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TO THE CANADIAN CLUB

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I would like, if I may, to take a hard look at the key issue affecting the progress of the world economy at this time - the condition of the U.S. dollar - then to tell you how I see Britain's economic and political situation with particular reference to the effects of North Sea oil and to conclude with a few words about Rolls-Royce in the world scene but more particularly what Rolls-Royce does and hopes to do in Canada.

It is now nearly five years since the world economy experienced the great shock of the increase in oil prices in 1973. It might, therefore, be appropriate to ask ourselves: how well have we adjusted in our new found circumstances? The answer is that our performance has not been good. We ought by now to have adjusted to the new and more difficult world in which we find ourselves. Instead, governments go on with policies which are no longer relevant or even workable today. The most striking and the most damaging example of this is the current turmoil in the world's currency markets.

Stable exchange rates are essential if businessmen are to have the confidence which is the only basis for the expansion of world trade which we all want, and indeed need, to see. To give you a simple illustration of the effect of currency fluctuations, a change in the value of the dollar against the pound of just one cent will add on or wipe out more than £1½ million from the profits of Rolls-Royce.

It is not the mechanism of the currency markets which causes these fluctuations and this unrest. It is, quite simply, the failure of governments in general and perhaps of the United States Government in particular to inspire belief in their commitment to stable currencies.

The U.S. dollar is now clearly an undervalued currency. Yet it would be a very brave and a rather foolish man who would stake his reputation that the dollar will not go even lower than it is today. Even now, after months of prodding by other governments, we are still told that the U.S. is not going to intervene to hold the dollar up to a specific rate. Yet that is the very thing, accompanied as it would need to be by responsible domestic policies, which will steady the dollar.

The aim has been to try to persuade Germany and Japan to expand their economies in order to diminish the adverse U.S. balance of payments. The effect has been quite the opposite.

The fears which are being generated among America's friends by the gyrations of a currency which lies right at the heart of the world's monetary and trading system are great indeed.

The U.S. dollar is the world's pre-eminent trading currency - unless it is stable we cannot expect a sustained recovery in world trade. Yet many businessmen in the U.S. and elsewhere feel that we do not really know what the Administration is trying to do. Only one man can still the uncertainty in the business community which has surrounded this Administration since it came into office and that man is President Carter.

If you ask what he should do, which is a fair question, I believe that a credible energy policy would go a long way towards dealing with the problem. I am a sound money man and I believe in firm control of the money supply coupled at this time with higher interest rates. This, in the simplest terms, would be my package.

Any attempt to stimulate the U.S. economy at this time will only lead to further inflation, an increase in the balance of payments deficit and a weaker dollar.

Before leaving the subject of the dollar - I do not believe that the U.S. dollar can continue indefinitely in its dual role - that of the national currency of the United States subject to U.S. domestic policies and the world's major reserve and trading currency.

Bretton Woods has served us well for some thirty-five years. I believe, however, that its underlying principles are now outdated, particularly in view of the recent redistribution of the world's wealth, due to the new financial role of the oil producers. There are new and very important factors to be taken into account and I believe that this whole subject is one to which the world's statesmen, if there are any, must address their minds without further delay and what is more important must come up with a solution.

If, as I believe, the dollar is basically undervalued, it follows that some other currencies are overvalued. One of these is the pound sterling. Sterling's rise was one of the more spectacular phenomena of 1977. There is no doubt that some recovery from the very low levels at the end of 1976 was justified. But this recovery has gone too far both for the good of the industry on which Britain depends, and as a measure of how successful we have been in coping with our deep-seated economic and industrial problems.

Rates of exchange should ensure parity of purchasing power between nations, allowing for relative prospective rates of change of price levels. Currently, however, sterling is overvalued on these criteria for four main reasons.

These are the renewed confidence following the adoption of commendable monetary policies, the euphoric reception of the initial effects of North Sea oil flows, official reluctance to countenance

lower long-term interest rates and the distorting effects of the continuing exchange control regulations preventing the free movement of capital export into and out of the United Kingdom.

In a more general sense, exports are the lifeblood of Great Britain. Our exporters have managed in the past two years to stop the steady decline in the United Kingdom's share of world trade, which has been the sad hallmark of the post-war years. In this they were undoubtedly helped by the lower level of sterling in relation to most other currencies. Yet by the end of last year the rise in sterling had pushed out prices up to levels where we have once again lost the temporary advantage which the fall in the pound during most of 1976 gave us.

