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What will the recovery look like?

Britain's coming so-called "economic miracle"

If money growth stabilizes (or accelerates), recovery is inevitable sooner or later

The trough of every recession is always marked by stereotyped gloom and doom in the media, so that people think there will never be a recovery. If monetary growth continues to plunge, these fears will be justified. (The annual growth rate of the old M3 measure of broad money has collapsed from 22% in the third quarter (Q3) 1988 to 3% today.) But Mr. Lamont has promised that the Autumn Statement will include a "monitoring range" for broad money, which presumably implies some acceleration in money growth from here on. As long as money growth now stabilizes (or increases for a period), a recovery is inevitable sooner or later. It is not too early to start asking what the recovery will look like.

A retrospect on the last recession, recovery and boom and may be helpful. Between Q2 1979 and Q4 1980 output per head fell by over 4% and employment by about 2%. Employment continued to fall until early 1983, but output per head increased from the start of 1981 until mid-1987, with the average annual growth being a very worthwhile 3.3%. Employment began to rise in Q3 1983. In 1987, 1988 and 1989 it increased rapidly, by about 2 1/2% a year, just as productivity growth came to a halt. (Between Q3 1982 and Q4 1989 employment climbed by no less than 12%!) The average annual increase in gross domestic product between Q4 1980 (trough) and Q2 1990 (peak) was 3%.

Productivity growth has resumed

What has happened in the current recession? Output per head was essentially static between mid-1987 and mid-1991, while between Q2 1990 and Q2 1992 employment fell by 5 1/2%. However, just as late 1980/early 1981, productivity has started to increase again, even as employment keeps on falling. In the year to Q2 1992 output per head in the whole economy was up by 2%. Despite all the diasappointments and waste of the Major/Lamont slump, underlying productivity growth ought still to be in the 2% - 2 1/2% area. Although the population of working age will be increasing very slowly in the 1990s (unlike the 1980s which were helped by the "baby boomers" entering the workforce) employment could probably increase by 3% - 4% (i.e., 1% a year for three to four years) without causing overheating in the labour market. Productivity growth is normally high at the start of the recovery, as new techniques introduced in the recession come up to speed. In short, growth in the four years to 1997 could be 3% or more without a serious risk of rising inflation. Indeed, a standard pattern is that inflation keeps on falling during the early recovery, with pay settlements remaining low because of the persistence of above-average unemployment. So Britain in the next three or four years may enjoy above-trend growth with low inflation. This is emphatically not a recommendation for a "dash for growth", but simply a statement of the most likely outcome.

Above-trend growth with low inflation likely in the mid-1990s

Professor Tim Congdon — 11th November 1992

Summary of paper on

An economic programme for the 1990s

Purpose of the paper After Britain's forced departure from the European exchange rate mechanism, policy-makers have been criticised for lacking a coherent policy framework. The purpose of this paper is to propose such a framework. It is similar in structure to the original Medium-Term Financial Strategy of the early 1980s.

Main points

* **Stable monetary growth (on the broad measures) is a condition of wider macroeconomic stability, while low monetary growth is required to achieve price stability. The central recommendations on money growth are**
    - **i. an initial easing of monetary policy over the next 18 months, with broad money growth up to between 6% and 10%, to counter the recession,**
    - **ii. gradual reductions (by 1% a year) in monetary growth from 1993/4 to between 2% and 5% by 1997/8, and**
    - **iii. stabilisation of broad money growth in the 2% - 5% band after 1997/8 to establish price stability by the early years of the next century.**

* **The money supply targets are to be achieved by variations in interest rates and funding policy, as envisaged in the 1980 Green Paper on *Monetary Control.* Monetary base control is not recommended.**

* **The exchange rate should float. It should be ignored in monetary policy unless it reaches extreme values and conflicts with the money target. An "extreme value" may be defined as a departure of more than 10% from "fair value", where fair value is defined as the purchasing-power-parity value of the trade-weighted exchange rate.**

* **Fiscal policy must be consistent with monetary policy over the medium term. To restore an underlying balanced budget the Government should reduce the cyclically-adjusted PSBR by 3/4% of GDP in every one of the next five years.**

* **From 1997/8 broad money growth of 2% - 5% a year and a budget in balance (or small surplus) should be maintained indefinitely into the future.**

This paper was written by Professor Tim Congdon.

