HM TREASURY

Speech by the Chancellor of the Exchequer, the Rt Hon Alistair Darling MP, at Mansion House

17 June 2009

Check against delivery.

My Lord Mayor, ladies and gentlemen.

It is an honour to be with you again tonight at this prestigious event.

Although I am aware, that given the past year, any occasion where a member of Parliament addresses a room of bankers is unlikely to win a popularity contest among the general public.

It has been a long year since I last spoke to you.

Twelve months ago, the UK and global economies were facing considerable uncertainty.

Then the major threat to the economy was widely perceived to be high inflation.

Today, while the threat of inflation is still there, we are facing a very different economic landscape.

We are working our way through the sharpest and most widespread global downturn in well over 60 years.

In the course of the last year, I found myself in the autumn painted as a doom-monger – and in the spring as a wild-eyed optimist.

Neither, I think, is a fair reflection of my character, or my position.

There is still a great deal of uncertainty in the global economy.

And we must remain cautious.

There is growing evidence that the steps taken, at home and internationally, are stabilising the banking system and supporting our economies.

And this is in line with my Budget forecast for growth around the turn of the year – and my confidence in the strength and resilience of the British economy in the medium-term.

While I am cautious, I also remain confident.

Confident that the steps to help people into work, and prevent job-loss becoming permanent unemployment, are also making a difference.

Today's figures show the claimant count rose by 39,000 in May.

For every single man and woman affected this causes worry and difficulties.

But the increase was smaller than widely expected.

It is not in any government's power to protect every job.

And even when the recovery is underway, it will inevitably take time for unemployment to start falling.

But the measures we have taken, which I extended at the Budget, mean over 250 thousand people have moved off unemployment in each of the last four months.

The average time out of work remains half what it was in the last recession in the early 1990s – preventing a legacy of long-term unemployment and saving the taxpayer some £4bn.

The IMF has praised the wide-ranging action, by the Government and the Bank of England, to tackle the downturn.

But we also have to be vigilant to the many global risks that could threaten a recovery.

Lord Mayor, at the London Summit the G20 agreed to act together to deal with the global financial crisis.

There is now a huge amount of support coming through, across all G20 countries – but there's still a great deal to be done to deliver on our promises.

Many countries still need to take action to repair their banking systems – and they need to do it with urgency.

Here we have strengthened the banks – increasing capital and isolating their impaired assets.

As a result, credit conditions have become less restrictive.

There is much further to go. We must ensure banks meet the demand for credit – essential to recovery and future growth.

While inflation has not been the major worry over the last year, global oil prices, up by over 25 dollars a barrel in three months, are again a growing concern.

A sharp spike in commodity prices could slow down the recovery.

We must act – together with other countries – to reduce price volatility.

Improving transparency in oil markets, removing the barriers to energy supply, and making better use of the energy we already have.

Lord Mayor, if we remain vigilant to these risks, and take action where necessary, I am confident there will be a sustained recovery.

But a strong recovery also needs a clear plan for the future. I want to talk about this tonight.

Now, it is traditional at this point in the speech to compliment the UK's financial services sector.

There may be some who think, given the role of some banks in the global economic turmoil, that this tradition should be broken tonight.

I intend to keep to that tradition.

The City of London – and other financial centres such as Edinburgh and Leeds – remain an immense asset to our country.

The financial sector makes up 8 per cent of our national economy, supporting a million jobs throughout Britain.

Last month, Win Bischoff and I set out how British financial services can remain globally competitive in the future.

Not at the expense of other financial centres, but in partnership with them.

I am determined to work with the sector to maintain the UK's position as the world centre for financial services.

That's why we need to learn the lessons from the events of the last 18 months, and make sure they are never repeated.

In the autumn, major banks were on the brink of collapse.

Had they been allowed to fail, the world economy would have been brought to its knees.

We stepped in – not for the sake of the banks – but because the alternative would have cost millions more jobs.

