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PG/10/76 CONFIDENTIAL

Economic Reconstruction Group

Minutes of the meeting held at 10.00 a.m. on Thursday, 15th January, 1976 at the House of Commons.

Present:	Sir Geoffrey Howe	(Chairman)
	Mr. Biffen	
	Mr. Powell	
	Sir Keith Joseph	
	Mr. Nott	
	Mrs. Oppenheim	
	Mr. Prior	
	Mr. Griffiths	
	Sir Leonard Neal	
	Mr. Budd	
	Mr. Ridley Mr. Cardona	(Secretaries)
Apologies:	Mr. Gilmour	

Fine-tuning

1. The Chairman welcomed Mr. Budd, formerly of the Treasury, to talk to the Group about fine-tuning.

2. Mr. Budd defined fine-tuning as frequent interference with the economy through taxation and public expenditure in order to influence the level of activity. Two fundamental questions had to be answered:

(i) Can we fine-tune?
and (ii) Should we fine-tune?

3. There were three distinct approaches in the recent attacks on fine-tuning. They were:-

(i) The monetarist position: policy-makers simply do not understand the economy because they ignore money. The economy will adjust by itself to external shocks in ways discounted, ignored or ruled out by conventional theories and economic models. A correct monetary policy will result in a steady rate of inflation, and minimise cyclical fluctuations in production and employment.

(ii) Godley and the New Cambridge position: policy-makers fail to understand the economy; a change in the budget deficit today means a change in the balance of payments deficit tomorrow. Left to itself with a stable public deficit, the economy reaches stability within a year or two and tends to stay there.

(iii) The view that Governments concentrate too much on the short-term, because of political pressures. Either Governments are not aware of the long-term effects of their actions, or they are, but did not care until some time later when they have to (over) correct them.

4. No-one would deny that fine-tuning had been used in a short-term way, making for a jerky kind of economic progress in the UK. For one thing it was technically very difficult to fine-tune not least because of failure to accept the normal

workings of the business cycle. There was always the risk that if a Government takes action, that action will reinforce rather than moderate the natural economic forces already at work.

5. Governments did not intervene to smooth out the fluctuation of stock market prices, and they had largely stopped intervening to support exchange-rates. What then was the rationale for intervening to influence the level of economic activity? It was debatable whether the Government knew much more about the future than private and expert market operators knew. If everyone could see cycles coming, then why should the Government help?

6. There was a discussion of Mr. Budd's talk and the issues which it raised. It was thought that other countries managed better, because they fine-tuned less and gave certain policy objectives different relative weights. It was pointed out that the size of the public sector was itself a stabilising - or destabilising - influence in the economy; Mr. Budd observed that its immobility meant that the burden of making adjustments fell disproportionately on the private sector. It was agreed that it was possible that natural forces would stabilise the economy, but that under some circumstances it could take too long: say 13 or 20 years.

7. There was a discussion about the institutional problems of economic policy-making. Perhaps there was inadequate knowledge of the monetary system; or perhaps there were not enough people with such knowledge in the Treasury and the Bank of England. Perhaps the Treasury's forecasting model tended to show that the economy was always on the point of going wrong, thus provoking unnecessary intervention. Perhaps the Chancellor had too much power, as only he really saw the forecasts. No other country had such secrecy in the making of economic policy.

8. Mr. Budd concluded with three recommendations:

(i) There should be more honesty about what could be done: Government should make clear what is possible, and how much is not amenable to Government control;

(ii) There should be more open discussion of the issues of economic management;

(iii) The Treasury should take into account the fact that private operators could understand the economy too, and moderate its attitudes towards monetary policy and respect the need to recreate an atmosphere of stabler and more certain expectations.

9. The Chairman concluded that in future discussions of economic policy in the Shadow Cabinet, he would amplify on the valuable points made in discussion with Mr. Budd at the previous two meetings. This material would, when combined with his paper to the Shadow Cabinet before Christmas, give the kind of indication needed by colleagues as the evolution of the Group's thinking.

10. For the Group's programme of work

(i) Mr. Griffiths and Mr. Nott would prepare a paper working out some of the major implications of the Group's conclusions on monetary policy, if possible after consulting Lord O'Brien and other experts;

(2) The Secretaries would prepare a paper on the Treasury's institutions, philosophy and procedures of economic management;

(3) Sir Keith Joseph would be pursuing the problems of reconciling a sensible housing policy with the implications of a different approach to monetary and final policy;

(4) At some point the Group would try to invite one or more of Messrs. Carli, Emminger, Morse or Bell to talk to the Group about the parallels and contrasts between UK and world economic developments.

1. The next meeting of the Group would be on Thursday, 19th February.

George Cardona
Adam Ridley

Conservative Research Department,
24 Old Queen Street,
London S.W.1

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