An economic programme for the 1990s

How a refurbished Medium-Term Financial Strategy could restore economic stability

Policy vacuum after departure from ERM

Britain's departure from the European exchange rate mechanism has left a vacuum in policy-making. The Chancellor of the Exchequer made an initial attempt to fill this vacuum in a letter to the Treasury and Civil Service Committee of the House of Commons on 8th October, but it was hardly convincing. The list of variables judged relevant for interest rate decisions was highly miscellaneous and did not reflect a coherent understanding of the forces determining national income. The Mansion House speech on 29th October was even worse, making not one meaningful proposal about future policy. Despite Mr. Lamont's affirmation of a new domestic orientation in monetary policy, the majority of the Cabinet wants sterling to return to the European exchange rate mechanism as soon as possible. Today, as so often in the past, British economic policy is a muddle.

The purpose of this paper is to set out some proposals for the conduct of economic policy over the medium term, meaning a period of at least five years. Their essence is to restore the central features of the policy-making framework between 1976 and 1985, in which control of the quantity of money (on the broad definitions) was regarded as basic both to the reduction of inflation and to the establishment of a reasonably stable economy. The proposals seek their justification partly in the relative success of that framework in the early 1980s, when stable and gradually declining growth of the money supply was accompanied by a stable economy and a slowdown in inflation. (It needs to be remembered that only a few years ago policy-makers were self-congratulatory about their achievements. In a book on *Keynes and Economic Policy*, published in 1987 but based on a conference held in 1986, Sir Terence Burns - then Chief Economic Adviser - wrote, "Over the five years to 1987 the variance of money GDP growth compares well with other post-war periods. In other words, the Medium-Term Financial Strategy has succeeded in its objective of delivering a relatively stable path for money GDP.")

Stable monetary growth a condition for wider macroeconomic stability

There is an obvious contrast between the stability of the early and mid-1980s (roughly from mid-1981 to mid-1986), and the instability of three boom-bust episodes in the last 20 years. These three episodes were from 1972 to 1975 (the Barber boom followed by the recession of late 1974 and 1975), from 1977 to 1980 (the Healey boomlet followed by the industrial slump of 1980) and from 1986 to 1991 (the Lawson boom followed by the Major/Lamont slump). All three of these boom-bust episodes were associated with extreme fluctuations in monetary growth. The historical record suggests that more stable monetary growth is a necessary condition for greater stability of output and employment. Since inflation is undoubtedly "a monetary phenomenon" (in Friedman's words), monetary growth also needs to be low if inflation is to be brought to an

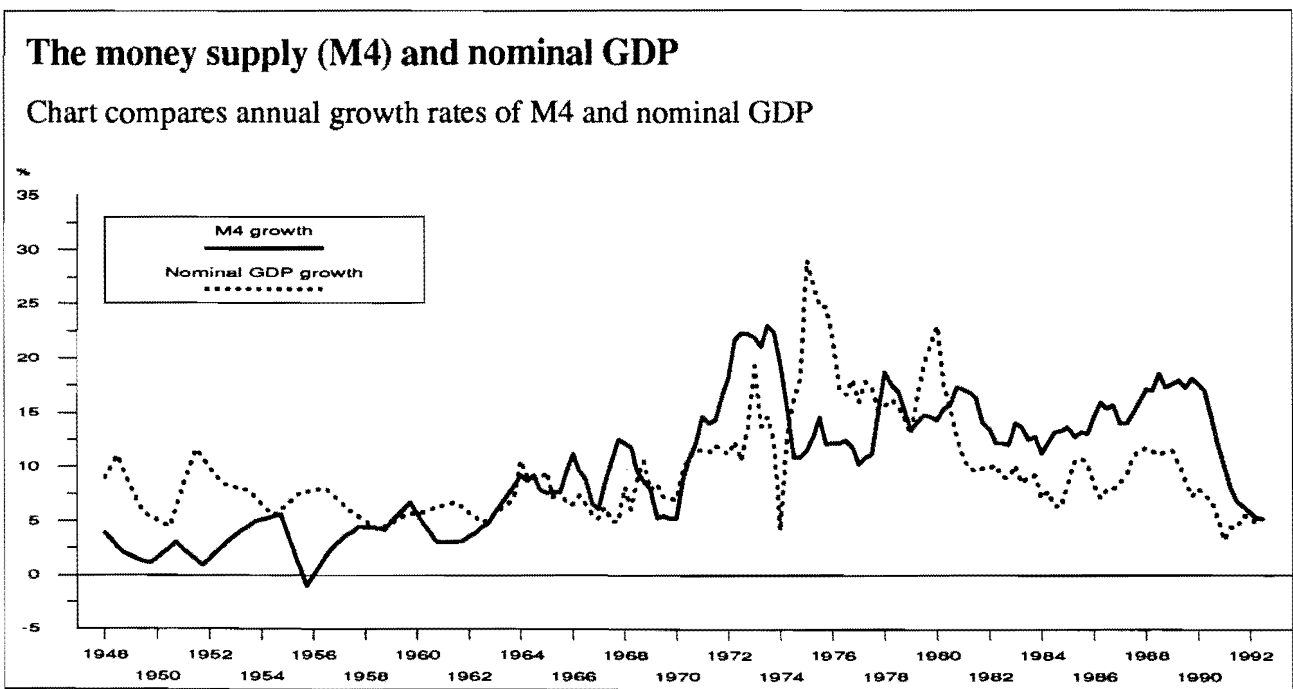
end. The implied ideal is low and stable monetary growth, and that would indeed be the eventual outcome of the proposals in this paper.