It was a controversial move, opposed by many at the time and by some to this day.

It was, however, an essential step on the road to recovery, now followed around the world.

Recent events present us with an opportunity to build a stronger, more efficient and resilient financial sector.

If we are going to do that, we cannot go back to business as usual.

If there is anyone in this room, or in the industry, who thinks that they can carry on as if nothing has happened, they need to think again.

In every country we are paying a huge price for this crisis.

Not just the financial cost, but also a profound social and human cost.

The central lesson of the past two years is that too many people simply failed to understand the impact of globalisation and innovation in financial markets.

All of us need to learn lessons. And this process has to start in the boardroom, the first line of defence.

Last summer, just as the crisis began to bite, a senior banker told me that “from now on we will only lend when we understand the risks involved”.

I did wonder what they had been doing up until then.

Months later we were the majority shareholder in that bank.

Lord Mayor, we need a change of culture.

Bank boards must have the right people and the right skills and experience to manage themselves more effectively.

And they need to be equipped to ask the right questions.

Their focus must be long-term wealth creation, not short-term profits.

They must recognise their duty to shareholders is best fulfilled by acting in the interests of their customers and all – not just some – of their employees.

And ensure staff are rewarded for long-term success – not for failure.

David Walker’s review of banks’ corporate governance will look at how bank boards and institutional investors can manage their businesses more effectively.

Lord Mayor, just as the banks need to learn the lessons, governments and regulators do too.

No one model of regulation has been successful in insulating a country from the current crisis – and we are not alone in strengthening regulation.

The Banking Act gave us new powers to deal with failing banks and strengthened the Bank’s existing responsibility for financial stability by putting it on a statutory footing.

But there is still more to do.

Some of the problems of the past two years went beyond the scope of existing regulation.

Others were simply not given sufficient attention by regulators.

We need to strengthen our approach.

The first lesson is that transparency is paramount.

Over the past two decades we have seen unprecedented change in the practices and products of the financial sector.

Their complexity was such that banks and regulators failed to fully understand the dangers involved.

Their risk models turned out to be flawed, the theories they were based on, false.

We need to encourage innovation and harness it for the benefit of consumers and investors.

But we must also ensure that the greater complexity this involves does not become an excuse for a lack of transparency or for avoiding regulation.

Next week I will set out a new tax code for how the banks can meet their obligations.

We have already strengthened the FSA's powers to ask financial institutions for information.

To promote greater transparency, accounting standards have to be improved.

It is essential to work at the G20 level to achieve a single and high-quality set of global standards.

Indeed, the second lesson is that solutions must not only be national, but international.

The reality is that the fortunes of different countries are more interdependent than ever before and the links across borders – particularly in financial markets – are much deeper.

Regulators cannot only look at their own backyard and hope to understand what's happening.

At the European and international level, the UK has been at the forefront of proposals to increase regulatory cooperation, common rules and enhanced monitoring of global financial risks.

The G20 has agreed to establish a new global Financial Stability Board, with a wider group of developed and emerging countries.

And it will work with the IMF to spot risks and provide early warning of financial imbalances.

At the European level, the de Larosiere proposals represent a good starting point for debate.

But we have to ensure strong, effective regulators at a national level – and retain the vital link between home regulators and national governments.

A third important lesson for regulation is that as well as focusing on preventing failure, we need to be ready in case it happens.

Around the world, regulators were concerned with trying to prevent problems – and stronger global standards will mean a stronger system in the future.

The US have put forward their proposals today – which I welcome – seeking to consolidate their regulatory bodies, like we did 10 years ago.

Here, we have already tightened up the system, providing the authorities with new powers to intervene when problems occur.

And we plan to go further, with our work on a regime for handling any future failure of an investment bank.

But there are still issues that we need to address.

Globalisation has meant larger, more complex financial institutions that span many countries.

But that global reach also puts us at risk to events beyond our borders.