British exports now are no more competitive than they were in the spring of 1976 before sterling began its slide. I believed then that the health of our industry would require a sharp drop in the parity of the pound, in order to compensate for our relatively higher inflation rates, and although our inflation rate has much improved I still believe this to be the case.

In the short run, at least, foreign exchange markets are not run for the convenience of those of us who are in industry.

A currency's worth reflects a whole range of factors, including how the markets assess the policies of the government of the day.

It was the world's foreign exchange markets which spectacularly served notice on the Labour Government in 1976, that its policies had to change. And it is those same foreign exchange markets which gave a vote of confidence to that same Government when it adopted sounder monetary and fiscal policies in 1977.

The fact is, however, that a great deal remains to be done and there is considerable ambivalence within our Government as to its attitude to the twin evils of low productivity and unemployment.

There is a strong body of opinion in Labour and Trades Union circles which encourages the saving of jobs by reducing the amount that each of us produces, when the truth is that it is only by raising productivity that a stable basis for employment, and eventually re-employment, can really be laid.

We are trying to deal with the symptoms and not the causes of our poor economic performance. It is a simple and obvious truth that money must be earned before it can be spent; but is this so simple and so obvious? I do believe that the Prime Minister and the Chancellor have grasped this basic economic truth but not so all of those who have a say in guiding the destinies of our economy and the ambition of our workforce. The blame for our poor industrial performance in Britain cannot be laid at any one door; but the biggest single contributor in my view is our poor productivity - resulting in large measure from our inability and our apparent unwillingness to face up to the problems of overmanning and at the same time to encourage and reward skill and effort. We have been engaged in a headlong rush for equality. A British businessman was commenting not long ago that the differential in earnings between the lowest and highest paid in much of British industry is narrower than in China.

Let there be no mistake, this has been achieved through a process of levelling down rather than levelling up. Until we reverse this egalitarian process we have little chance of recovering our position among the industrialised nations and of creating the wealth we need to increase our general standard of living.

North Sea oil will give us a respite, but we must use this time to cure the fundamental illness of our economy. Basically what we all need from top to bottom is more incentive.

We have taxed too much and spent too much through the Government, thereby stifling individual initiative. Successive

governments have chopped and changed in their economic policies leaving industry battered, bruised and bewildered in the process. The results are obvious for all to see.

Industrial production in most European countries is now about a fifth higher than it was at the beginning of this decade; in Britain it has hardly changed at all. The disillusion which our ludicrously high direct taxation causes spreads through society. It leads to a tendency to fiddling wherever the opportunity arises and an unwillingness to work.

Tackling this ought to be the major concern facing the Chancellor in this Budget due tomorrow. He ought to be concentrating such tax cuts as he can now afford to make where they would do most good - that, in my opinion, is in rewarding initiative and enterprise.

The so-called North Sea oil bonanza gives him just such an opportunity to do so. I say 'so-called bonanza' because it is in fact nothing of the kind. It is true that the oil will increase Britain's resources in at least two ways.

The Government expects it to increase our national income by about £6,000 millions a year by the mid-1980s, and it is expected to help Britain's balance of payments by about £8,000 millions to £9,000 millions a year in the process. While this is indeed a valuable bonus it is not massive in terms of our per capita gross national product - and it is temporary. The best estimates are that if it peaks in 1985, we are net importers again by 1991.

The Government is planning to use the North Sea oil revenues in four ways: for industrial investment, to develop energy conservation, to reduce the levels of personal taxation, and to improve certain of Britain's social services.

In the House of Commons recently, the Prime Minister said that the Government's objective was to ensure that when the flow of our oil from the North Sea begins to decline, the British

economy and British society will have been strengthened by its use and not weakened.

My advice to the Prime Minister is that he should focus his attention now on reducing personal taxation and in investing in industries that can be expected to make a significant long-term contribution to the British economy. This is the way forward and this is the way I believe the vast majority of my fellow countrymen want to go.

Before leaving the subject of the United Kingdom perhaps I might say a word about devolution.

I am a Scot by origin. My grandfather luckily heeded Dr. Samuel Johnson's famous remark that the finest sight a Scotsman ever sees is the highroad to England! I feel therefore that I am entitled to say that I consider devolution a piece of political nonsense.

There never was any serious problem until ten years ago. A combination of British industrial decline, North Sea oil, mostly off the coast of Scotland, political opportunism and Wilsonian sleight of hand have produced the present situation.

Scotland is a relatively poor country with old industries - shipbuilding, coal, steel, heavy engineering and the like - centred around Glasgow. It is over-represented proportionally to its population in the House of Commons and it gets more than its fair share of the consolidated revenues of the U.K.