The proposals are nevertheless not confined to monetary policy as such. They also include debt management (i.e., funding policy), fiscal policy and the exchange rate. These further aspects of policy have to be mentioned since there are many interactions between them and the behaviour of the money supply. The proposals should therefore be seen as elements of an integrated package. The different parts of the package are internally consistent both with each other and with the ultimate goal of low and stable monetary growth, and that goal is their logical focus.

I. Targets for monetary growth

The first proposal relates to the money supply itself. What targets for monetary growth are appropriate for Britain in the next few years? If the economy were starting from a high rate of inflation and had an above-trend level of economic activity (as in 1979), the answer would be straightforward. Monetary growth should be lower in the coming year than in the last year, lower again in the year after that and so on, until it was reduced to a level compatible with price stability. However, the British economy in late 1992 does not have a high rate of inflation with an above-trend level of activity. On the contrary, inflationary pressures are at their weakest since the late 1960s and activity is far beneath trend.

The recession has been of such intensity that corporate failures and personal bankruptcies have reached their highest-ever figures. The consequent erosion of banks' (and building societies') capital poses a more significant threat to the solvency of the British financial system than at any time this century. Low monetary growth has been largely responsible for the incidence of bankruptcies,



The money supply (M4) and nominal GDP

Chart compares annual growth rates of M4 and nominal GDP

since it has undermined corporate liquidity (i.e., the amount of money in companies' bank accounts). Inadequate corporate liquidity has forced managements to sell off assets (subsidiaries, land, commercial property) to try to improve balance sheets. But the economy, considered as a whole, cannot sell off assets to itself. The result of all the individual attempts to straighten balance sheets has been to depress the overall level of asset prices and so to increase the toll of corporate failures. Asset price deflation has brought particularly severe problems to small companies, many of which were set up (with borrowed money against the security of a house or a building) during the Lawson boom.

Faster money growth needed over next 18 months to halt debt deflation

In these circumstances the priority must be to restore liquidity to balance sheets, and to support a recovery in commercial property values and house prices. The recovery should, as far as possible, be mild and controlled, and it should try to avert a return to the speculative psychology which characterised the boom phases of the last three boom-bust cycles. The suggestion here is that the right target in the remaining months of the 1992/3 financial year and in the 1993/4 financial year is that broad money growth, as measured by M4, should be between 6% and 10%. That should be sufficient to ease the worst of the pressures in the property market, without re-igniting long-term inflationary forces. (With annual inflation likely to remain under 5% in the next 18 months, personal sector money balances will probably grow at around 5% a year. Overall monetary growth of, say, 8% a year would therefore be associated with increases in corporate money balances well into double digits, which would certainly facilitate balance-sheet recuperation.)