Many people talk about how to deal with banks, so important to the financial system, that they cannot be allowed to fail.

But large banks cannot come to believe that, no matter what they do, governments will always bail them out.

Their size must not become an open invitation for reckless behaviour by the banks – safe in the knowledge that their governments will be forced to intervene.

The solution is not as simple, as some have suggested, as restricting the size of banks.

We have learnt that you don't necessarily need to be a big bank – or indeed a complex one – to threaten to bring the system down.

You cannot remove all risk. But you can try to understand where the risks lie.

And you can also ensure that banks themselves have in place proper plans, to mitigate those risks and to deal with the possibility of a failure.

This is the right way of dealing with the big bank problem.

But because these banks are global, there is also an urgent need for an international mechanism for resolving failed large multinational banks.

We will be bringing forward proposals to the G20 finance ministers in the Autumn to ensure that we deal with that.

Fourth, we also need to look at the way we approach regulation.

In the past regulation has focused primarily on individual firms.

But the crisis has taught us that it is not enough to pass an individual firm as healthy.

Regulators and central banks need to work together and look more carefully at the system as a whole.

They need to understand how exposures built up in different institutions – different countries even – can threaten stability.

And how asset price cycles can change those risks over time, as well as the links between the financial system and the wider economy.

As we’ve seen in the United States and the European Union this week, many countries are engaged in a debate, about the interaction between financial supervision and macroeconomic policy.

Already people are advocating new institutions and new tools to implement a new approach.

Institutions are important. So are the tools for them to do the job.

But to concentrate only on institutions, seems to me, to miss the point.

At its heart, this is about judgements that are based on an a clear understanding of what’s happening.

It is about making the right call at the right time.

Whatever the system is, judgement will always matter.

There are no simple solutions to these problems.

We know that it would have been better if the banks were holding more capital or had better liquidity provision when the crisis hit.

But for this to work effectively, it has to be agreed and implemented internationally.

There is a debate going on at home and abroad.

I will publish my own proposals shortly, to help lay the foundations of a new financial regime.

But it is clear that the solutions must be based on better corporate governance, greater transparency, internationally agreed frameworks, better systems for dealing with bank failure, and greater focus on system-wide risks.

We also have to ensure we keep the market for financial products competitive in the face of greater consolidation.

Lord Mayor, a strong and stable banking sector is an essential precondition for a sustained recovery.

But so too is ensuring strong and stable public finances.

In the UK, we entered the current crisis with national debt low by international standards.

But lower tax receipts, higher benefit payments and the costs of supporting the financial system have inevitably pushed up deficits and debt in all countries.

And most governments have chosen to provide additional temporary support to their economies, by increasing spending and cutting taxes.

It is clear to me that to have done nothing, to have walked away, would have caused more pain, prolonging and deepening the recession.

In the long run, inaction would have increased, not reduced, the burden on this country's finances.

So I made a deliberate decision, to stick to our plans for public spending through the current spending review period that finishes in 2011 – and also to bring forward investment in areas such as housing – to support the economy.

Lord Mayor, I have been very clear that support for the economy now must be matched by action to ensure we live within our means in the medium term.

And just as we were one of the first countries to recapitalise the banks, we were also one of the first to set out a plan to reduce borrowing.

A plan to cut our deficit in half over four years – with tax increases for those that can afford them and slower spending growth in the years ahead.

No-one wants to put up taxes. And I am fully aware of the need to keep our corporate and personal tax rates competitive.

But it is right to do it in a way that those most able to bear the burden make the greatest contribution.

As well as raising extra revenue, I set out a clear path for public spending in future years – a path that will see real current spending grow each year, but at a slower rate than in the past.

This follows a decade which has seen public services transformed – hospital lists cut and schools rebuilt – thanks to a tripling of public investment and extensive reform.

We will not allow these achievements to be squandered.

I am in no doubt that there are tough choices ahead and we must be clear about our priorities.