I do not believe that Scottish Nationalism is really more than a combination of protest against what they consider, and rightly consider, to be the failure of both major political parties to manage the economy, the remoteness of an ever increasing bureaucracy and the feeling that with the aid of North Sea oil they can hardly fail to manage their affairs better than is done at present in Whitehall and Westminster.

This is all well and good but how does it stack up with reality?

If they get their way and have a government in Edinburgh with substantial domestic powers you will get a position where MPs with Scottish seats can rule on English matters in London but English MPs cannot rule on Scottish affairs in Edinburgh. This combined with the fact that Scotland is over-represented at Westminster already, will not be allowed to go on indefinitely.

The Labour Party power base is in Scotland - if their representation in London is reduced you would probably get a Labour-dominated Scottish government in Edinburgh, and a Conservative government in London. The Edinburgh government could well become just another layer of bureaucracy. In this scenario you would certainly have a demand for greater powers for the Scottish parliament and when these were refused the seeds of separatism would be well and truly sown.

Finally, England can survive without Scotland but Scotland cannot survive without England. England is comparatively large and comparatively rich - Scotland is small and poor. English investment is essential to Scotland. Scottish investment is not a factor in England.

The whole situation is shot through with short term political opportunism and the long term effects have been ill thought through.

The trouble is, the majority of the English and, I believe, the majority of the Scots are not taking it sufficiently seriously.

I will, if I may, conclude with a few words about Rolls-Royce.

Rolls-Royce invented the gas turbine or jet engine and were the world leaders in this field until the early 1960s. The company then made a series of errors of judgment resulting in the somewhat unnecessary liquidation in 1971.

The company's engineering skills have remained unsurpassed as is evidenced by the fact that it is an advanced version of the engine which precipitated the bankruptcy which won the recent

competition to power the next major re-equipment programme of Pan Am.

The road to recovery has not been an easy one.

The last five years have seen a major recession in world trade. Inflation in the U.K. at a rate never experienced before and very unstable exchange rates. Nevertheless I believe that we

are on the brink of a major upsurge in demands for new aircraft.

The Pan Am order when they chose our engine on its technical merits after an exhaustive study puts Rolls-Royce firmly back on its feet. Its commercial reputation and confidence in its long term future as one of the world's three major engine manufacturers has now been fully re-established.

Before moving on, I would like to pay tribute to Air Canada with whom we have an excellent relationship - they were launch customers for the RB.211. They stuck with us through the dark days, when incidentally the competition was also in trouble, and I would like to take this opportunity of saying thank you to them.

In Canada, Rolls-Royce has a strong tradition of technological and economic involvement. This is at the root of our firm and positive commitment to our future in Canada.

Our Canadian companies have been particularly successful in the production and marketing of industrial and marine applications of our engines. Nearly one hundred Rolls-Royce engines are already installed in Canada pumping oil and gas and providing electrical power. We owe a debt of gratitude to the TransCanada Pipeline Company in particular for their faith in our ability to serve their needs - they are in fact the largest users in the world of Rolls-Royce engines for pipeline operations.

The Alyeska line, although not in Canada, is entirely Rolls-Royce powered.

As you know, the Alaskan Highway pipeline proposal by Foothills

Pipelines is now pending Canadian Government approval. This project and associated distribution systems, would require a considerable number of engines of the type produced by Rolls-Royce - a significant proportion of which could be manufactured in Canada.

There are many other projects in which Rolls-Royce are engaged in Canada - indeed I have made no reference to the activities of our largest Canadian subsidiary, Bristol Aerospace, in such areas as wind-powered turbines, electronics, rocketry, nuclear power, and meteorological forecasting and monitoring.

It would be inappropriate for me to abuse this occasion by listing our triumphs and hopes in Canada. Suffice it to say that in thinking of our own interests, we try to think also of Canada's. We are very aware of the pressures on companies such as ours to produce as well as sell in your country. I believe we have a better record than most in furthering these legitimate national aspirations. Indeed, much of the \$26 million that the Rolls-Royce Group in Canada will have invested between 1971 and 1981 will be to this end. Over 60 per cent of our sales of products and services from Canada during the same ten-year period will be to markets outside Canada - thus having an additional positive impact on your country's economy.

Rolls-Royce technological and economic impact in Canada in the past has been achieved in co-operation with the departments of the Government of Canada as well as Canadian private industry. I believe that our future lies along the same path.