But after 1993/4 gradual reductions in money growth recommended to achieve price stability

After 1993/4 the target band for broad money growth should be reduced by 1% a year, as envisaged in the original Medium-Term Financial Strategy announced in the 1980 Budget. The band might also in time be narrowed to 3% instead of 4%. By 1997/8 broad money growth would be down to between 2% and 5% a year. This would probably be consistent with price stability and perhaps no further reductions in monetary growth need be projected thereafter. The implied set of targets for broad money growth is as follows:

6% to 10% for the rest of 1992/3 and in 1993/4
5% to 8% in 1994/5
4% to 7% in 1995/6
3% to 6% in 1996/7
2% to 5% in 1997/8.

Narrow money targets should be abandoned

Narrow money targets should not accompany the new targets for broad money. Narrow money (i.e., notes and coin, and - in some definitions - sight deposits) is largely determined by past and present levels of retail spending, and contains hardly any interesting information not already given by the figures for retail sales. Narrow money on the M0 definition (i.e., notes and coin alone) is almost never used in large transactions involving capital items or in the purchase and

sale of assets. But it is asset price changes and consequent fluctuations in investment that motivate much of the volatility in aggregate spending. M0 targets have been in existence continuously since 1983 and have been met most of the time. They have conspicuously failed to prevent damaging macroeconomic instability. They should be dropped, as their continuation would merely complicate the interpretation of the important signals being given by credit and broad money.

II. Methods to achieve broad money targets

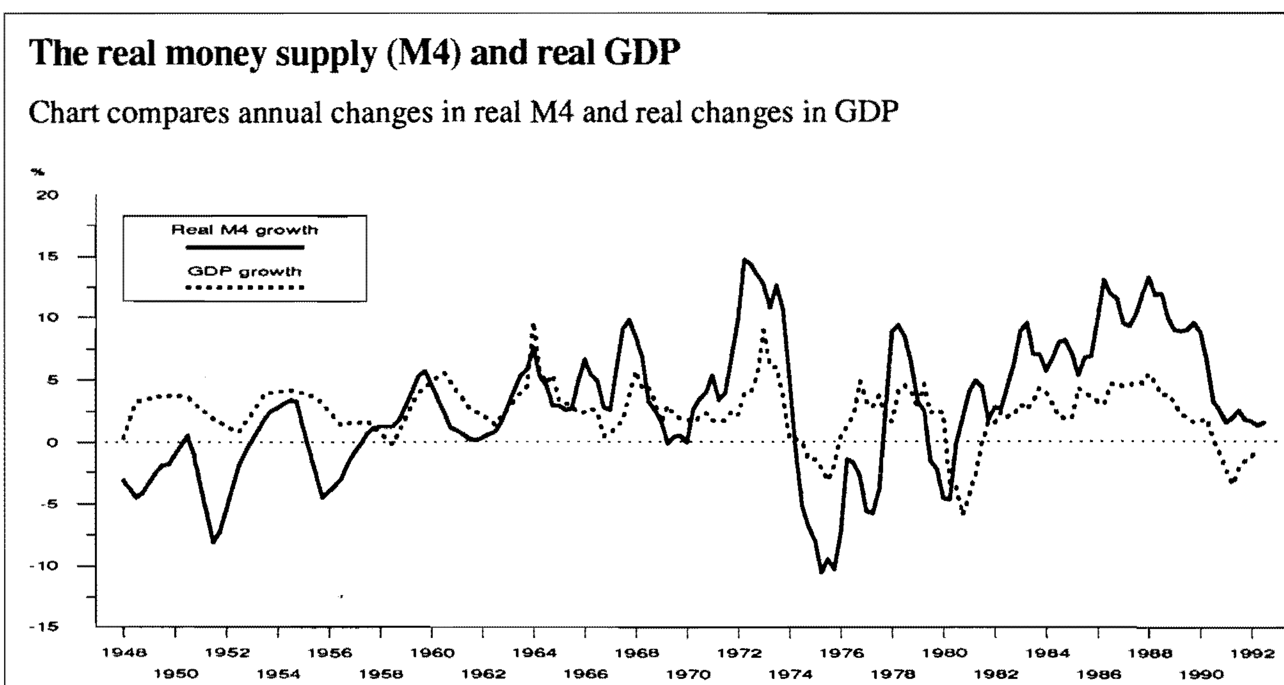
The second part of the package describes the methods to be used in the attainment of broad money targets. In modern conditions the bulk of the money supply consists of bank deposits (or bank and building society deposits, if the M4 aggregate is under discussion), and the growth of the money supply is largely determined by the growth of the banking system. The banking system expands by seeking new assets, both loans to the private sector and claims on the public sector in the form of Treasury bills, government debt and other instruments. The process can be analysed by monitoring the so-called "credit counterparts" to monetary growth, for which monthly statistics have been compiled by the Bank of England for many years. There is little doubt that bank (and building society) lending is inversely related to interest rates.