But given the uncertainties which still lie ahead, I think it would be a mistake to try now to set in stone detailed spending plans for individual departments five years ahead.

Lord Mayor, we are balancing immediate action with a clear plan to strengthen the public finances as the economy recovers.

I will continue to do whatever is necessary to ensure sustainable public finances, reducing borrowing and debt – while continuing to invest in public services and infrastructure.

So we will use the proceeds from selling our shareholdings in the banks to cut government debt.

Alongside my Budget programme of asset sales to support capital spending.

And just as the private sector uses a recession to reassess and refocus its activities, I am determined that we in the public sector become more productive and efficient.

We must push forward with public services reform.

As part of that, we will ensure we meet the diverse needs of our changing society, by encouraging innovation, devolving power, harnessing new technologies and expanding choice.

We must also focus, not just on the pounds and pence that we spend, but on what the money actually buys for us.

That way we will continue targeting spending on the country's priorities and also make our money work harder.

We must build on our plans to deliver efficiency savings – savings that already total £35bn since 2007.

That is why last year I launched a root-and-branch review of key departments' spending, to find areas where we can avoid overlaps and eliminate waste.

In the period ahead, there will rightly be a debate over how future spending should be allocated.

But to attempt to balance the books now, simply by cutting spending across the board, would choke off the recovery and damage our public services, on which not just families, but the future of our economy depends. It would be sheer madness.

Lord Mayor, every business, every one in our country, depends on these public services.

Looking round this room, I can see many people who have rightly stressed to me the critical importance of world-class education for our future.

And the doubling in the science budget, the funding of research and the modernisation of laboratories is another cause which many of you have championed.

I can also see those of you who have – again rightly - pressed the case of the importance of Crossrail for the prosperity of this city and our country. And work is now underway.

Well-managed and controlled public spending supports private endeavour and growth.

There are those who think that public investment – and the role of Government – is a drain on our economy.

I have never agreed with this argument.

In the light of the role that governments have played in recent months in preventing the global recession becoming much worse, it is clearly absurd.

Governments have shown what a difference they can – and must – make.

What is now needed is a renewed partnership between Government and industry.

Not trying to pick winners, but intervening to reduce market failures and providing the conditions to help key sectors prosper.

This requires government action to be prioritised in the areas that will support our growth industries – in skills, innovation and high-tech research.

To keep modernising our infrastructure – investing in transport links, in railways and Heathrow, in energy efficiency and security of supply.

If we encourage investment, promote research, exploit our science base, and the skills of our people – we will become a more productive economy.

And make sure Britain remains a top global destination for foreign investment, as new figures today showed.

It is not a question of private versus public. We need both – because that is the only way to encourage a more diverse and balanced economy.

Just as we need a more diversified financial services sector, we need successful companies in all the global growth areas of the future.

In the creative and digital industries, where we have a depth of talent, and which we are supporting, as we announced yesterday, by rolling-out high-speed broadband.

In our world-beating bioscience and in advanced manufacturing, like Airbus and the automotive sector, which we are supporting.

In renewable energy, where we have to build on our natural advantages and know-how to create tens of thousands of high-skilled jobs – and help the world combat climate change.

Green energy will be key to spreading prosperity in a sustainable way, and in meeting commitments that must be agreed at Copenhagen later this year.

Supporting these high-tech, high-growth industries is the key to our future success and prosperity.

Government can, and it should, make a difference. And we will.

Lord Mayor, I remain confident about the prospects for our economy.

It is a confidence tempered with caution.

Because we, and countries across the world, still face many challenges.

But just as we've had a clear plan for dealing with the recession, we are now putting in place a clear plan for the recovery.

It will ensure sustainable public finances in the medium term, as well as building for the future, by investing in the growth industries of tomorrow.

There are many opportunities to be seized.

And I am confident that, if we continue to do what’s right, we will overcome the challenges and build the stronger future our country deserves.