for the long-term interests and prosperity of the country. I will not shrink from the tough decisions needed to deliver stability for long-term growth. I have therefore decided to give the Bank of England operational responsibility for setting interest rates, with immediate effect. The Government will continue to set the inflation target and the Bank will have responsibility for setting interest rates to meet the target. The Government's policy is set out in a letter I sent to the Governor yesterday, the text of which I am releasing now. It is the Government's intention to legislate for these proposals as soon as possible. In the interim, the Governor has agreed to put in place the arrangements that will apply once the legislation has been enacted.

The main elements of the reforms are as follows. In place of the current personalised system of decision-making, decisions will be made by a new nine-member Monetary Policy Committee, on the basis of a majority vote. This is similar to arrangements in other countries including the USA and other G7 members. In addition to the

Governor and two Deputy Governors, nominated by the Government, who will sit on the committee, the Government will also appoint four members of the Monetary Policy Committee from outside the Bank of England.

Openness of decision-making will be ensured by the publication of minutes of proceedings and votes of the Monetary Policy Committee. There will be enhanced requirements for the Bank of England to report to the Treasury Select Committee of the House of Commons to explain and be questioned on their decisions. The Court of the Bank of England will review the performance of the Bank of England, including that of the Monetary Policy Committee. The Court will be substantially reformed to make it representative of the whole of the United Kingdom and to take account of the full range of Britain's industrial and business sectors. These changes in accountability and the new breadth of representation on the Court amount to the most radical internal reform to the Bank of England since it was established in 1694 - over 300 years ago.

Britain is, in fact, one of the few major industrial nations in which its Central Bank does not have operational responsibility for decisions on interest rates. And our record on inflation and interest rates over recent years is poor, while other countries with independent Central banks have performed better.

Taken as a whole, these proposals will ensure that decisions are taken for the long-term interests of the economy and not on the basis of short-term political pressures. This is the way to create the stability we need for higher investment and high levels of growth and employment.

The changes I have proposed are the right decisions: the right decisions for business which wants to plan ahead with confidence, the right decisions for families who have suffered enough from the uncertainties of short-term economic instability, and the right decisions for Britain.

The specific reforms I am proposing are British solutions, designed to meet British domestic needs for long term stability. Our monetary reforms provide the platform for stability and are the building block for a new economic policy that will equip us for the challenges of the future: one that takes steps to ensure higher levels of investment, for which I will announce new measures in due course, and improving employment opportunity by the modernisation of the welfare state. These measures will be addressed in the coming Budget and future Budgets.

But there is, as I have suggested today, a more long term context. In the last century, Britain was industrially pre-eminent. The history of this century has been one of economic decline, not least because of short termism and the pursuit of stop-go economics. I am determined that we make the right preparations for long term national economic success, as we look to the century that lies ahead, so that we can move forward again economically. I am therefore setting in place a long term policy for long-term prosperity. The ultimate judgement of the success of this measure will not come next week, or indeed in the next year but in the long-term. I am convinced that this radical reform, together with measures we will announce to equip our economy for the challenges ahead, creates the platform of stability upon which Britain can build.

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