Interest rates to be varied to influence credit growth and, therefore, money growth

The main theme of monetary policy in practice has therefore to be the variation in interest rates to influence the growth rate of bank (and building society) lending to the private sector. The Bank of England can set short-term interest rates by routine operations in the money market. Such operations can influence the level of bankers' balances (which must never fall below zero) and so alter banks' marginal cost of funds, in the manner first understood in the 1870s and outlined again in the 1980 Green Paper on *Monetary Control*. (Henry Gibbs,

The real money supply (M4) and real GDP

Chart compares annual changes in real M4 and real changes in GDP



Governor from 1875 to 1877, wrote that by open market operations affecting bankers' balances the Bank could make itself "the real arbiter" in the City.) There is no question - despite a mass of confused writing on the subject in the early 1980s - that sterling interest rates are under complete Bank of England control.

Personal sector borrowing is more responsive to changes in interest rates than corporate sector borrowing. Mortgage borrowing, in particular, is the earliest important category of credit to increase or fall after interest rates have been lowered or raised. Indicators of mortgage demand are crucial to the conduct of monetary policy and require policy-makers' fullest attention. However, from time to time credit demand may respond sluggishly, or even perversely, to interest rate changes. The attainment of money supply targets then requires active resort to open market operations in government debt between the central bank and non-banks. These operations have been variously categorized over the decades as "debt management policy", "funding policy" and "official gilt-edged tactics". Their traditional purpose has been to change the quantity of money held by non-banks, in order to serve the Government's wider objectives. This should again be their purpose in future.

But funding policy may be needed as a supplementary techique

In the 1980s bank credit to the private sector typically grew by about 20% a year. The growth of the money supply was curbed (to about 12% a year, usually) in the early 1980s by "overfunding" (i.e., selling more government debt to non-banks than the public sector borrowing requirement and using the excess proceeds to repay government debt held by the banks). In the late 1980s, after overfunding had foolishly been stopped, the growth of the money supply accelerated towards 20%, with results which are now familiar and notorious. It seems likely that in the early 1990s credit expansion to the private sector will be restrained by banks' attempts to protect their capital. A resumption of moderate monetary growth may require deliberate "underfunding" (i.e., the Government finances at least part of its PSBR from the banks).

Favoured approach to monetary control similar to that in force before 1985

The approach to monetary control recommended here is similar to that actually in force before 1985. Nothing particularly new or radical is being proposed. It is not appreciably different from that found in other industrial countries and, in particular, it resembles the Bundesbank's control framework in Germany. (Every issue of the Bundesbank's *Monthly Report* itemizes the credit counterparts to German broad money in its first two pages of commentary. An interesting difference is that in the German context the acquisition of so-called "monetary capital" by non- banks is a deduction from broad money. Monetary capital is a liability of the banking system, but is deemed not to be "money" in any sense. An increase in monetary capital has an economic significance analogous to increased holdings of short-dated gilt- edged securities by non-banks in Britain, which would be regarded as "funding" on current UK definitions.)

Some monetary economists have favoured a system of fractional reserve banking to help control the money supply. In a system of this kind banks are expected to keep their liabilities a stable multiple of certain assets which are supposedly under precise official control. The classic textbook recommendation is that the quantity of the central banks' liabilities (the "monetary base") be regulated, in the belief that the total quantity of money will thereby also be determined. In evidence to the Treasury Committee of the House of Commons in 1980 Professor Milton Friedman proposed monetary base control as a much superior alternative to the methods mentioned in the Government's Green Paper on *Monetary Control*. Friedman's argument stemmed from an erroneous, although extremely common, conception of modern banking, in which banks' balance sheets are thought to be constrained by the size of their cash holdings. In the real world banks are prepared to pay for the services of a central bank which supplies them with cash readily, efficiently and with minimum cost. The history of banking and central banking shows that there are excellent functional reasons for this situation, and Professor Friedman and his many followers are whistling in the wind if they think they are going to change it. In practice the serious constraint on banks' balance sheets is capital, not cash. Monetary base control is emphatically not part of the package being advocated here.

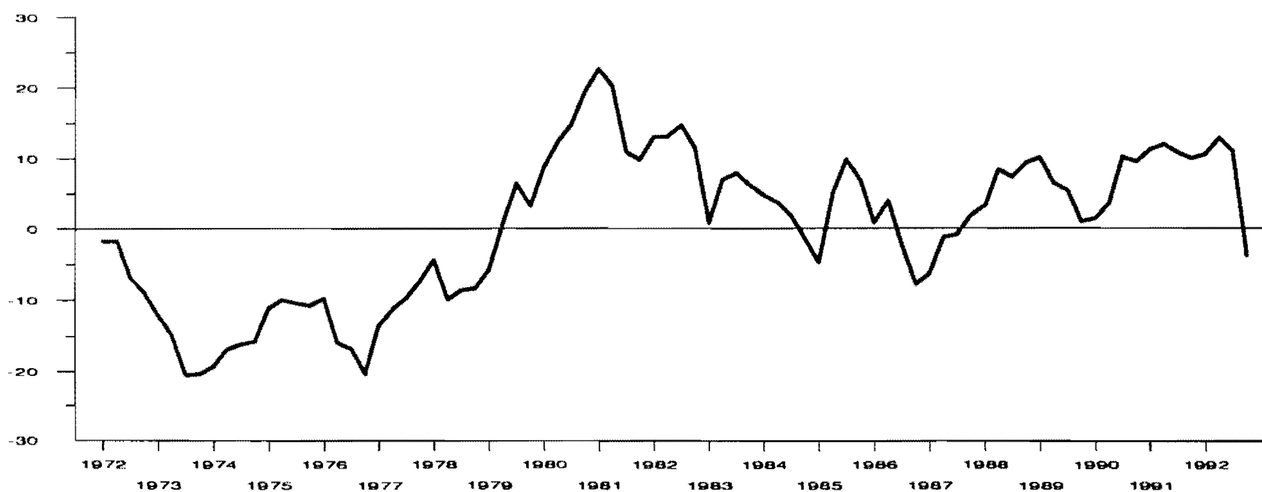
Monetary base control *not* part of the package

III. The role of the exchange rate

One of the most controversial areas of British monetary policy in the last 20 years has been the interaction between domestic monetary restraint and the exchange rate. The complexities of monetary targetting have been contrasted with the purported simplicity of a fixed exchange rate, while many observers have found it easier to analyse the effects of changes in the exchange rate than the effects of changes in the money supply. There have also been several

The behaviour of the real exchange rate

Chart shows the deviation of sterling's trade-weighted index from its estimated purchasing power parity level. A positive deviation indicates sterling overvaluation, a negative deviation undervaluation



occasions on which monetary growth has given a signal for interest rates in direct conflict with the signal from the exchange rate. How then should the exchange rate enter into policy formation? Should it be excluded altogether, to avoid the risk of incompatibility with the money supply targets? Or should it have some residual role? And, if it is to have a residual role, what particular "exchange rate" should be the focus of official attention?

Exchange rate instability a curse on industry

The third part of our package is to propose that the exchange rate should have a role in monetary policy distinct the money target only if it reaches extreme values. (If the exchange rate merely confirms the message of the money numbers, it is of no great interest.) As the collapse in manufacturing industry in 1980 demonstrated, exchange rate instability - like instability in the growth of credit and money - can be very harmful and ought to be avoided. The precise definition of an "extreme" exchange rate is necessarily arbitrary, but fluctuations 10% either side of the "fair value" ought to be manageable. Fair value is to understood as that value of the exchange rate which equalizes the prices of tradeable goods in Britain and overseas in terms of a common currency (i.e., the purchasing-power-parity exchange rate). The assumption here is that few companies would scrap capital in an export-oriented industry if prices were 10% below normal over a period of one or two years. Long-run capacity ought not to be impaired by exchange rate movements as limited as those implied by the 20% band. It is only when the overvaluation reaches levels of 15%, 20% or more that long-term damage is done. Our conclusion on the exchange rate is as follows:

External considerations can override money target if the exchange rate reaches extreme values

For exchange rate variations within a 10% band either side of purchasing power parity, ignore the exchange rate in interest-rate decisions. The broad money target would be paramount.

For exchange rate variations within a value 10% to 15% away from PPP (in either direction), interpret the message from the money supply target flexibly if the money target and exchange rate are in conflict. (For example, if the exchange rate is 12% under-valued yet monetary growth is beneath-target, leave interest rates unchanged instead of reducing them.)

For exchange rate variations further than 15% away from PPP, override the message from the money supply target if the money target and exchange rate are in conflict.

Relevant exchange rate is the trade-weighted index

The relevant exchange rate in this context is the trade-weighted index, which mainly reflects sterling's value against other European currencies and the dollar. One drawback of ERM membership was that the pound moved in line with the deutschemark, regardless of the DM/dollar exchange rate. But Britain's trading and investment links with nations outside Europe, particularly with the USA,

are far more important to it than are other European nations' trading and investment links outside Europe to them.

If it liked the general idea, the Government might want to consider the frequent publication of the purchasing-power-parity value of the trade-weighted index, so that industry and the financial markets could tell when the exchange rate had become an influence on official interest rate decisions. Of course, the PPP value can be calculated in several ways and the Government might seek submissions from interested parties on the best procedure. (A good method would be to take the average value of the real exchange rate over the last 20 years as the base value for PPP. The selection of one year as the base can be misleading if it was marked by significant under- or overvaluation.) In fact, the Central Statistical Office already publishes several "measures of UK competitiveness in trade in manufactures", which serve as a guide to those instances in the past when the money supply target might have been overriden.

As the chart based on relative producer prices (on p.8) shows, there were only two periods in the last 20 years when the trade- weighted exchange rate was more than 15% away from PPP, in late 1976 when it was 20% undervalued and in 1980 when it was 20% overvalued. As 1976 also saw rather high monetary growth, both the exchange rate and monetary trends pointed to a rise in interest rates. (Minimum Lending Rate went to 15% on 7th October 1976.) The only case when the exchange rate would have overriden the money target was therefore in 1980. In view of the crash in manufacturing that year because of the lack of competitiveness, this can hardly be a great surprise. It is indeed plausible that the various measures of financial liberalisation at that time caused broad money growth to be misleading as an indicator of future inflation pressures. The only other period of noticeable overvaluation lasting a singificant length of time was in the years 1988 to 1991, when - at any rate towards 1990 and 1991 - the behaviour of the money supply also argued for lower interest rates.

IV. The budget position

What, finally, should be done with fiscal policy? In the mid-1970s the Callaghan-Healey Labour Government operated an inconsistent macroeconomic policy. It ran a large budget deficit (in order to maintain economic activity) at the same time that monetary growth was being curbed (in order to combat inflation). The result was rapid growth in public debt, which raised fears about long-run fiscal unsustainability. Two closely related aims of the MTFS were to harmonize fiscal and monetary policy, and to prevent public debt accumulating faster than national income. The fiscal aspect of the MTFS was a success, since the PSBR was reduced sharply as a share of GDP in the early 1980s and was converted into a surplus for a few years in the late 1980s. Britain, whose public finances in the mid-1970s were similar to those in Italy, does not at present have a serious public debt problem.

Deterioration in underlying public finances since 1989 needs to be reversed

However, there has undoubtedly been a sharp deterioration in public sector finances since 1989 and not all of this deterioration can be attributed to the recession. The procedure for returning to an appropriate fiscal position can be described in a sequence of steps. The first is for the Treasury to calculate a cyclically-adjusted PSBR as well as the actual PSBR and to set out the expected path of both over the next few years, assuming unchanged policies and an unchanged level of economic activity (relative to trend). The cyclically-adjusted PSBR is that PSBR which would obtain if GDP were exactly at its trend level. Of course, there would some arbitrariness in the calculation, but that does not mean the exercise would be meaningless. The Treasury can try to justify its calculation to outsiders and, if the numbers are contentious, the divergences of view can be discussed. Strong emphasis should be placed on the point that the deviations of the PSBR from projected levels are often of the order of 1% or 2% of GDP, even when the projections are for only a year ahead.

Aim should be to reduce cyclically-adjusted PSBR over the medium term

The second step is to agree on the desirable level of the cyclically-adjusted PSBR over the long run. There are different views on this question, but it can hardly be controversial that the ratio of debt to GDP cannot be allowed to rise indefinitely for ever. (That would lead to the Italian situation.) A viable suggestion is that fiscal policy be designed to keep the debt/GDP ratio stable over the long run. Calculations of the PSBR/GDP ratio consistent with a particular debt/income ratio and inflation rate are easy to make, given an assumption about the long-run rate of real economic growth. Mr. Alan Budd, the Government's present Chief Economic Adviser, has written on this subject in the past and reached the conclusion that the PSBR/GDP should be held at about 1% over the long run. However, there is an alternative and more ambitious approach. It is obvious that any public debt has a deadweight cost to society, because interest has to be paid on the debt and taxation has to be raised to pay the interest. Such taxation has all the usual disincentive and distortionary effects. Society would clearly benefit if the debt could be eliminated altogether.

The discussion can be short-circuited by saying that a 1% PSBR/GDP ratio is the maximum acceptable to a government which believes in price stability and low taxes in the long run. Moreover, since the real world is a complicated place where politicians tend to be irresponsible, the best practical rule may be to ensure that the budget is balanced or even slightly in surplus over time. The Government should therefore aim - in every year - to have a cyclically-adjusted PSBR no higher than zero. At present there is no doubt that the cyclically-adjusted PSBR is positive, although there is room for debate about whether it is 2% or 4% of GDP. It follows that measures should be taken to reduce the PSBR/GDP over the next few years. The path of these reductions is a political matter, but the virtue of spelling out precise figures is that it would discourage politicians from unwise tax cuts (or similar) close to elections. (That was the thinking behind the original MTFS. For all its weaknesses, the MTFS of the early 1980s did secure a big improvement in Britain's public finances.)

A 3/4%-a-year reduction in the cyclically-adjusted PSBR would achieve a surplus by 1997/8

If we assume that the cyclically-adjusted PSBR/GDP ratio is currently 3%, a reasonable path might be one which reduces this by 3/4% of GDP over every year until 1997/8, when there would be a cyclically-adjusted surplus of 3/4% of GDP. A surplus of this kind would certainly make it easier to keep broad money growth down to the 2% - 5% area which we have suggested would be compatible with long-run price stability. Spending ministers would have to be told that - if, despite their best efforts, public expenditure were growing too rapidly - taxes would be raised to meet the targets for the cyclically-adjusted PSBR/GDP ratio. Of course, this approach to the public finances would rule out discretionary adjustment of the fiscal balance to influence aggregate demand. All the work of economic stabilization would fall on the management of credit and broad money. Fiscal policy would be subordinated to long-run structural objectives, notably the minimization of debt interest.

The package as a whole

The discussion of fiscal policy completes the package of proposals. Its objectives are clear. First, the main features of the MTFS, as conceived in the late 1970s, should be restored. In particular, the target for broad money must again become the centrepiece of policy. Except in unusual circumstances, other aspects of policy should be subordinate to it. (An extreme exchange-rate movement is recognised as one such "unusual circumstance". There should be no need for separate targets for other "asset prices", which ought to be reasonably stable if credit and money are increasing steadily at low rates.) Secondly, the MTFS is a programme to restore a sound currency, in the genuine sense of a currency which is of stable value over an indefinitely long period of time (i.e., the inflation rate is zero). The intention would be that, from 1997/8, the MTFS comes to an end, to be replaced by the simple rules of 2% - 5% annual broad money growth and a budgetary position (after allowance for the business cycle) which is always in balance or surplus.

Low money growth and a balanced budget to secure price stability in long run

In the Mansion House speech Mr. Lamont argued that policy errors were inevitable, given the inherent uncertainties about the structure of the economy. In his words, "Much of the criticism of the Treasury's forecasting record has been misplaced. The last few years have been extremely difficult ones for forecasters who have been getting it wrong all over the world". The mistake here is to believe that sensible policy decisions (to influence the future course of the economy) can be reached only if reliable forecasts (to indicate likely future events) are available. The whole point of the original MTFS was that policy should not be based on forecasts. Instead the aim should be to establish a nominal framework - in terms of money and public debt (both stocks and flows) - which would be compatible with price stability over the medium and long term. The budget deficit and money supply growth had to be consistent with that framework, and (as far as possible) to serve no other ends. As this approach worked quite well in the early 1980s, what is the objection to restoring it in the 1990s?

The package would restore an approach which worked quite well in the early 1980s